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PROEFSCHRIFT

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PREFACE

The central focus of this book is the regulation of public funding of failing banks in the EU. Three areas of EU law are involved in this topic: (i) prudential regulation, (ii) State aid rules and (iii) the resolution framework. If the level of own capital and eligible liabilities is insufficient to absorb losses and recapitalise a failing bank, the resolution thereof will be difficult to envisage without the use of public funding. As a result, there is a delicate interaction between the State aid regime for the banking sector and the EU resolution framework for failing banks.

The EU is unique in having a State aid regime, under which Member States give up part of their sovereignty by requiring the Commission's approval of State aid awards. The urgency, the interdependence of financial markets and the extraordinary size of the subsidies committed by Member States to save national banks during the global financial crisis (GFC), led the Commission to modify its ordinary decision-making practices and to adopt a new set of soft laws for the EU banking sector. The 2013 Banking Communication constitutes the basis of the State aid regime for the EU banking sector as we know it today. With the introduction of the EU resolution framework the question whether the State aid regime for the EU banking sector is still fit for the purpose of identifying and controlling State aid to banks has become more imperative. The EU resolution framework was introduced because the GFC showed that general corporate insolvency procedures may not always be appropriate for banks, as they may not always ensure sufficient speed of intervention, the continuation of the critical functions of banks and the preservation of financial stability. This formed the justification to take away the power to determine resolution from the national courts and confer this on administrative resolution authorities at EU and national level.

In her thesis, Marije Louisse examines how the EU resolution framework impacts the State aid regime for the banking sector. She discusses which challenges can be identified in the co-existence of the EU resolution framework and State aid regime in regulating public funding of failing banks in the EU after the onset of the GFC and which potential steps can be taken to address such challenges in order to contribute to an adequate and efficient institutional and regulatory framework for the EU banking sector. The impact of the EU resolution framework on the State aid regime for the EU banking sector is assessed along three lines of research. The first line of research assesses the impact of the EU resolution framework on the access to public funding as a remedy for failing banks. The second line of research assesses the impact of the EU resolution framework on the exercise of State aid control by the Commission. The third line of research assesses the impact of the EU resolution framework on the restructuring process of a failing bank.

The study contributes to the ongoing multi-angled debate on public funding of failing banks from an EU law point of view. Such a debate is still necessary, especially considering that the global crisis caused by the coronavirus pandemic has – and will have – major consequences for banks. Although we now have the resolution framework for the banking sector, which makes the EU hopefully more resilient, it needs to be further completed and strengthened. This dissertation aims to contribute to that process by focussing on the coherence between the State aid regime for the banking sector and the resolution framework in in regulating public funding of failing banks in the EU. The editors are pleased to include the work in the Series Law of Business and Finance.

Bas Kortmann
Dennis Faber
Corjo Jansen
Ben Schuijling

Nijmegen, June 2020

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LIST OF ABBREVIATIONS

AMC	Asset management company
AT 1	Additional Tier 1
Basel Committee	Basel Committee on Banking Supervision
Basel III	An internationally agreed set of measures developed by the Basel Committee in response to the GFC
BRRD	Directive 2014/59/EU
BRRD II	Directive (EU) 2019/879
BRRD II bis	Directive (EU) 2017/2399
BRRD investment firm	Investment firm that is in scope of the resolution framework
CET 1	Common Equity Tier 1
CMU	Capital Markets Union
Commission	The European Commission
CRD IV	Directive 2013/36/EU
CRD V	Directive (EU) 2019/878
CRR	Regulation (EU) No 575/2013
CRR II	Regulation (EU) 2019/876
DG COMP	Directorate-General for Competition of the Commission
DG FISMA	Directorate-General for Financial Stability, Financial Services and Capital Markets Union of the Commission
DGS	Deposit Guarantee Scheme
DGS Directive	Directive 2014/49/EU
EBA	European Banking Authority
EC Treaty	Treaty establishing the European Community
ECB	European Central Bank
ECJ	Court of Justice of the European Union or the EU Courts, where appropriate
EDIS	European Deposit Insurance Scheme
EEA	European Economic Area
EEA Agreement	Agreement on the European Economic Area
EEC	European Economic Community
EEC Treaty	Treaty establishing the European Economic Community
EFTA States	The states that participate in the European Free Trade Association
EIB	European Investment Bank
EIOPA	European Insurance and Occupational Pensions Authority

ELA	Emergency liquidity assistance
EMF	European Monetary Fund
EMU	European Monetary Union
EPFS	Extraordinary public financial support
ERL	Eurosystem Resolution Liquidity
ESA	European Supervisory Authority
ESCB	European System of Central Banks
ESFS	European System of Financial Supervision
ESM	European Stability Mechanism
ESM DRI	ESM direct recapitalisation instrument
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
EU	European Union
EU Courts	The GC and ECJ
Eurosystem	The ECB and the national central banks of the Member States that have the euro as their currency
Eurozone	The Member States that have the euro as their currency
Eurozone Member States	The Member States that have the euro as their currency
FOLTF	Failing or likely to fail within the meaning of Article 32(4) BRRD (Article 18(4) SRMR)
FSB	Financial Stability Board
GC	General Court or, where relevant, its predecessor, the Court of First Instance
GFC	Great financial crisis
GFST	Government financial stabilisation tools
G-SIB	Global systemically important bank
G-SII	Global systemically important institution
ICS Directive	Directive 97/9/EC
IMF	International Monetary Fund
IPS	Institutional protection scheme
MDA	Maximum distributable amount
Member State	A member state of the European Union or, where applicable, a participating state in the European Economic Area
MiFID II	Directive 2014/65/EU
M-MDA	Maximum distributable amount related to the MREL
MoU	Memorandum of Understanding
MPE	Multiple point of entry
MREL	Minimum requirement for own funds and eligible liabilities
MV	Market value
NCWO	No credit or creditor worse off (principle)
Normal insolvency proceedings	Normal insolvency proceedings as defined in Article 2(1)(47) BRRD
NPA	Non-performing asset
NPE	Non-performing exposure

NPL	Non-performing loan
O-SII	Other systemically important institution
Participating Member States	Participating Member States of the SSM
PONV	Point of non-viability
PONV conversion power	Writing down or converting regulatory capital by the resolution authority within the meaning of Article 59 BRRD (Article 21 SRMR)
Precautionary guarantees	State guarantees to back liquidity facilities provided by central banks according to the central banks' conditions and State guarantees of newly issued liabilities within the meaning of Article 32(4)(d) BRRD (Article 18(4)(d) SRMR)
Precautionary recapitalisation	An injection by a Member State of own funds or purchase of capital instruments (CET 1, AT 1 or Tier 2 instruments) issued by a bank, including a bank which is publicly owned, within the meaning of Article 32(4)(d) BRRD (Article 18(4)(d) SRMR)
Reorganisation and Winding Up Directive	Directive 2001/24/EC
Resolution framework	The BRRD and SRMR, including, where applicable, the SRF Agreement
REV	Real economic value
SBBS	Sovereign bond-backed securities
SME	Small and medium sized enterprises
SPE	Single point of entry
SRB	Single Resolution Board
SRF	Single Resolution Fund
SRF Agreement	Intergovernmental Agreement on the Transfer and Mutualisation of Contributions to the Single Resolution Fund (May 2014)
SRM	Single Resolution Mechanism
SRMR	Regulation (EU) No 806/2014
SRMR II	Regulation (EU) 2019/877
SSM	Single Supervisory Mechanism
SSMR	Regulation (EU) No 1024/2013
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
TLAC	Total loss-absorbing capacity
TREA	Total risk exposure amount
Union	European Union

LIST OF ABBREVIATIONS OF BANK NAMES

Abanka	Abanka Vipa d.d.
ABLV Bank	ABLV Bank, AS
ABLV Bank Luxembourg	ABLV Bank Luxembourg, S.A.
ABN AMRO	ABN AMRO Group N.V.
Aegon	Aegon N.V.
Alpha Bank	Alpha Bank S.A.
Amagerbanken	Amagerbanken Aktieselskab
Andelskassen	Andelskassen J.A.K. Slagelse
ATE Bank	Agricultural Bank of Greece S.A.
Attica Bank	Attica Bank S.A.
Banca Carige	Cassa di Risparmio di Genova e Imperia
Banca Etruria	Banca Popolare dell'Etruria e del Lazio
Banca Marche	Banca delle Marche
Banca Popolare di Vicenza	Banca Popolare di Vicenza S.p.A.
Banca Romagna	Banca Romagna Cooperativa
Banca Tercas	Tercas-Cassa di Risparmio della Provincia di Teramo S.p.A
Banco CEISS	Banco de Caja España de Inversiones, Salamanca y Soria, S.A.U.
Banco de Sabadell	Banco de Sabadell S.A.
Banco Popular	Banco Popular Español S.A.
Banco Santander	Banco Santander S.A.
Banco Santander Totta	Banco Santander Totta S.A.
BANIF	Banco Internacional do Funcal S.A.
Bank Burgenland	Hypo-bank Burgenland AG
Bank of Ireland	Bank of Ireland Group plc
Bank of Peloponnese	Cooperative Bank of Peloponnese Coop Ltd.
Barclays	Barclays plc
Bayerische Vereinsbank	Bayerische Vereinsbank AG
BayernLB	BayernLB
BES	Banco Espírito Santo, S.A.
BPP	Banco Privado Português, S.A.
Bradford & Bingley	Bradford & Bingley plc

CAM	Caja de Ahorros del Mediterráneo
Carichieti	Cassa di Risparmio della Provincia di Chieti
Carife	Cassa di Risparmio di Ferrara
CCB	Cooperative Central Bank Ltd
CCM	Caja Castilla la Mancha
CEC Bank	CEC Bank SA
CGD	Caixa Geral de Dépositos, S.A.
Co-op Bank	Co-operative Bank p.l.c.
Crédit Agricole	Crédit Agricole S.A.
Deutsche Bank	Deutsche Bank AG
Dexia	Dexia N.V./S.A., Dexia Crédit Local S.A., Dexia Banque Belgique SA and/or Dexia Banque Internationale à Luxembourg S.A.
Eurobank	Eurobank Ergasias S.A.
Factor Banka	Factor Banka d.d.
FIH Group	FIH Holding A/S (FIH Holding), FIH Erhvervsbank A/S (FIH) and its wholly-owned subsidiaries
Fortis	Fortis Banque SA/NV, Fortis Banque Luxembourg S.A. and/or Fortis Bank Nederland N.V.
HETA	Heta Asset Resolution AG
HGAA	Hypo Group Alpe Adria AG
HSH Nordbank	HSH Nordbank AG
Hypo Steiermark	Landes-Hypothekenbank Steiermark AG
Iccrea Banca	Iccrea Banca S.p.A.
IKB	IKB Deutsche Industriekreditbank AG
ING	ING Groep N.V.
Jadranska Banka	Jadranska banka d.d. Sibenik
Kaupthing Bank Luxembourg	Kaupthing Bank Luxembourg S.A.
KBC	KBC Group N.V.
Laiki	Cyprus Popular Bank Public Co Ltd
LCCU	Lithuanian Central Credit Union
MKB Bank	MKB Bank Zrt.
MPS	Banca Monte dei Paschi di Siena
National Bank of Greece	National Bank of Greece S.A.
Nord/LB	Norddeutsche Landesbank Girozentrale
Northern Rock	Northern Rock plc
Novo Banco	Novo Banco S.A. (the bridge bank created in the resolution of BES)
Panellinia Bank	Panellinia Bank S.A.
Permanent TSB	Permanent TSB Group Holdings Plc
Piraeus Bank	Piraeus Bank Group
Proton Bank	Proton Bank S.A.
QIL	Quinn Insurance Ltd

Roskilde Bank	Roskilde Bank A/S
SachsenLB	SachsenLB AG
SNS Reaal	SNS Reaal N.V.
State Street Bank	State Street Bank International GmbH
T Bank	T Bank S.A.
Trasta Komercbanka	Trasta Komercbanka AS
UBI	Unione di Banche Italiane S.p.A.
UniCredit	UniCredit Banca S.p.A.
Veneto Banca	Veneto Banca S.p.A.
WestLB	WestLB AG

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CHAPTER 1

INTRODUCTION

> *"The debate regarding the justification of the bailouts is unlikely to ever be settled because it is almost impossible to assess the systemic consequences that disorderly failures would have had on the financial system and the broad economy. What is clear, however, is that citizens around the world do not want to be presented with a 'too big to fail' dilemma again. The job of regulators is therefore to make the system safer, and to create a process whereby systemically important financial institutions (SIFIs) can fail in an orderly manner. To preserve public finance ex post and market discipline ex ante, the guiding principle of the post-crisis financial regulations is that no private financial institution should be viewed by markets as being too important to be allowed to fail."*
>
> *Philippon and Salord 2017, p. 3.*

1.1 The GFC and its revelations

The Great Financial Crisis (GFC) has taught us a few things about the institutional and regulatory framework that is required for a healthy banking sector in the European Union (EU). Although banks had been in trouble before,[1] the onset of the GFC in 2008 was different. This time the financial stability of the Member States of the EU and the single financial market in the EU as a whole was at stake. The integration of the national markets for financial services had created broader and deeper systemic connections amongst banks across the EU. As a result, the likelihood that a disturbance in the banking sector of one Member State would spill over into another had increased.[2] The European arrangements for safeguarding financial stability were, however, still based on the guiding principle that a decentralised institutional setting, mostly based on the exercise of national responsibilities, would be able to prevent and manage crises affecting the

1 Banking crises took place in or as a result of the first oil crisis in 1973 (Green 1989, p. 137), the write off of Third World loans (Green 1989, p. 145), the stock market crash in 1987 (Green 1989, p. 148) and the economic crisis in the early 1990s. See also Gray and De Cecco 2017, p. 25; Reinhart and Rogoff 2013, p. 5; Laeven and Valencia 2010.

2 Recine and Teixeira 2009, p. 6.

single financial market.[3] It was against this background that all eyes were on the European Commission (the Commission) to regulate the access to the main instrument that was available to ensure financial stability at the onset of the GFC: State aid.

Member States granted large amounts of State aid to banks established in their territories, while the Commission loosened its assessment framework for the approval of these State aid awards.[4] Many banks were nationalized, while other banks were heavily dependent on State aid in order to survive.[5] Between 2008 and 2015, Member States granted circa EUR 759 billion in capital, impaired asset measures and repayable loans and circa EUR 1,188 billion in guarantees to financial institutions in distress.[6]

> National central banks of the Member States (both in and outside the Eurozone) also played an important role in ensuring financial stability, by cutting interest rates, by providing liquidity, and by taking so-called non-traditional or unconventional measures, such as enhanced credit support, comprising, *inter alia*, unlimited central bank liquidity to eligible banks at the main financing rate and against adequate collateral.[7] The role as 'lender of last resort' of the national central banks was however the most critical. In this role, they granted on a temporarily basis money to individual solvent banks that were experiencing temporary liquidity problems. This is also called emergency liquidity assistance or ELA.[8]

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3 Recine and Teixeira 2009, p. 7. An example of such decentralized institutional setting is the Memorandum of Understanding (MoU) on co-operation in financial crisis situations that was signed by the EU Banking Supervisors, Central Banks and Finance Ministries in 2005. Schoenmaker introduced the 'trilemma of financial stability' to describe that a stable financial system, an integrated financial system and national financial autonomy are incompatible (Schoenmaker 2011).

4 Liikanen Report 2012, p. 67. Almunia 2013; Lannoo *EStAL* 2014, p. 630; EC DG Competition Management Plan 2015, p. 22.

5 In Belgium, Cyprus, Greece, Ireland, Netherlands, Portugal and Slovenia, more than 50% of the financial system by assets has received State support (EC State aid brief 2015, footnote 4).

6 EC, The 2016 Scoreboard - Aid in the context of the financial and economic crisis.

7 EC Staff Working Paper 2011, p. 20.

8 The amounts of ELA that have been granted by the national central banks during the GFC were typically not disclosed, for the very reason that the disclosure might give rise to speculation and increase funding difficulties (EP, Briefing - Emergency Liquidity Assistance - moving away from "constructive ambiguity"?, 2 March 2017, PE 587.395, p. 2). Lane *JEP* 2012, p. 55. The ELA Agreement that was published by the ECB on 17 May 2017, however, provides for more transparency (see par. 8 thereof).

As a result of the large amounts of State aid that were granted, Member States were increasingly confronted with budgetary deficits that by far exceeded the maximum limits agreed on in the Treaty of Maastricht.[9] The GFC was therefore not only a financial and economic crisis, but also a sovereign debt crisis.[10] The average ratio of the government debt to the gross domestic product of the Member States increased from 57.6% in 2007 to 86.7% in 2014.[11] In addition, the average ratio of the planned or actual government deficit to gross domestic product increased from -0.9% in 2007 to -3.0% in 2014 (with a top of -6.6% in 2009).[12]

> Not in all Member States the direction of causality was from banks to sovereigns only. In some Member States (like Greece, Portugal and Spain) the banking sector also suffered from the fragile sovereign situation due to its exposure via sovereign securities and loans to governments.[13]

This toxic relationship between banks and Member States was not the only concern. There were also insufficient consequences for risky behaviour for banks, as failure did not lead to quitting the market. Many banks that were awarded State aid during the GFC already suffered from endogenous problems, which became apparent because of the GFC. The GFC worked as a catalyst for these problems, such as shortcomings in credit risk management, insufficient internal controls, problems in credit monitoring procedures, weaknesses in the management of investments held, imprudent investment decisions, an aggressive approach to credit risk policies or a strategy of aggressive expansion. Despite these internal problems, banks

9 According to Article 1 of the Protocol on the excessive deficit procedure of the Treaty of Maastricht (or the TEU), as signed in Maastricht on 7 February 1992, the maximum limits are 3% for the ratio of the planned or actual government deficit to gross domestic product at market prices and 60% for the ratio of government debt to gross domestic product at market prices.

10 Please be referred to the Liikanen Report 2012, p. 4 for the different phases or waves of crises in the EU.

11 Eurostat, General government gross debt, available on the website of Eurostat: www.ec.europa.eu/eurostat.

12 Eurostat, General government deficit/surplus, available on the website of Eurostat: www.ec.europa.eu/eurostat. See also Grünewald 2014, p. 48-51.

13 Angelini 2014, p. 5.

were able to continue their activities because of the State aid that they received in order to protect the financial stability.[14]

Altogether, the GFC revealed that the institutional and regulatory framework for the banking sector in the EU was inadequate not only to safeguard the stability of the single financial market and to break the link between Member States and banks, but also to limit the risk of 'moral hazard'.[15] It became clear that certain changes had to be made to address the inadequacies revealed by the GFC.[16]

1.2 Changes in the institutional and regulatory framework for the banking sector

This section discusses the changes that have been made in the institutional and regulatory framework for the banking sector in the EU to address the inadequacies revealed by the GFC. As such, this preludes the research question of this dissertation, which is presented in section 1.3.

1.2.1 The introduction of an EU network of supervision

In October 2008, the Commission set-up a High Level Group chaired by Jacques de Larosière to advise on the future of European financial regulation and supervision. The High Level Group recommended a new EU financial stability architecture based on a two-pillar structure comprising macro-and micro-prudential oversight.[17] This structure was set up in 2010, starting operations on 1 January 2011, in the form of the European

14 The approval of the Commission of State aid, however, requires compliance with certain conditions, including internal restructuring of the bank in order to credibly return to long-term viability. Such restructuring may include the removal of the senior management, divestures, remuneration caps, etc. Also, in certain cases banks could not credibly return to long-term viability, as a result of which they were wound up in normal insolvency proceedings.

15 Although there is no European definition of moral hazard, the author understands moral hazard to refer to dangerous or even reckless behaviour by a person or firm in an economic context where the consequences of that behaviour are indemnified or insured by others (See also Mulhearn and Vane 2015, p. 31).

16 Recine and Teixeira 2009, p. 9.

17 Larosière Report 2009, p. 44-48. See also De Serière *Ondernemingsrecht* 2009.

System of Financial Supervision (ESFS). The ESFS consists of the European Systemic Risk Board (ESRB), for the conduct of macro-prudential oversight,[18] and the European Supervisory Authorities (ESAs) for supporting supervisory coordination and convergence of supervisory standards. The respective Member States' competent and macro-prudential authorities are also part of the ESFS.

The ESAs are the European Banking Authority (EBA)[19], the European Securities and Markets Authority (ESMA)[20] and the European Insurance and Occupational Pensions Authority (EIOPA)[21]. The EBA, ESMA and EIOPA are the successors of the Committee of European Banking Supervisors (CEBS), the Committee of European Securities Regulators (CESR) and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), respectively. The difference between the ESAs and their predecessors is that the ESAs have a more formal structure (being decentralized agencies instead of comitology committees) and have more binding powers.[22] The ESAs work together in the Joint Committee of the European Supervisory Authorities for overall and cross-sectoral coordination, with the aim of ensuring cross-sectoral supervisory consistency. The EBA is the competent ESA in the field of banking and is therefore the most relevant ESA for the banking sector.

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18 See Regulation (EU) No 1092/2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (the ESRB Regulation) and Council Regulation (EU) No 1096/2010 conferring specific tasks on the European Central Bank concerning the functioning of the European Systemic Risk Board.

19 See Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority), as amended by subsequent legislation (the EBA Regulation).

20 See Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority), as amended by subsequent legislation (the ESMA Regulation).

21 See Regulation (EU) No 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), as amended by subsequent legislation (the EIOPA Regulation).

22 EC, Report on the operation of the European Supervisory Authorities (ESAs) and the European System of Financial Supervision (ESFS), 8 August 2014, COM(2014) 509 final, p. 3-4. EP, Review of the New European System of Financial Supervision (ESFS) – Part 1: The Work of the European Supervisory Authorities (EBA, EIOPA and ESMA), 2013, PE 507.446, p. 20-22.

1.2.2 The introduction of the European Banking Union

Coordination between supervisors within the EU network of supervision was deemed a vital step, but the GFC had shown that mere coordination was not enough. Primarily in the context of a single currency, there was a need for common decision-making. The Commission proposed the European Banking Union in mid-2012 in order to create a common structure for decision-making based on a harmonized set of rules.[23]

The foundation of the European Banking Union is the Single Rulebook.[24] The Single Rulebook sets out a regulatory framework that applies to banks in all Member States,[25] consisting of the Capital Requirements Directive and Capital Requirements Regulation (CRD IV and CRR),[26] the Bank Recovery and Resolution Directive (BRRD) and Single Resolution Mechanism Regulation (SRMR),[27] and a thorough revision of the Directive on Deposit Guarantee Schemes (DGS Directive).[28]

> <u>BRRD and SRMR (resolution framework)</u>
> The BRRD and the SRMR together form the basis of the resolution framework for the banking sector as of 1 January 2016.[29] This framework has to provide for sufficiently early and quick intervention

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23 EC, Communication from the Commission to the European Parliament and the Council: A Roadmap towards a Banking Union, COM(2012) 510 final.

24 Besides strengthening the regulation of the banking sector, the Single Rulebook also implemented the Basel III rules of the Basel Committee on Banking Supervision (Basel Committee) (in CRD IV and CRR) and the FSB Report 2014 (in the BRRD and SRMR).

25 This framework also applies to certain investment firms (also referred to as 'BRRD investment firms') that, due to their activities, are considered to be similar to banks. This makes them ineligible for certain derogations to required levels of own funds. See Article 4(1)(2) CRR for the definition of investment firm. The definition of investment firm that is used in the BRRD and the SRMR differs from this definition as a result of which even a smaller group of investment firms falls in scope of the BRRD and the SRMR.

26 Directive 2013/36/EU (CRD IV) and Regulation (EU) No 575/2013 (CRR).

27 Directive 2014/59/EU (BRRD) and Regulation (EU) No 806/2014 (SRMR).

28 Directive 2014/49/EU (DGS Directive).

29 The BRRD had to be implemented by the Member States by 31 December 2014, except for the bail-in provisions that Member States could choose to apply only from 1 January 2016 when they became mandatory. The SRMR is applicable from 1 January 2016 (with the exception of a number of provisions, mainly in relation to the setup of the SRB). The SRB became fully operational on 1 January 2016. As will be discussed in section 4.3.4, the BRRD and SRMR also contain the resolution framework for entities other than banks, such as certain investment firms and financial institutions.

in an unsound or failing bank so as to ensure the continuity of the bank's critical financial and economic functions, while minimising the impact of a bank's failure on the economy and financial system.

DGS Directive (deposit guarantee framework)
The DGS Directive provides for harmonisation and simplification of protected deposits, faster pay-outs and improved financing, notably through the *ex ante* funding of deposit guarantee schemes paid for by contributions from banks and a mandatory borrowing facility between national schemes within certain fixed limits.[30] The DGS Directive applies in the Member States from 3 July 2015.

CRD IV and CRR (prudential framework)
The CRD IV and CRR provide for a harmonized framework for the prudential requirements for banks. The CRD IV and CRR apply in the Member States from 31 December 2013 and 1 January 2014, respectively.

Although the Single Rulebook forms the foundation of the European Banking Union, the idea of the Single Rulebook precedes the idea of the European Banking Union. Both the CRD IV and the CRR were finalised in 2013 after intense negotiations, whereas the fourth President's Report, the first document referring to the European Banking Union, is from 2012.[31] In addition, the concept of the Single Rulebook is disentangled from the European Banking Union: the Single Rulebook applies to all Member States, even though it is a clear help to the establishment of the European Banking Union.

Within the European Banking Union, the Single Rulebook is (currently) accompanied by two pillars. The first pillar is the Single Supervisory Mechanism (the SSM)[32] under which the European Central Bank (ECB), in cooperation with the national competent authorities, carries out tasks to ensure that banks and bank groups *in the Eurozone*[33] comply in a uniform way with the prudential requirements for banks, as included in CRD IV and CRR. The second pillar is the Single Resolution Mechanism (the

30 Recital (7) DGS Directive.
31 President of the European Council Report 2012, p. 4.
32 As contained in Council Regulation (EU) No 1024/2013 (the SSMR).
33 The SSM is also open to non-Eurozone Member States willing to join the European Banking Union. Currently, there are no non-Eurozone Member States that have joined the European Banking Union. EP Annual Report Resolution 2018, under G.

SRM).[34] The SRM is a common framework on bank recovery and resolution, under which a centralised power of resolution is established and entrusted to the Single Resolution Board (SRB) established in accordance with the SRMR and to the national resolution authorities, for banks and bank groups in the Eurozone.[35] In addition, the SRMR provides that a Single Resolution Fund (SRF) is built up over a period of eight years for the funding of resolution of banks and bank groups in the Eurozone. The SRF is financed by *ex ante* contributions from the banking industry.

> The SRF is considered an essential element without which the SRM could not work properly. If the funding of resolution were to remain national in the longer term, the link between sovereigns and the banking sector would not be fully broken, and investors would continue to establish borrowing conditions according to the place of establishment of the banks rather than to their creditworthiness.[36] An intergovernmental agreement[37] (the SRF Agreement) between 26 Member States regulates the core elements of the SRF, including (i) transferring the contributions raised at national level to the national compartments of the SRF, (ii) mutualisation of the national compartments' funds over a transition period of eight years, (iii) lending between national compartments that are not yet mutualized and (iv) the potential contribution of non-Eurozone Member States to the SRF. The SRF Agreement has been ratified by 20 Member States, including all 19 current participating Member States of the SSM and Hungary. The SRF shall reach the target level of at least 1% of the number of covered deposits of all banks within the European Banking Union by 31 December 2023.

1.2.3 The reform of the State aid regime for the banking sector

At the onset of the GFC, the only instrument available at EU level to deal with failing banks and their return to viability in an orderly manner was State aid control by the Commission.[38]

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34 As contained in the SRMR.
35 Recital (11) SRMR.
36 Recital (19) SRMR.
37 Intergovernmental Agreement on the Transfer and Mutualisation of Contributions to the Single Resolution Fund (May 2014) (the SRF Agreement).
38 Almunia 2013; Lannoo *EStAL* 2014, p. 630; EC DG Competition Management Plan 2015, p. 22.

> During the GFC, 'taxpayers' money' was the main source of funding for failing banks, because access to other funding resources was not secured. There were no supranational funds available, such as the SRF or the European Stability Mechanism (ESM), and shareholders and creditors of banks could not be forced to contribute to failing banks (other than through the liquidation of a bank). The only other funding resources that were available at the time of the GFC were ELA awarded by the national central banks (within the Eurozone as part of the Eurosystem) and contributions from national deposit guarantee schemes, albeit that there was a lack of a uniform regime within the EU.

The need for a strong State aid control regime became – utterly – obvious at the start of the GFC. The Commission had to deal with the threat to financial stability, while maintaining strict controls on the granting of State aid. In the early days of the crisis, the Commission found the solution to this challenge in the Communication on State aid for rescuing and restructuring firms in difficulty (the 2004 R&R Guidelines).[39] The Commission used the criteria set out in these guidelines to assess the State aid awards in the banking sector on their compatibility with the internal market. Although the 2004 R&R Guidelines had been used with some success in a small number of cases involving State aid to banks before and in the early days of the GFC, they were not ideally suited to address large-scale interventions in the banking sector. The 2004 R&R Guidelines therefore required adaptation to the crisis situation. Between 2008 and 2011, the Commission published six communications (the Crisis Communications) containing a tailored framework for State aid control for banks in difficulty that followed the general principles laid down in the 2004 R&R Guidelines. The Crisis Communications did not contain new rules, but allowed for the adjustment and sharpening of the Commission's practice in relation to its assessment of State aid awards to failing entities.[40] The Commission used the Crisis Communications to coordinate the responses of Member States, to preserve a level playing field in the banking sector, and to make sure that bail-outs were carried out according to similar conditions across the EU.[41] Between 2007 and 2014 the Commission took more than

39 The 2004 R&R Guidelines have been replaced by the 2014 R&R Guidelines, which went into effect on 1 August 2014.
40 EC Staff Working Paper 2011, p. 31.
41 Almunia 2013.

450 State aid decisions determining the restructuring – or winding up in an orderly manner[42] – of 112 EU banks.[43]

While the contours of the European Banking Union were taking shape, the Commission started with its review of the Crisis Communications.[44] With the introduction of the new resolution framework in the form of the BRRD and SRMR, the role of State aid control in the banking sector had to be revisited and State aid control had to be embedded in the resolution framework. As it was no longer necessary for the Commission to act as the *de facto* resolution authority, the Commission was able to refocus on the impact of State aid on competition within the EU.[45] In August 2013, the Commission adopted the 2013 Banking Communication, in which it consolidated and strengthened the State aid regime for the banking sector.[46]

1.3 Research question

As discussed in the previous sections, the GFC has revealed certain inadequacies in the institutional and regulatory framework for the banking sector in the EU, which have sparked certain changes in this framework. The swift and thorough overhaul of the framework was an inevitable, but also critical operation. As a result, the institutional and regulatory framework for the banking sector has been improved, but at the same time it faces new challenges. The purpose of this dissertation is to discuss the challenges as a result of the co-existence of the resolution framework – in the form of the BRRD and SRMR – and the State aid regime for the banking sector. It describes how both the resolution framework and the State aid regime regulate public funding of failing banks in the EU after the onset of the GFC. It also then analyses how the resolution framework impacts the State aid regime for the banking sector. Finally, it assesses potential steps that can be taken to address the challenges in the co-existence of both regimes to contribute to an adequate and efficient institutional

42 If it is not possible – and necessary – to restore the health of a bank, State aid can also be granted to facilitate the liquidation of the bank. This is called 'liquidation aid' as opposed to 'rescue and restructuring aid', which aims at restoring the viability of a bank.

43 EC State aid brief 2015, p. 1.

44 Almunia 2013.

45 Laprévote and Paron *EStAL* 2015, p. 110.

46 The State aid regime for the banking sector, as laid down in the 2013 Banking Communication, is discussed in more detail in Chapter 3.

and regulatory framework for the banking sector in the EU. In this context, this dissertation aims to answer the following three-part research question:

How does the resolution framework impact the State aid regime for the banking sector? Which challenges can be identified in the co-existence of the resolution framework and State aid regime in regulating public funding of failing banks in the EU after the onset of the GFC? And which potential steps can be taken to address such challenges in order to contribute to an adequate and efficient institutional and regulatory framework for the banking sector?

The impact of the resolution framework on the State aid regime for the banking sector is assessed along three lines of research. The first line of research assesses the impact of the resolution framework on the access to public funding as a remedy for failing banks. The second line of research assesses the impact of the resolution framework on the exercise of State aid control by the Commission. The third line of research assesses the impact of the resolution framework on the restructuring process of a failing bank. Section 1.5 describes these lines of research in more detail.

1.3.1 Terminology

This dissertation uses the terms 'public funding' and 'failing bank', although they are not defined as such in the resolution framework or the State aid regime for the banking sector. The reason for using these terms is that the resolution framework and the State aid regime for the banking sector both apply their own terms for public funding (e.g. State aid, restructuring aid, rescue aid, liquidation aid, resolution aid, extraordinary public financial support (EPFS), emergency liquidity assistance (ELA), precautionary recapitalisation, government financial stabilisation tools) and failing banks (e.g. banks in difficulty, banks with a capital shortfall, banks that are 'failing or likely to fail', banks that are not solvent, or banks that face a significant deterioration of their financial position). The terms that are used in the resolution framework and State aid regime are subject to specific legal interpretations, which may not always concur with the common usage of these terms, as will be explained in more detail later on in this dissertation.[47] The terms 'public funding' and 'failing bank' are therefore introduced in this dissertation as neutral terms without any special

47 See e.g. section 3.3 on the concept of State aid and section 5.2 on the concepts of EPFS and ELA.

connotation under the resolution framework or the State aid regime for the banking sector.

Public funding
The term 'public funding' in this dissertation refers to funding that is made available by Member States or supranational authorities or through resources that they control. Public funding can even stem from private resources, if these are under the control of a Member State or supranational authority. It is not restricted to State aid. Public funding can be used to pursue public policy objectives or commercial objectives. For example, saving a failing bank can have a public policy objective (e.g., if it is intended to safeguard financial stability) or a commercial objective (e.g., if a Member State provides a guarantee or a loan on commercial terms to a failing bank). Public funding can take different forms. The funding can be directly provided by a Member State (e.g. through capital injections, guarantees or liquidity support) or indirectly through other public or private bodies or public undertakings (e.g. through national resolution funds or deposit guarantee schemes).[48] It can also be made available by or through supranational authorities, such as the SRB and the ECB, or the European Stability Mechanism (ESM). [49]

Failing bank
A bank can fail in many ways. It can be unable to pay debts or other liabilities as they fall due (illiquidity), its assets can be less than its liabilities (balance-sheet insolvency) or it can violate the regulatory capital requirements (regulatory insolvency).[50] The term 'failing bank' in this dissertation covers all these situations.

Depending on the type of failure, different consequences can or will be triggered under the resolution framework. If the financial position of a bank 'significantly deteriorates' this may trigger recovery actions to be imposed by the bank itself. If a bank 'infringes, or is likely to infringe in the near future' on (certain) requirements of CRR, CRD IV, the Markets in

48 See also Grünewald 2014, p. 25-26. She refers to these parties as 'quasi-fiscal authorities'.
49 The ESM was established in 2012 by an intergovernmental treaty (the ESM Treaty) between the participating Member States of the SSM. It is the successor of the European Financial Stability Facility (EFSF). The ESM can provide financial support to participating Member States of the SSM and, as of December 2014, to individual banks in the form of direct recapitalisation.
50 Campbell and Moffatt 2015, p. 56-57.

Financial Instruments Directive II (MiFID II)[51] or the Markets in Financial Instruments Regulation (MiFIR)[52], early intervention measures can be taken by the competent authority. If a bank is 'failing or likely to fail' this may trigger the bank being put in resolution or being wound up in normal insolvency proceedings.[53]

The type of failure also dictates which public funding resources are apt to remedy such a failure of a bank. If a bank has, for example, a shortage of liquidity, a loan facility or guarantee on senior debt instruments can be more efficient than a capital injection.

Lastly, the financial difficulties of a bank govern which public funding resources are available. Under the 2004 R&R Guidelines rescue and restructuring aid was only available for banks that were 'in difficulty'. The Commission considered a bank as being in difficulty where it was unable, whether through its own resources or with the funds it was able to obtain from its owners/shareholders or creditors, to stem losses which, without outside intervention by the public authorities, would almost certainly condemn it to going out of business in the short or medium term.[54] In other words: the bank would have been subject to collective insolvency proceedings, but for the State aid granted. Only in such a situation would the bank gain access to rescue and restructuring aid. No similar criterion is included in the State aid regime for a banking sector. Indeed, during the GFC many banks were supported not because they were in difficulty, but in order to prevent them from further restricting their lending exposure to the real economy.[55] The 2013 Banking Communication does, however, provide that certain State aid measures are only available for banks without a 'capital shortfall'.

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51 Directive 2014/65/EU (MiFID II).

52 Regulation (EU) 600/2014 (MiFIR).

53 Normal insolvency proceedings are defined in Article 2(1)(47) BRRD as "*collective insolvency proceedings which entail the partial or total divestment of a debtor and the appointment of a liquidator or an administrator normally applicable to institutions under national law and either specific to those institutions or generally applicable to any natural or legal person*." This definition is broad (see also Janssen 2019, p. 254-256).

54 2004 R&R Guidelines, points 9 and 10.

55 Hancher, Ottervanger and Slot 2016, p. 556.

1.3.2 Scientific and social relevance of the research question

The literature on public funding of failing banks is mainly written from an economic, political and social perspective.[56] This dissertation aims to contribute to the ongoing debate on public funding of failing banks from a legal point of view.[57] The debate is multi-angled, as it does, for example, cover issues in relation to finding the balance between financial stability, competition and protecting taxpayers, the desirability of public funding, the shift of powers from Member States to European institutions, such as the ECB and the SRB, the completion of the Economic and Monetary Union (EMU) and the development of the internal market in and outside the Eurozone.

The ongoing turmoil in the Italian banking sector shows that such a debate is still necessary.[58] Also, at the time of writing this dissertation, 10 years after the start of the GFC, predictions of a new crisis are already being made.[59] Although no one hopes for a new systemic crisis, crises can also contribute to necessary reforms and progression. It is because of the GFC that we now have the resolution framework for the banking sector, which makes the EU hopefully more resilient to a next crisis.

Taking into account the very short timeframe in which the resolution framework has been adopted, it needs more time, however, to be further completed and solidified. This dissertation aims to contribute to that process by focussing on the coherence between the State aid regime for the banking sector and the resolution framework. It may be of interest not

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56 There are of course also some good examples of contributions from legal authors that focus on this topic (e.g. Lo Schiavo *EBORL* 2018, Bodellini *EBOLR* 2018, Schillig 2018, Laprévote and Gray 2017, Babis *LFMR* 2016, Micossi, Bruzzone and Cassella *CEPR* 2016, Hadjiemmanuil *EE* 2016, Gardella 2015, Lannoo *EStAL* 2014, Dewatripont *IJoIO* 2014, Kokkoris *ICR* 2013).

57 According to Véron "*(…) the context for future SRB activity will be materially affected by the development of EU state aid control in the banking sector (…) Whether and how this changes in the future is a critically important space to watch.*" (Véron 2019, p. 15-16). Lastra, Russo and Bodellini mention that: "*Aligning the provisions of the state aid framework with the provisions of the resolution regime in relation to public intervention is of paramount importance*." (Lastra, Russo and Bodellini 2019, p. 6).

58 See e.g. FT, Berlin leads backlash against Italian bank rescue, 26 June 2017; FT, Why Italy's €17bn bank rescue deal is making waves across Europe, 26 June 2017; FT, ECB confirms that two struggling Italian banks will close, 24 June 2017; FT, New year, old problems for Italy's banking sector, 26 December 2018.

59 See e.g. FT, Start preparing for the next financial crisis now, 18 February 2018; Observer, Historian Who Predicted the 2008 Financial Crisis Warns the Next Recession is Near, 22 March 2018.

only to policymakers, but also to practitioners dealing with questions from clients in practice. In addition, it aims to contribute to the scholarly debate by engaging in the development of arguments in discussions that are not yet settled. Ultimately, this dissertation aims to ensure that the law is correctly and transparently applied in the realization of EU goals in order to (re)gain the trust of EU citizens.

1.3.3 Research methodology

The first three chapters of this dissertation (Part 1) address descriptive analysis issues by (1) describing what a bank is and what a balance sheet of a bank looks like, and (2) reviewing and structuring the information that is available on the State aid regime and resolution framework for the banking sector in order to prepare for the assessment in Part 2: how the resolution framework and the State aid regime for the banking sector contribute to regulating public funding of failing banks in the EU.

> Both the resolution framework and the State aid regime for the banking sector have been covered in many publications. Nonetheless, the author has decided to cover both frameworks extensively in this dissertation for two reasons. The first reason, is that a good understanding of both frameworks is key for understanding the analysis that is made in Part 2 of the impact that the resolution framework has on the regulation of public funding of failing banks in the EU, as originally only covered by the State aid regime for the banking sector. Taking into account that scholars and practitioners focus – most of the time – only on one of the two frameworks, this dissertation describes both frameworks to cater for any gaps in the necessary knowledge to understand the consequences of the co-existence of both frameworks. The second reason, is that by structuring the information that is available on the State aid regime and resolution framework for the banking sector in Chapter 3 and Chapter 4 in the exact same way, it provides for the possibility to make an assessment of coherence between the resolution framework and State aid regime for the banking sector. This is a relevant assessment considering the – potential – further integration of both frameworks in the future. The assessment in this dissertation is focused on the coherence between both frameworks in respect of the three research lines. A coherence assessment can however also be made on other aspects, such as legal outline, geographical scope, material scope or group application.

The last three chapters of this dissertation (Part 2) address both descriptive analysis issues and normative analysis issues by (3) describing the way in which the State aid regime for the banking sector is amended and complemented by the resolution framework, (4) analysing the impact thereof on the access to public funding as a remedy for failing banks, on the exercise of State aid control by the Commission and on the restructuring process of a failing bank and (5) identifying any hurdles, tensions and challenges that result from this impact.

The sources that are used for this dissertation range from the European legal framework – consisting of treaties, regulations, directives, communications, guidelines, policy documents and other soft law instruments -- to publications from EU institutions, jurisprudence and relevant literature. In addition, the State aid decisions taken by the Commission for the banking sector, the decisions taken by the national resolution authorities and the SRB in relation to the resolution of banks and the decisions by the ECB with respect to the assessment whether a bank is failing or likely to fail are analysed. With respect to the State aid decisions taken by the Commission, the author has created a database of all the decisions taken during and after the GFC in the banking sector in order to be able to search the decisions.

1.3.4 Restrictions

This research is restricted in several ways. Firstly, the resolution framework for the banking sector is laid down in the BRRD and the SRMR. The entities that can be placed in resolution under the BRRD and the SRMR are, however, not only banks and banking groups. Also certain investment firms (whether part of a banking group or not) and financial institutions forming part of a banking group can be subject to resolution. Discussion of the particularities of the application of the resolution framework to these entities falls outside the scope of this dissertation. This dissertation focuses on the application of the resolution framework *on banks and banking groups*.[60]

Secondly, political, economic and social considerations have played their part in the realization of laws and regulations, and even in decisions in individual cases. It is not always possible to discover the impact of these

60 See Louisse 2019 on the resolution of investment firms.

considerations on the choices that have been made or the outcome of certain processes. When not explicated, these considerations are out of scope of this research.

> As a result, a more thorough analysis of the relationship between financial stability and competition in the banking sector, which would have required the processing of the relevant literature by economists, is outside the scope of this dissertation. This may be a topic for future research.

Thirdly, this dissertation does not discuss the impact of insolvency law on the regulation of public funding of failing banks. Although the resolution framework has introduced an alternative for the winding up of a bank in insolvency proceedings, this has not made national insolvency proceedings less relevant for failing banks.[61] Winding up a bank under national insolvency proceedings is still the alternative for banks where resolution is not in the 'public interest'. In addition, resolution can involve the liquidation of certain parts of a bank under national insolvency proceedings. Also, the efficacy of the 'no creditor worse off' principle'[62] under the resolution framework depends on the national insolvency proceedings that would have applied if the bank had not been put in resolution.[63]

> Taking into account the relevance of national insolvency proceedings for the functioning of the resolution framework, it is unfortunate that these proceedings are still not harmonized within the EU.[64] The Directive on the reorganisation and winding up of credit institutions (Reorganisation and Winding Up Directive)[65] only provides for the harmonisation of private international law rules for the insolvency of banks throughout the EU. In some countries (such as Italy) specific proceedings have been developed for the liquidation of banks that include a form of cooperation with the competent authority. In other countries, banks are liquidated under the national insolvency proceedings, which apply to commercial businesses.[66]

61 Binder 2019, p. 4-5.
62 This principle ensures that shareholders and creditors whose claims have been written down or converted to equity in resolution do not incur greater losses than they would have incurred if the bank in resolution had been wound up in normal insolvency proceedings.
63 Grünewald 2017, p. 305-306.
64 See also Janssen 2019, p. 290-296.
65 Directive 2001/24/EC (Reorganisation and Winding Up Directive).
66 Haentjens and De Gioia-Carabellese 2015, p. 112-113.

Fourthly, this dissertation does not include a comparison with the US resolution framework. Although this would have been useful in some instances (e.g., for assessing the benefits of a bank holding structure with a special purpose entity (SPE) at the top), this would have been a rather complex and unwieldy process, particularly as the State aid complexities do not arise there.[67]

Fifthly, the State aid regime and resolution framework are still in development, as will be elaborated in the next section. This dissertation is up to date until 7 June 2019 – the date on which the Banking Package was published in the Official Journal of the EU. Any further developments after this date have not been included in this dissertation.

1.4 More changes ahead

The changes discussed in section 1.2 were only the start of the thorough revision of the institutional and regulatory framework for the banking sector. In 2015, the Presidents of the Commission, European Council, Eurogroup, ECB and European Parliament published a report on Completing Europe's Economic and Monetary Union (the 'Five Presidents' Report').[68] It outlined a reform plan aiming to achieve a genuine economic, financial and fiscal Union in three stages (at the latest by 2025), *inter alia*, through completing the European Banking Union, launching the Capital Markets Union and strengthening the EU supervisory framework.

This section addresses the actions that are taken or are proposed further to the Five Presidents' Report in order to give more context to the research question and to show that the topic of this dissertation is not static, but subject to continuous change. Where relevant, these actions are addressed in the remainder of this dissertation.

67 See e.g. Busch and Van Rijn *EBOLR* 2018, Nieto and Wall 2017, Goodhart and Avgouleas 2014, p. 70-76, Bliss and Kaufman *EP* 2006.

68 Five Presidents' Report: Completing Europe's Economic and Monetary Union, 22 June 2015.

1.4.1 Completion of the European Banking Union

In October 2017, the Commission published the Communication on Completing the European Banking Union building on the Five Presidents' Report.[69] The initiatives that are taken and proposed by the Commission to complete the European Banking Union are discussed in the following sections.

1.4.1.1 The Banking Package

On 23 November 2016, the Commission published a legislative package consisting of five proposals for amendment of the CRD IV, CRR, BRRD and SRMR (the Banking Package).[70]

The BRRD II bis Proposal was adopted and published as Directive (EU) 2017/2399 on 27 December 2017 (BRRD II bis). BRRD II bis had to be implemented by the Member States by 29 December 2018. This directive changes the definition of 'debt instruments' in the BRRD and replaces Article 108 BRRD in respect of the ranking in insolvency hierarchy.

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69 2017 Communication on completing the Banking Union.

70 EC, Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures, COM(2016)854 final (the CRD V Proposal), EC, Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements and amending Regulation (EU) No 648/2012, COM(2016)850 final (the CRR II Proposal), EC, Proposal for a Directive of the European Parliament and the Council amending Directive 2014/59/EU on loss-absorbing and recapitalisation capacity of credit institutions and investment firms, COM(2016)852 final (BRRD II Proposal), EC, Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 806/2014 as regards loss-absorbing and Recapitalisation Capacity for credit institutions and investment firms, COM(2016)851 final (the SRMR II Proposal) and EC, Proposal for a Directive of the European Parliament and of the Council on amending Directive 2014/59/EU of the European Parliament and of the Council as regards the ranking of unsecured debt instruments in insolvency hierarchy, COM(2016)853 final (BRRD II bis Proposal).

The BRRD II Proposal was adopted and published as Directive (EU) 2019/879 on 7 June 2019 (BRRD II). BRRD II has to be implemented by the Member States by 28 December 2020.[71] BRRD II, *inter alia*, amends the term 'eligible liabilities', introduces the terms 'bail-inable liabilities', 'resolution entity' and 'resolution group', amends the minimum requirement for own funds and eligible liabilities (MREL), aligns the MREL with the TLAC Standard[72], provides for sanctions when the MREL is breached, introduces a new moratorium tool to be employed in the pre-resolution phase and provides for further protection when subordinated eligible liabilities are sold to retail clients.

The SRMR II Proposal was adopted and published as Regulation (EU) 2019/877 on 7 June 2019 (SRMR II). The SRMR II applies from 28 December 2020. It mirrors the amendments made by BRRD II to BRRD, but then for the SRMR.

The CRD V Proposal was adopted and published as Directive (EU) 2019/878 on 7 June 2019 (CRD V). CRD V has to be implemented by the Member States by 28 December 2020.[73] This directive, *inter alia*¸ provides for streamlining the Pillar 2 capital requirements, clarifying the interaction between Pillar 2 add-ons, Pillar 1 requirements, the own funds and eligible liabilities requirement, the MREL and the combined buffers (the 'stacking order') and clarifying the distinction between Pillar 2 requirements and Pillar 2 capital guidance.[74]

The CRR II Proposal was adopted and published as Regulation (EU) 2019/876 on 7 June 2019 (CRR II). CRR II will apply from 28 June 2021 with a number of exceptions.[75] CRR II, *inter alia*, introduces a binding 3%

71 Member States shall apply point (17) of Article 1 BRRD II, as regards Article 45i(3) BRRD from 1 January 2024. Where, in accordance with Article 45m(1) BRRD, the resolution authority has set a compliance deadline that ends after 1 January 2024, the application date of point (17) of Article 1 BRRD II as regards Article 45i(3) BRRD shall be the same as the compliance deadline.

72 FSB, Total Loss-absorbing Capacity (TLAC) Term Sheet, 9 November 2015.

73 However, the provisions necessary to comply with the amendments set out in point (21) and points (29)(a), (b) and (c) of Article 1 CRD V as regards Article 84 and Article 98(5) and (5a) CRD IV shall apply from 28 June 2021 and the provisions necessary to comply with the amendments set out in points (52) and (53) of Article 1 CRD V as regards Articles 141b, 141c and Article 142(1) CRD IV shall apply from 1 January 2022.

74 EP, Amending capital requirements – The 'CRD V package', PE 599.385, April 2019, p. 5-6.

75 See Article 3 CRR II.

leverage ratio and a harmonised binding net stable funding ratio. It also implements the TLAC Standard.

1.4.1.2 Proposal for the EDIS as third pillar of the European Banking Union

It is envisaged that, as a third pillar, the European Banking Union will comprise a European Deposit Insurance Scheme (EDIS) for payouts to depositors and contributions to resolution of the banks and bank groups that fall in scope of the SSM. The Five Presidents' Report signals that, as the current set-up with national deposit guarantee schemes remains vulnerable to large local shocks, common deposit insurance would increase the resilience of the European Banking Union against future crises. This is currently still a future step, although the Commission published a proposal for a regulation on 24 November 2015 with the intention of creating a more European system, disconnected from the sovereign, so that financial stability is enhanced, citizens can be certain that the safety of their deposits does not depend on their geographical location, and sound banks are not penalised by their place of establishment.[76] It is intended that the EDIS will be privately funded through *ex ante* risk-based fees paid by all the participating banks in the SSM. In 2017, the Commission stated that the EDIS will progressively evolve from a reinsurance scheme into a fully mutualised co-insurance scheme over a number of years.[77] At the time of writing this dissertation, it is not envisaged that the EDIS will be put in place before 2020.[78]

1.4.1.3 The introduction of a common backstop to the SRF

As of 2016, all participating Member States of the SSM (participating Member States) have entered into a harmonised loan facility agreement with the SRB, providing a national individual credit line to the SRB to back their national compartments in the SRF in case of possible funding

76 EC, Proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) 806/2014 in order to establish a European Deposit Insurance Scheme, COM(2015)586 final (the EDIS Proposal).

77 2017 Communication on completing the Banking Union, p. 10. Some authors argue that the SRF and EDIS should be combined in order to allow for swift decision-making and avoiding multiple agencies and funds (Gros and Schoenmaker *JCMS* 2014, p. 530). Gortsos argues that significant synergies could be achieved if the resolution financing function of EDIS were to be transferred to the SRF (Gortsos 2019, p. 22-23).

78 Gortsos 2019, p. 20-21.

shortfalls following resolution cases of banks in the Eurozone. It is considered desirable by the participating Member States and the Commission that a common backstop is designed that leaves no room for national considerations or segmentation. After all, when a fiscal backstop is provided for at national level, the strength of a banking system will always remain to be judged by that of its sovereign.[79] The common backstop should be in place at the latest by the end of the transition period for the SRF in 2023. An option would be that a similar common fiscal backstop be created in the form of a credit line from the ESM to the SRF.[80] This would, however, require a revision of the ESM Treaty.

In December 2017, the Commission published a proposal for a Council Regulation on the establishment of the European Monetary Fund (the EMF).[81] It was the intention that the EMF would replace the ESM and take over its tasks. In December 2018, it became clear that no EMF will be established. Instead, it was decided by the heads of state and government of the 19 Eurozone Member States that the ESM Treaty will be amended in order to enable the ESM to provide a common backstop to the SRF in the form of a revolving credit line. It is intended that the common backstop will cover all possible uses of the SRF.[82] At the time of writing this dissertation, the amendments to the ESM Treaty were not yet available.

1.4.1.4 Package to address NPLs

As a result of asset quality reviews and stress tests conducted by the ECB, it became clear that a number of banks in participating Member States experience high levels of non-performing loans (NPLs). This was the reason for the Commission to propose the package to address high NPL ratios on 14 March 2018. The package consists of a proposal for a regulation amending the CRR and introducing common minimum coverage levels for newly originated loans that become non-performing (non-performing

79 Schoenmaker 2014, p. 3. Liikanen Report 2012, p. 10-11, 80; Almunia 2013.

80 EC EMU Reflection Paper 2017, p. 20.

81 EC, Proposal for a Council Regulation on the establishment of the European Monetary Fund, COM(2017)827 final (the EMF Proposal). The Annex to the Proposal contains the proposed Statute of the European Monetary Fund (the Proposed EMF Statute). EP, In-Depth Analysis – A European Monetary Fund?, May 2017, PE 602.076. 2017 Communication on completing the Banking Union, p. 14.

82 Term sheet on the European Stability Mechanism reform, 4 December 2018. See also EC Report on application and review resolution framework 2019, p. 6-7.

exposures or NPEs) (the NPE Proposal),[83] a proposal for a new directive on credit servicers, credit purchasers and the recovery of collateral (the NPL Proposal)[84] and a blueprint on the set-up of national asset management companies (AMCs) dealing with NPLs.[85] The NPE Proposal was adopted and published as Regulation (EU) 2019/630 on 25 April 2019 (NPE Regulation). The NPE Regulation applies from 26 April 2019. At the time of writing this dissertation, work on the NPL Proposal was still ongoing.

1.4.1.5 An enabling framework for the development of SBBS

On 24 May 2018, the Commission published a proposal for a regulation on sovereign bond-backed securities (SBBSs).[86] SBBSs aim to further integrate and diversify financial markets across national borders by further weakening the sovereign – bank nexus and enhance the supply of euro-denominated low-risk assets, thus enhancing the efficiency and resilience of the Eurozone financial system.[87] SBBSs would be created by the private sector. A private sector entity would assemble an underlying portfolio of sovereign bonds of all EU Member States whose currency is the euro and would subsequently transfer them to a legally separate, self-standing entity, specifically set up for the sole purpose of issuing to investors a series of securities representing claims on the proceeds from this underlying portfolio. SBBSs would not rely on any risk sharing or fiscal mutualisation between Member States. Only private investors would share risks and possible losses. SBBSs are therefore different from Eurobonds.[88] At the time of writing this dissertation, the proposal is being discussed within the Council.

83 EC, Proposal for a Regulation of the European Parliament and of the Council on amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures, COM(2018)134 final (the NPE Proposal).

84 EC, Proposal for a Directive of the European Parliament and of the Council on credit servicers, credit purchasers and the recovery of collateral, COM(2018)135 final (the NPL Proposal).

85 EC, Commission Staff Working Document, AMC Blueprint, COM(2018)133 final (the AMC Blueprint).

86 EC, Proposal for a Regulation of the European Parliament and of the Council on sovereign bond-backed securities, COM(2018) 339 final (the SBBS Proposal).

87 Other measures, such as a change in the regulatory treatment of sovereign debt, are also discussed and evaluated in that respect. Cimadomo et al *ECB Economic Bulletin 2018*, p. 97. EC EMU Reflection Paper 2017, p. 21-22. Demertzis and Zenios 2018. EP, Briefing - Are Sovereign Bond-Backed Securities ('SBBS') a 'self-standing' proposal to address the sovereign bank nexus?, September 2018, PE 624.405, p. 7-8.

88 SBBS Proposal, p. 2. See about Eurobonds Lo Schiavo 2018, p. 172-177.

1.4.2 Proposal for a Capital Markets Union

In September 2015, the Commission adopted an action plan setting out a list of over 30 actions and related measures to establish the building blocks of an integrated Capital Markets Union (CMU) in the EU by 2019.[89] The CMU has to ensure more diversified sources of finance so that companies, including SMEs, can tap capital markets and access other sources of non-bank finance in addition to bank credit. At the same time, the idea is that a well-functioning CMU strengthens cross-border risk-sharing through deepening integration of bond and equity markets.[90] Together with the European Banking Union, the CMU promotes a stable and integrated financial system in the EMU.

The introduction of the CMU also has an impact on banks, since they play a central role in the CMU as lenders to a significant proportion of the economy and intermediaries in capital markets. The Commission expects that bank lending will continue to be the main source of funding for many businesses alongside capital markets.[91] One of the goals of the CMU is therefore to strengthen the banking capacity to support the wider economy. The actions taken in relation to this objective are the initiatives to:

89 EC, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – Action Plan on Building a Capital Markets Union, COM(2015) 468 final. In June 2017, the Commission published a mid-term review of the CMU action plan (EC, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the Mid-Term Review of the Capital Markets Union Action Plan, COM(2017) 292 final). In November 2018, the Commission published a report on the progress achieved (EC, Communication from the Commission on the Capital Markets Union: time for renewed efforts to deliver for investment, growth and a stronger role of the euro, COM(2018) 767 final).

90 Five Presidents' Report, p. 12.

91 EC, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – Action Plan on Building a Capital Markets Union, COM(2015) 468 final, p. 6.

– explore the possibility for all Member States to benefit from local credit unions to operate outside the scope of the EU's capital requirements rules for banks;[92]
– revitalise simple, transparent and standardised European securitisations to free up capacity on banks' balance sheets and provide access to investment opportunities for long term investors;[93]
– build a pan-European covered bond framework, building on national regimes that work well, and explore the feasibility of similar funding tools for SME loans (European Secured Notes);[94] and
– develop a secondary market for NPLs.[95]

1.4.3 Proposal for an adjusted ESAs framework

In September 2017, a proposal was published by the Commission to adjust and upgrade the ESAs framework to ensure they can assume an enhanced responsibility for financial market supervision (the ESAs

92 As part of the Banking Package, the Commission proposed an amendment to the EU's capital requirement rules for banks, empowering it to exempt the entire credit union sector of a Member State. CRD V provides for such exemption.

93 Regulation (EU) 2017/2402 lays down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation. The regulation applies from 1 January 2019. In addition, the Commission adopted a delegated regulation amending Delegated Regulation (EU) 2015/35 as regards the calculation of regulatory capital requirements for securitisations and simple, transparent and standardised securitisations held by insurance and reinsurance undertakings on 6 June 2019. At the time of writing this dissertation, this delegated regulation has not yet entered into force.

94 EC, Proposal for a Regulation of the European Parliament and of the Council on amending Regulation (EU) No 575/2013 as regards exposures in the form of covered bonds, COM(2018)93 final. The regulation amends CRR with the aim of strengthening the conditions for granting preferential capital treatment, by adding further requirements. EC, Proposal for a Directive of the European Parliament and of the Council on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EC and Directive 2014/59/EU, COM(2018)94 final. The directive introduces a common definition to receive an EU covered bond label. See also EBA, Report on the European Secured Notes (ESNS), 24 July 2018. On 27 February 2019, the Council and the European Parliament reached a provisional agreement on the proposals. At the time of writing this dissertation, the proposals have not yet been adopted.

95 This development has been discussed in section 1.4.1.4.

Framework Proposal).[96] The ESAs Framework Proposal aims to ensure that the ESAs are adequately equipped in terms of powers, to establish a more effective governance of the ESAs – taking into account the inherent tension between the European mandate of the ESAs and the national mandate of the competent authorities that are members of the ESA Boards – and to create an appropriate funding base which allows them to allocate resources in relation to their needs to fulfil their objective. On 21 March 2019, the European Parliament and the Member States reached a political agreement on the core elements of the ESAs Framework Proposal.[97] At the time of writing this dissertation, the ESAs Framework Proposal had not yet been formally adopted.

> The ESAs Framework Proposal does not provide for any changes in the resolution framework. It does, however, provide for changes in the EBA Regulation that will have an effect on the resolution framework. It is proposed, for example, that the EBA be tasked with developing and keeping up to date a Union resolution handbook on the resolution of financial institutions in the Union, which sets out supervisory best practices and high quality methodologies and processes.[98]

96 EC, Proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority); Regulation (EU) No 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority); Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority); Regulation (EU) No 345/2013 on European venture capital funds; Regulation (EU) No 346/2013 on European social entrepreneurship funds; Regulation (EU) No 600/2014 on markets in financial instruments; Regulation (EU) 2015/760 on European long-term investment funds; Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds; and Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, COM(2017) 536 final (ESAs Framework Proposal). This proposal was amended by a proposal of the Commission dated 12 September 2018 (COM(2018) 646 final) in order to pursue the specific objective of reinforcing the mandate of the ESAs in matters relating to the preventing and combating of money laundering and terrorist financing.

97 EC, Capital Markets Union: Political agreement on a stronger and more integrated European supervisory architecture, including on anti-money laundering, 21 March 2019, IP/19/1655.

98 Article 29(2) of the EBA Regulation, as proposed by the ESAs Framework Proposal. See also Nuijten and Joosen *TvFR* 2019 for a further discussion of the ESAs Framework Proposal.

1.4.4 Moving towards a Fiscal Union?

For many observers, the only lasting solution to the GFC is a decisive shift towards the fiscal unification of the Eurozone, as a result of which individual Member States cede substantial sovereignty over taxation and public spending decisions to a central Eurozone fiscal authority in return for which their debts are underwritten by the Eurozone as a whole. Further restriction of national autonomy over domestic financial policies within the Eurozone could be justified by virtue of spillover effects that characterize the currency union within the Eurozone.[99]

> As a step towards a Fiscal Union, the reformed Stability and Growth Pact (SGP) of 2005[100] required Member States to (a) adhere to the excessive deficit criteria and (b) abide by the medium-term budgetary objective of positions close to balance or in surplus once they join the Eurozone.[101] As a result of the GFC, the EU took further significant steps towards a Fiscal Union, putting in place a permanent bailout fund, the ESM. Also, to prevent excessive deficits and debts from emerging in the first place, new mechanisms were put in place for tighter EU monitoring of national budgets and for strict, judicial enforcement of national deficit and debt limits through the so-called Six-Pack and Two-Pack.[102] Ultimately, any State – in the Eurozone or beyond – that wants to have access to the ESM in times of crisis was required to ratify a new Fiscal Compact Treaty.[103] On 1 January 2013, this treaty entered into force following its ratification by 12 Eurozone Member States.[104] The Treaty sets out certain balance rules on fiscal stance that Member States have to implement at national level. It also imposes limits on the size of

99 Scott 2015, p. 34-35.
100 The SGP was originally agreed on by the EU Member States in 1997. In 2005 it was amended to allow it to better consider individual national circumstances and to add more economic rationale to the rules to be complied with.
101 Protocol 12 TFEU gives further details on the excessive deficit procedure, including the reference values on deficit and debt. Article 136 TFEU provides for specific provisions to be adopted for the Eurozone. It is the basis of a sanctions regulation for Eurozone countries (included in the so-called Six-Pack) and the so-called Two-Pack, which includes enhanced monitoring and surveillance in the Eurozone.
102 Craig 2015, p. 27, 34. Calliess 2015, p. 42.
103 Keleman 2015, p. 199-200.
104 With Belgium ratifying the Treaty on 28 March 2014, all Eurozone Member States have ratified the Treaty. In addition, six non-Eurozone Member States have ratified the Treaty, albeit only certain Titles of the Treaty apply to them (EP Fiscal Compact Treaty Scorecard 2015, p. 7).

public debt and structural deficit, covering similar ground to previous instruments, such as the SGP and the Six-Pack. The most important addition in this respect is the obligation to implement rules on budgetary discipline into national law. In addition, the Member States undertake 'to work jointly towards an economic policy that fosters the proper functioning of the economic and monetary union', through 'enhanced convergence'.[105] Compliance with the EU fiscal framework however remains weak and the Fiscal Compact Treaty by no means implies a Fiscal Union.[106] On 21 October 2015, an independent European Fiscal Board was created to act as an advisory body to the Eurozone's system of multilateral economic monitoring. This advisory entity coordinates and complements the national fiscal councils that have been set up in the context of the Council Directive on requirements for budgetary frameworks of the Member States.[107] It provides a public and independent assessment, at EU level, of how budgets – and their execution – perform against the economic objectives and recommendations set out in the EU fiscal governance framework.[108]

The Five Presidents' Report identified that, as a further step, a Eurozone-wide fiscal stabilisation function should be created to better deal with shocks that cannot be managed at the national level alone.[109] The function should not lead to permanent transfers and should not duplicate the role of the ESM as crisis management tool, but should minimise moral hazard. The Commission has flagged three options for this type of stabilisation function. The first option is to create a European Unemployment Reinsurance Scheme (EURS). The Commission has also proposed to set up a European Investment Protection Scheme (EIPS). Under this scheme, Member States would automatically be entitled to benefit from assistance, subject to strict eligibility criteria and triggering mechanism. This assistance would consist of loans and grants provided through the EU budget, the ESM and an insurance mechanism based on voluntary Member States' contributions. A rainy day fund accumulating funds from Member States to cushion a large shock could accompany the EURS and EIPS. National budgets will however continue to be the main fiscal policy instrument for Member States to address changes in economic circumstances. A stabilisation function at

105 Hinarejos 2015, p. 39-40.
106 EP Fiscal Compact Treaty Scorecard 2015, p. 8. Calliess 2015, p. 46-47.
107 Council Directive 2011/85/EU. This Council Directive forms part of the Six-Pack.
108 EP, At a Glance – The advisory European Fiscal Board, 22 June 2017, PE 542.647.
109 Five Presidents' Report, p. 14.

European level would only complement the stabilisation role played by Member States' national budgets.[110] At the time of writing this dissertation, none of these stabilisation functions had been realized (yet).

> According to Berger, Dell'Ariccia and Obstfeld the steps to equip the Eurozone with the beginnings of a full Fiscal Union involve complicated institutional decisions, reallocation of sovereign power, and questions of democratic accountability. Without more tangible elements of a Fiscal Union, the Eurozone will, however, remain fundamentally vulnerable to shocks.[111]

1.5 Structure of the dissertation

This dissertation is structured in two parts. The first part introduces the prudential regulations, the State aid regime and the resolution framework that apply in the banking sector. Discussion of the prudential rules is inevitable for understanding the relationship between the resolution framework and State aid regime, since the functioning and results of both depend to a large extent on the financial position of the failing bank in question. The second part analyses the impact of the resolution framework on the State aid regime for the banking sector along the three lines of research, as set out in section 1.3.

Part 1: Moving towards resolvable banks: A discussion of the prudential, State aid and resolution framework for the banking sector

Chapter 2 (A bank and its balance sheet) describes the basics of the funding profile of banks in order to gain a better understanding of how the State aid regime and resolution framework work. This chapter outlines what a bank is and which banking models can be distinguished. It furthermore describes the balance sheet of a bank, its funding profile and the reasons for the special prudential treatment of banks. It continues by explaining the regulatory capital requirements that have to be met by banks and what happens if banks fail to do so. Moreover, it describes the impact of the resolution framework on the balance sheet of a bank. If there are not sufficient capital instruments and eligible liabilities on its balance sheet, the resolution of a bank will be difficult to envisage without the

110 EC EMU Reflection Paper 2017, p. 25-26.
111 Berger, Dell'Ariccia and Obstfeld 2018.

use of public funding. The resolution framework therefore provides for a minimum requirement for own funds and eligible liabilities (MREL). This chapter will show that the possibilities for authorities to intervene, if the MREL is breached by a bank, are still limited. Lastly, the chapter discusses funding instruments and asset measures that can be applied by banks in times of difficulty.

Chapter 3 (The State aid regime for the banking sector) describes the State aid regime for the banking sector. It starts with a description of the development of the State aid regime for the banking sector. It describes how the Commission shifted from using Article 107(3)(c) TFEU to Article 107(3)(b) TFEU for its assessment of State aid awards in the banking sector, as a result of which it started to approve State aid awards in order to 'remedy a serious disturbance in the economy of a Member State'. It discusses the concept of State aid and the contours of the current State aid regime for the banking sector, including the legal outline and scope of the State aid regime. Moreover, the chapter dives into the assessment of State aid by the Commission in the banking sector and touches on the topic of granting State aid to a group. Lastly, this chapter discusses the consequences of awarding State aid to a bank, describing the restructuring that a bank has to undergo when receiving State aid, the consequences of the receipt of State aid for the position of third parties (such as shareholders and creditors of a bank) and judicial protection against the decisions from the Commission.

Chapter 4 (The resolution framework for the banking sector) describes the resolution framework for the banking sector, and more or less has the same structure as Chapter 3 in order to be able to assess the impact of the resolution framework on the State aid regime for the banking sector in Part 2. It starts with describing the development of the resolution framework. It subsequently discusses the legal outline and scope of the resolution framework. It analyses the relationship between the two main legislative instruments of this framework: the BRRD and SRMR. It subsequently sets out the concept of resolution and describes the process of resolution, while also paying attention to the complex relationship between the SRB and the national resolution authorities. It discusses the provisions of the resolution framework in relation to group resolution and elaborates on the treatment of the bank in resolution and third parties (such as shareholders and creditors of a bank) involved therein. It ends with discussing the judicial protection available for banks and third parties against decisions of the SRB and national resolution authorities. Chapter 4 does not discuss the provisions of the resolution framework that specifically govern public funding, as these are discussed in Part 2.

Part 2: From State aid regime to EPFS policy: Regulating public funding of failing banks in the EU after the introduction of the resolution framework

Chapter 5 (The impact of the resolution framework on the access to public funding for failing banks) describes and analyses the impact that the resolution framework has on the access to public funding as a remedy for failing banks. It first analyses the concepts of extraordinary public financial support (EPFS) and emergency liquidity assistance (ELA). It then discusses the different ways in which the resolution framework restricts the access to EPFS and ELA. Subsequently, it analyses these access restrictions. It discusses that access is restricted both in absolute and relative ways. It also discusses that the access to public funds is restricted under the resolution framework depending on in which phase (recovery, resolution or insolvency) and under which legal instrument (BRRD or SRMR) the public funds are used. Lastly, it describes potential hurdles in restricting access to public funding as a remedy for failing banks.

Chapter 6 (The impact of the resolution framework on the exercise of State aid control by the Commission) describes and analyses the impact that the resolution framework has on the exercise of State aid control by the Commission. This chapter starts with describing the different roles that the Commission has since the introduction of the resolution framework. Since then, the Commission basically has two roles. It still acts as State aid authority, but, in addition, it also acts as co-resolution authority within the SRM. The chapter then introduces the new term of 'resolution aid' and describes how the Commission assesses it. It then discusses the assessment by the Commission of 'intrinsically linked provisions of the resolution framework' as part of its State aid assessment, as well as the impact of the resolution framework on the State aid assessment outside of resolution and the assessment of the newly introduced forms of supranational funding. Lastly, it analyses the impact of the resolution framework on State aid control and discusses the tensions that exist between the different roles of the Commission and the different rules that are taken into account by the Commission in its assessment of State aid and supranational funding.

Chapter 7 (The impact of the resolution framework on the restructuring process of a failing bank) describes and analyses the impact that the resolution framework has on the restructuring process of a failing bank. It starts with describing the restructuring processes that a failing bank can be subject to after the introduction of the resolution framework. It subsequently assesses the competences of the different authorities in the restructuring process of a failing bank. It looks into the cooperation between the different authorities and the judicial protection against decisions of these authorities. It continues with a discussion of the burden-sharing obligations of the shareholders/creditors of a failing bank under the resolution framework and the State aid regime for the banking sector. Lastly, it analyses the consequences of the co-existence of the State aid regime for the banking sector and the resolution framework for the restructuring process of a failing bank, and identifies any challenges in this process as a result thereof.

Chapter 8 contains the conclusion. It starts with a retrospective on Part 1 of this dissertation. Subsequently, it discusses the assessments that have been made in Part 2 with respect to the impact of the resolution framework on the access to public funding as a remedy for failing banks, the exercise of State aid control by the Commission and the restructuring process of a failing bank. It summarises the hurdles, tensions and challenges that are identified as part of these impact assessments. It also discusses potential steps to address these hurdles, tensions and challenges and presents some thoughts on the further development of the regulation of public funding within the European Banking Union. The chapter ends with a reflection on the contribution of the resolution framework to solving the inadequacies revealed by the GFC.

PART 1

Moving towards resolvable banks:

A discussion of the prudential, State aid and resolution framework for the banking sector

CHAPTER 2

A BANK AND ITS BALANCE SHEET

> *"For several years to come, the new resolution tools will have to be applied to balance sheets that are not quite ready for it. This is bound to create bitter legal and political fights."*
>
> *Philippon and Salord 2017, p. 3.*

2.1 Introduction

This chapter aims to provide the necessary background on the basics of the funding profile of banks in order to gain a better understanding on how the State aid regime and resolution framework interact. Joosen already mentioned that there is a close relationship between judgments by competition law authorities in State aid cases and the applicability of prudential supervision law to the bank concerned.[1] (Non-) compliance with prudential requirements may trigger the need for State aid and at the same time may also restrict the access to State aid.[2] With the introduction of the resolution framework, a similar relationship originated between the prudential requirements and the resolution framework. If there are not sufficient capital instruments and eligible liabilities on its balance sheet, the resolution of a bank will be difficult to envisage without the use of public funding.[3] The resolution framework therefore provides for a minimum requirement for own funds and eligible liabilities (MREL), through which banks are required to maintain a certain level of own funds and 'eligible liabilities', that is liabilities that are eligible for bail-in. The MREL applies in addition to the regulatory capital requirements under the prudential framework laid down in CRR/CRD IV. The MREL needs to safeguard that the bank is resolvable. A bank is resolvable, if it is feasible and credible to either wind up the bank in normal insolvency proceedings or to resolve it by applying resolution tools and exercising resolution powers.

1 Joosen 2017, p 378-379.
2 The 2013 Banking Communication for example provides that certain State aid measures are only available for banks without a 'capital shortfall' (2013 Banking Communication, point 28).
3 Tröger 2017, p. 5.

The prudential requirements that are applicable to banks will change as a result of the Banking Package. Where relevant in this chapter, reference is made to the Banking Package.

This chapter is structured as follows. Section 2.2 discusses what a bank is by taking a closer look at the definition of credit institution in banking regulation and the business model of a bank. Section 2.3 discusses the composition of the funding profile of a bank. Section 2.4 swiftly explains the regulatory capital requirements that have to be met by banks. Section 2.5 describes the impact of the MREL on the balance sheet of a bank. Section 2.6 describes what funding instruments and asset measures are available, if a bank gets into financial difficulties. Section 2.7 concludes this chapter.

2.2 The term 'bank'

This section discusses what a bank is, by taking a closer look at the definition of credit institution in banking regulation and the business model of a bank.

2.2.1 The definition of credit institution in banking regulation

The term 'bank' is not used in banking regulation. Instead, 'credit institution' is used. A credit institution is defined as "*an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account*."[4] The terms 'deposits', 'other repayable funds', 'grants credits' and 'from the public' used in this definition are not further defined in banking regulation. This results in a degree of variation between the Member States as to the interpretation of the term 'credit institution', and therefore the entities to which the requirement to obtain a banking license applies. It is of considerable importance that the definition is interpreted in a uniform manner across the EU, taking into account that it is not only of significance for the purposes of determining whether an entity is subject to the authorisation requirement under CRD IV/CRR, but also whether or not an entity is in scope of the BRRD, SSM and SRM. The EBA provided some possible approaches to further clarify the term 'credit

4 Article 4(1)(1) CRR. Bierens 2015, p. 12-13. See also Joosen *TvFR* 2015 and Theissen 2013, p. 173-189 for an extensive discussion of the definition of bank.

institution', by suggesting a definition of deposits and other repayable funds in an opinion dated 27 November 2014.[5]

> *"'deposit' (this could include the following core components: a sum of money; repayable on demand or at a contractually agreed point in time (but otherwise repayment of the principal is unconditional) and with or without interest or a premium; received from third parties [legal or natural persons]; and received in the course of carrying on the activity by way of business, and be subject to a number of exclusions, for example monies referable to the provision of property or services (for example, advance payments under a contract for the sale, hire or other provision of property or services which are repayable only in the event that the property or services are not in fact sold, hired or otherwise provided) or the giving of security could be excluded from the scope of the definition);*
>
> *'other repayable funds' (this could be defined to include 'bonds and other comparable securities such as negotiable 'certificates of deposit' providing these are continually issued by the entity concerned)."*

In its opinion, the EBA urges the Commission to give consideration to possible clarifications to the definition of credit institution.[6] At the time of writing this dissertation, the Commission had however not yet published these clarifications.[7] In the remainder of this dissertation, the author uses the term 'bank', when referring to a credit institution as defined in Article 4(1)(1) CRR.

2.2.2 *The business model of a bank*

In line with the definition of credit institution, a typical bank takes deposits from savers (primarily households and corporates) and grants loans to borrowers (mainly corporates, governments and households).[8] The ability to pool deposits from many sources that can be lent to many different borrowers creates the flow of funds inherent in the banking system. By managing this flow of funds, banks generate profits, acting as the intermediary of interest paid and interest received, and taking on the risks of offering credit.[9]

In addition to taking deposits or other repayable funds from the public and granting credits for its own account, a bank can conduct many more activities. Annex I to CRD IV contains a list of activities that are subject to mutual

5 EBA, Opinion of the European Banking Authority on matters relating to the perimeter of credit institutions, 27 November 2014, EBA/Op/2014/12.
6 The Commission may do so on the basis of Article 456(1)(a) CRR.
7 As a result of which the explanation of the term 'credit institution' still differs among the Member States.
8 Mayer 2014, p. 27.
9 Collinet *Global Antitrust Review* 2014, p. 137-138.

recognition between the Member States. This means that Member States have to ensure that these activities may be carried out within their territories by any bank authorised and supervised by the competent authority of another Member State, provided that these activities are covered by the authorisation.[10] These activities include, besides takings deposits and other repayable funds and lending, financial leasing, payment services, providing guarantees and commitments, providing investment services, conducting investment activities, providing ancillary services (such as safekeeping and administration of securities) and issuing electronic money.[11] The variety of activities that a bank can conduct make that the European banking sector is characterized by a continuum of possible business models, rendering any classification based on balance sheet indicators difficult.[12]

A distinction could, for example, be made between, on the one hand, banks that conduct the full array of banking services, ranging from the traditional banking services of deposit taking and lending to payment services and investment banking activities (so-called 'universal banks') and, on the other hand, banks that cover only a few of these services (so-called 'specialized banks'). Examples of the latter category are banks that focus on retail banking, corporate banking, investment banking (that is, proprietary trading, market making and/or hedging activities) or private banking.[13] Universal banks are not necessarily large (or systemically important) banks and specialist banks are not necessarily small banks. This depends on their franchise and the scope of business lines they cover.[14] The largest banking groups in the EU are however typically universal banks.[15]

> The universal banking model was called into question because of the GFC. In 2014, the Commission proposed to separate deposit-taking from trading and to introduce a ban on proprietary trading.[16] Further to this proposal, the Council proposed a mandatory separation of

10 Article 33 CRD IV.
11 The applicability of other directives and regulations may be triggered, depending on which activities are conducted by the bank. E.g., when providing investment services or conducting investment activities, banks are also subject to MiFID II (Article 1(3) MiFID II).
12 Cernov and Urbano 2018, p. 6.
13 It is however also possible to make other distinctions to classify banks by business models. See Cernov and Urbano 2016, p. 5-11.
14 Schildbach 2012, p. 4.
15 Liikanen Report, p. 42. Alexander *EBOLR* 2015, p. 229. Cernov and Urbano 2018, p. 23.
16 EC, Proposal for a Regulation of the European Parliament and of the Council on structural measures improving the resilience of EU credit institutions, COM(2014) 43 final.

proprietary trading from the 'core' activities of a bank instead of a ban. In case of separation, the separate ring-fenced entities would be maintained in the group. In such a case, the long-standing universal banking model in Europe would remain untouched, since the separated activities would be carried out in the same banking group. Hence, banks' ability to provide a wide range of financial services to their customers would be maintained.[17] However, the Commission's proposal was withdrawn on 4 July 2018 because no agreement on the proposal was foreseeable, the proposal having made no progress since 2015.[18]

Banks operate in an environment that is characterised by constant change and constant competition.[19] In 2015, the EBA flagged: "*(…) there are significant potential implications of the new regulatory measures for certain components of banks' business models. There is likely to be pressure on the future profitability and the returns of the banking sector as it changes to meet the new requirements. In addition, the complexity and costs of managing the change in the regulatory environment will be high and some banks will need to develop new business models, which will be successful once the regulatory framework is finally in place. (…) As a result of the changes in banks' business models, it is also likely that some aspects of lending will move to the shadow banking sector. Non-traditional banking institutions will start to participate in markets that 'traditional' banks, either for reasons of profitability or complexity, decide to leave. This trend is already evident in the increasing role that private equity firms and hedge funds are playing in the commercial real estate segment in some countries. There is also cross-sector interplay as insurance firms have started to participate in certain areas of lending/financing, leading to some overlap with the banking industry.*"[20] In 2019, European bank profitability is still under pressure due to cyclical factors, cost inefficiencies and competitive challenges arising from outside the sector.[21]

Traditional banks are also challenged by new 'digital' banks offering specific online services (fintech) and banks that have emerged from players in other industries, such as social media companies and major supermarket chains with strong and trusted brands and

17 Liikanen Report, p. iii. See also Alexander 2015, p. 476 and further.
18 Although the proposal was withdrawn, resolution authorities can currently require banks to make structural changes in their business model under the resolution framework, as a result of which the same result can be achieved.
19 Lautenschläger 2016.
20 EBA Report Bank Business Models 2015, p. 36.
21 De Guindos 2019. EBA, Risk Assessment of the European Banking System, December 2018.

an extensive archive of customer data.[22] The banking activity is however generally a reserved activity. Typical banking activities are regulated and require the authorisation of the competent authority, which is the ECB within the European Banking Union and the national competent authority outside the European Banking Union.[23]

2.3 The funding profile of a bank

This section discusses the funding profile of a bank, because understanding the funding profile of a bank is important for understanding the risks forming the reason for the special treatment of (failing) banks. It starts with describing the balance sheet of a bank

2.3.1 The balance sheet of a bank

As a result of the great diversity of banking models, there is no one-size-fits-all-approach to describe the balance sheet of a bank. Table 1 shows a hypothetical example of the balance sheet of a universal bank. The universal banking model currently still is the predominant banking model within the EU.[24]

Table 1: Hypothetical example of universal bank balance sheet[25]

Balance sheet

Assets	**Equity and liabilities**
Cash and balances at central banks	*Equity*
Residential mortgages	Share capital
Loans and receivables – customers	Share premium
Loans and receivables – banks	Reserves
Securities financing	Capital securities
Derivatives	
Financial investments	*Liabilities*
(e.g. in interest-earning securities)	Client deposits

22 PWC, Who are you calling a 'challenger'? How competition is improving customer choice and driving innovation in the UK banking market, 2017, p. 10. Forbes, Who Will Trust Facebook Bank?, 15 March 2019.
23 Article 8(1) and 9(1) CRD IV and Article 4(a) – in conjunction with Article 6 – SSMR.
24 EBA Final MREL Report 2016, p. 30.
25 This example is inspired by the balance sheet composition of ABN AMRO over 2016 as included in the ABN AMRO Group Annual Report 2016, p. 129. See also Vasquez and Federico 2012, p. 23.

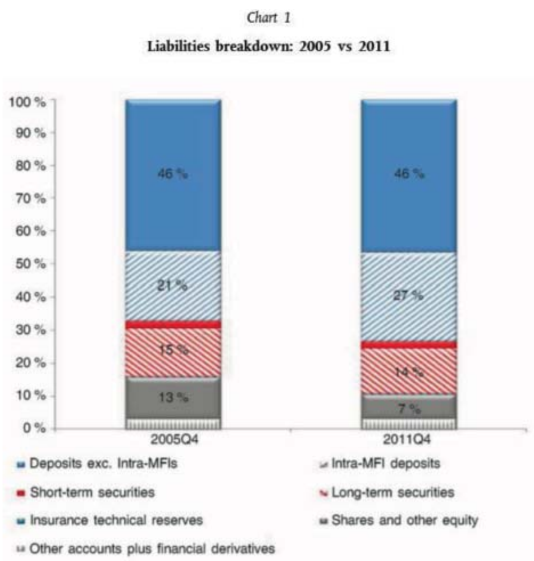
Other assets	Bank deposits
	Long term & subordinated debt
	Short-term debt
	Securities financing
	Derivatives
	Other liabilities

The equity and liabilities side of the balance sheet always has to be equal to the assets side of the balance sheet. This means that the sum of all equity and liabilities always has to be equal to the sum of all assets.

The assets side and the equity and liabilities side of the balance sheet of a bank together reflect the funding profile of a bank.

In a Recommendation dated 20 December 2012,[26] the ESRB set out the liabilities breakdown of Eurozone banks on the basis of a comparison between the funding structure of the balance sheets of Eurozone banks as of the end of 2005 with that as of the end of 2011.

Figure 1: Liabilities breakdown of Eurozone banks



Source: ESRB Recommendation on funding of credit institutions 2012

26 ESRB Recommendation on funding of credit institutions 2012.

It can be derived from this chart that the largest share of *liabilities* of a bank is normally made up of client deposits, followed by intra-monetary financial institutions (MFIs) deposits[27] and long term securities. On average, shares and other equity only make up a small percentage of total liabilities. This percentage even further decreased during the GFC.

The largest share of *assets* of a bank is normally made up of loans to customers.[28] These customers can e.g. be retail customers or corporate customers. The loans can take many different forms. They can be residential mortgages, consumer loans or corporate loans, security backed or not, with a fixed or variable interest, long term or short term, etc. Other assets on the balance sheet of a bank are, for example, loans to other MFIs, derivatives contracts or securities held as investment.

Historically, the focus of regulators and supervisors has been on the liabilities side of the balance sheet of banks. For example, the ratio of total deposits to total liabilities is used as a measure of how stable a bank's funding is. In addition, the regulatory capital requirements, but also the MREL as introduced under the resolution framework, address the composition of the liabilities side of the balance sheet. In order to provide a more comprehensive picture of a bank's funding profile, increasing attention is however paid to the assets side of the balance sheet – e.g. through the application of the leverage ratio and the asset quality review by the ECB.

> Addressing asset quality issues is one of the key priorities for the ECB in its banking supervision.[29] In 2014 and 2015, the ECB conducted asset quality reviews and stress tests. As a result, it became clear that a number of banks in participating Member States experience high levels of non-performing loans (NPLs). This was the reason for the Commission to publish a package to address NPLs, as further discussed in section 2.6.2.

27 MFIs comprise banks and money market funds. MFIs deposits are deposits held by such banks and money market funds at the bank in question.

28 EC Staff Working Paper 2011, p. 25. See, for example, the balance sheet composition of ABN AMRO over 2016 as included in the ABN AMRO Group Annual Report 2016, p. 129.

29 ECB, Addressing future non-performing loans, available on the website of the ECB: www.bankingsupervision.europa.eu.

2.3.2 *Reasons for special prudential treatment of banks*

The balance sheet of a bank reveals the reasons for the special prudential treatment of banks. These reasons include the maturity mismatch, the high leverage of a bank's business model and the possibility to quickly change the volume of banking activities.[30]

> Maturity mismatch: Banks collect demandable deposits and raise funds in the short-term capital markets and invest them in long-term assets. This maturity mismatch allows them to offer risk sharing to depositors, but also exposes them to the risk of bank runs. Bank runs can involve the withdrawal of funds by depositors (retail runs) or the drying up of liquidity in the short-term capital markets (wholesale runs).[31]
>
> High leverage of business model: The main activity on the asset side of a balance sheet of a bank involves lending activities. Those activities are financed through a limited amount of equity supplemented by funds provided by creditors. No other sector is characterized by such a high leverage.[32]
>
> Possibility to quickly change volume: Banks can quickly expand (and contract) their balance sheet and hence the volume of their business. No other sector has grown as rapidly and as explosively as the banking sector in the last decades.[33]

In particular, the reliance of banks on short-term wholesale funding to finance the expansion of their balance sheets, together with excessive leverage have been highlighted as key factors in the buildup of systemic risks that underlie the GFC.[34]

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30 See also Grünewald 2014, p. 9-11.
31 Mayer 2014, p. 32. Haentjens and De Gioia-Carabellese 2015, p. 80-81. Bierens 2015, p. 15-17.
32 EC Staff Working Paper 2011, p. 25.
33 EC Staff Working Paper 2011, p. 25.
34 Vasquez and Federico 2012, p. 6. Bologna 2018, p. 5.

2.4 Regulatory capital requirements

2.4.1 Introduction

This section discusses the regulatory capital requirements that apply to all banks that are established in a Member State. As a result of these requirements, banks are not entirely free in the way they compose the equity and liabilities side of their balance sheet, because they have to maintain a certain 'regulatory capital'. The regulatory capital (or own funds) of a bank consists of Tier 1 capital (CET 1 and Additional Tier 1) and Tier 2 capital. The requirements for banks in relation to their Tier 1 capital and Tier 2 capital are also referred to as 'Pillar 1 requirements' (see section 2.4.2). In addition to these Pillar 1 requirements, banks are faced with the combined buffer requirement (i.e. the combination of various buffer requirements related to certain risks applicable to all banks or a subset of banks) to address macro-prudential risks[35] (see section 2.4.3) and with the 'Pillar 2 requirement' (see section 2.4.4).[36] Lastly, banks also have to calculate their leverage ratio, liquidity coverage ratio and net stable funding ratio as a result of Basel III (see sections 2.4.5 and 2.4.6).

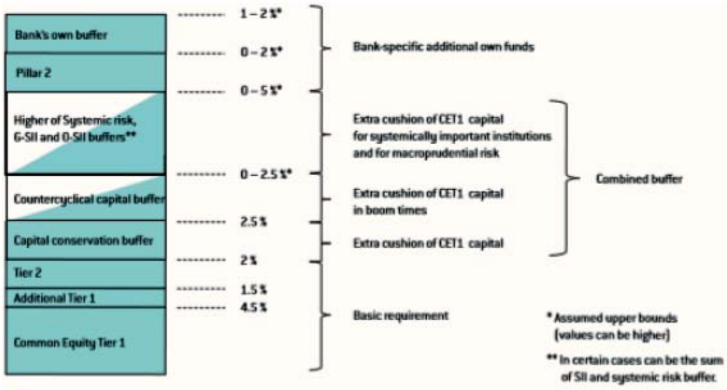
The below figure gives an overview of the regulatory capital requirements that a bank can be faced with under CRR and CRD IV (except for the leverage and liquidity ratios).[37]

35 See Article 128(6) CRD IV for the buffers that together form the combined buffer requirement.

36 Article 104(1)(a) and (2) CRD IV. The pillar structure was introduced as part of the Basel II package. Besides Pillar 1 (minimum capital requirements) and Pillar 2 (supervisory review), which are further discussed in sections 2.4.2 and 2.4.4, there is also a Pillar 3 (disclosure) that introduced disclosure and market discipline principles. Pillar 3 is not further discussed in this dissertation. See also Melis and Weissenberg 2019, p. 4-8.

37 Berger, Hüttl and Merler *Bruegel Policy Contribution* 2016, p. 12. The capital requirements will change as a result of the Banking Package and Basel IV (or the finalised reforms).

Figure 2: Regulatory capital requirements applicable to a bank under CRR and CRD IV



Source: Berger, Hüttl and Merler *Bruegel Policy Contribution* 2016, p. 12.

The percentages in the shown figure are expressed as a percentage of the total risk exposure amount (TREA). The TREA is not the same as the total liabilities and own funds of a bank. The TREA is calculated in accordance with Article 92(3) and (4) CRR and is the sum of:

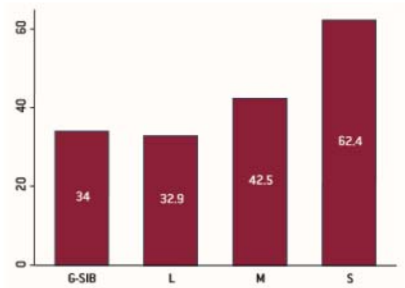
a) the risk-weighted exposure amounts[38] for credit and dilution risk[39] and counterparty credit risk[40]; and
b) the own funds requirements for market risk,[41] credit valuation adjustment risk for OTC derivatives[42] and operational risk.[43]

Please see the figure below for the average ratio of TREA to total liabilities and own funds of a bank by bank size category in 2015. Depending on the bank size, this ratio differs between 32.9% (for large banks) and 62.4% (for small banks). The actual impact of the regulatory requirements on the equity that should be maintained in accordance with the regulatory requirements therefore differs depending on the size of the bank. For small banks the regulatory requirements are, *ceteris paribus*, heavier than

38 See Article 113 and further CRR for the calculation of the risk-weighted exposure amounts.
39 See Articles 107-191 CRR.
40 See Articles 271-311 CRR.
41 The market risk consists of position risk, large exposure risk (trading book), foreign-exchange and commodities risk and settlement risk. See Articles 325-377 CRR.
42 See Articles 381-386 CRR.
43 See Articles 312-324 CRR.

for large banks, because the average ratio of TREA to total liabilities and own funds is larger for small banks.[44]

Figure 3: Average ratio of TREA to total liabilities and own funds of a bank by bank size category



Source: Bruegel calculations based on EBA Data and SNL Financial. Note: The amounts shown are averages across size groups weighted by total assets. The size groups are categorised according to total assets: smaller than €30 billion (S), between €30 billion and €150 billion (M), and larger than €150 billion (L). G-SIBs are excluded from these three groups and defined in FSB (2015).

Source: Berger, Hüttl and Merler *Bruegel Policy Contribution* 2016, p. 5.

The regulatory capital requirements are further discussed in the following sections.

2.4.2 *Pillar 1 requirements*

The Pillar 1 requirements contain the minimum capital requirements for banks.[45] These minimum capital requirements relate to the Tier 1 capital and Tier 2 capital (together: the Total Capital) that a bank has to maintain. The Tier 1 capital of a bank consists of the sum of Common Equity Tier (CET) 1 capital and Additional Tier (AT) 1 capital.[46] At all times, banks have to satisfy the following regulatory capital requirements expressed as a percentage of the TREA:[47]
a) CET 1 Capital Ratio of 4.5%;
b) Tier 1 Capital Ratio of 6%; and
c) Total Capital Ratio of 8%.

44 Berger, Hüttl and Merler *Bruegel Policy Contribution* 2016, p. 5.
45 Gleeson 2018, p. 61-77.
46 Article 25 CRR.
47 Article 92 CRR.

According to Joosen, the subordinated nature of claims exercisable by holders of CET 1, AT 1 and Tier 2 capital is the most important and central criterion outlined in the regulations of this subject matter. This subordination is layered, since CET 1 capital is more subordinated than AT 1 capital and Tier 2 capital is less subordinated than AT 1 capital.[48] CET 1 capital is the primary source of loss absorption and thus the most expensive form of regulatory capital to be attracted by banks.[49] AT 1 capital is considered going-concern capital, as a result of the conditions in relation to the minimum trigger event, as further discussed in section 2.4.2.2. [50] Tier 2 capital should be seen as 'gone concern' capital, because it is only available when the bank is wound up in normal insolvency proceedings or liquidated.

> CRR II introduces a change in the definition of AT 1 and Tier 2 capital as a result of which the law or contractual provisions governing AT 1 and Tier 2 instruments should require that, upon a decision by the resolution authority to exercise the write down and conversion powers referred to in Article 59 of the BRRD (the so-called PONV conversion power)[51], the principal amount of the instruments is to be written down on a permanent basis or the instruments are to be converted to CET 1 instruments.[52]

2.4.2.1 CET 1 capital

CET 1 capital items[53] consist of (a) capital instruments, provided the conditions laid down in Article 28 or, where applicable, Article 29 CRR are met; (b) share premium accounts related to the capital instruments referred to in point (a); (c) retained earnings;[54] (d) accumulated other comprehensive

48 Joosen 2015, p. 190.
49 Delivorias 2016, p. 3.
50 Delivorias 2016, p. 3.
51 As further discussed in section 4.5.2.
52 CRR II, amendments to Article 52(1) points (p) and (q) and Article 63 points (n) and (o) CRR. This will not change the status of capital instruments issued by EU institutions, because this is already the consequence of Article 59 BRRD. It does however ensure that only instruments issued by third-country subsidiaries of EU institutions that meet this additional requirement can be considered as Additional Tier 1 or as Tier 2 instruments by their EU parent entities when they calculate consolidated own funds requirements.
53 Article 26(1) CRR.
54 Article 26(2) CRR. Banks may include interim or year-end profits in CET 1 capital before the bank has taken a formal decision confirming the final profit or loss of the bank for the year only with the prior permission of the competent authority.

income;[55] (e) other reserves;[56] and (f) funds for general banking risk.[57] Certain prudential filters and deductions have to be applied to all CET 1 capital items.[58] The items referred to in points (c) to (f) are recognised as CET 1 only when they are available to the bank for unrestricted and immediate use to cover risks or losses as soon as these occur.[59]

Competent authorities have to evaluate whether issuances of CET 1 instruments meet the criteria set out in Article 28 or, where applicable, Article 29 CRR. With respect to issuances after 31 December 2014, banks may classify capital instruments as CET 1 instruments only after permission is granted by the competent authority, which may consult the EBA.[60]

The EBA has published a list on its website of capital instruments that competent authorities in the Member States have classified as CET 1.[61] The list is updated on a regularly basis. Capital instruments that qualify as CET 1 capital are, for example, ordinary shares issued by a bank that has the form of a public or private limited liability company or certificates issued by a bank that has the form of a cooperative society.

55 Pursuant to Article 4(1)(100) CRR 'accumulated other comprehensive income' has the same meaning as under International Accounting Standard (IAS) 1, as applicable under Regulation (EC) No. 1606/2002. IAS 1 contains a definition of 'other comprehensive income' in paragraph 7. It can be derived from this definition that the components of other comprehensive income include changes in revaluation surplus, actuarial gains and losses on defined benefit plans, gains and losses arising from translating the financial statements of a foreign operation, gains and losses on remeasuring available-for-sale financial assets and the effective portion of gains and losses on hedging instruments in a cash flow hedge.

56 Other reserves are reserves within the meaning of the applicable accounting framework that are required to be disclosed under the applicable accounting standard, excluding any amounts already included in accumulated other comprehensive income or retained earnings (Article 4(1)(117) CRR).

57 This item includes those amounts which a bank decides to put aside to cover such risks where that is required by the particular risks associated with banking (Article 4(1)(112) CRR in conjunction with Article 38 Directive 86/635/EEC).

58 Articles 32-49 and 79 CRR. Pursuant to Article 79 CRR where a bank holds capital instruments or has granted subordinated loans, as applicable, that qualify as CET 1, AT 1 or Tier 2 instruments in a financial sector entity temporarily and the competent authority deems those holdings to be for the purposes of a financial assistance operation designed to reorganise and save that entity, the competent authority may waive on a temporary basis the provisions on deduction that would otherwise apply to those instruments. See also Articles 73-76, 81-85, 87 and 90 CRR.

59 Article 26(1), last paragraph CRR.

60 Article 26(3) CRR. Joosen 2015, p. 183-184.

61 EBA, EBA updates on monitoring of CET1 capital instruments, 20 July 2018. The list is available on the website of EBA: https://eba.europa.eu.

By way of derogation, during the period from 1 January 2014 to 31 December 2017, capital instruments that were issued prior to 1 January 2014 within the context of recapitalisation measures pursuant to State aid rules and that were considered compatible with the internal market by the Commission under Article 107 TFEU could also classify as CET 1.[62]

> It can be derived from the sixth update of the CET1 list that was published by the EBA on 17 November 2017, that Austria, Belgium, Germany, Greece, Italy, Portugal and Spain permitted banks to include these instruments in their CET 1. This is no longer possible as of 1 January 2018, unless these instruments are fully eligible to CET 1 in their own right.[63] This was the subject of the decision of the ECB dated 27 November 2017 in relation to the request of Dexia Crédit Local S.A. (Dexia) to include in CET 1 the preferred shares held by the Belgian and the French States after conversion thereof in new 'A shares' fulfilling the criteria of CET 1 in combination with the issuance of contingent liquidation rights to preserve the economic rights that were attached to the preferred shares so as to satisfy the burden-sharing requirements imposed by the Commission as a condition to the approval of the State aid awarded to Dexia. The ECB considered that the new A shares did not qualify as CET 1 instruments under Article 28 CRR. It however permitted Dexia to include the instruments in CET 1 capital on the basis of Article 31 CRR, as discussed below.[64]

Article 31 CRR provides that competent authorities may permit banks in emergency situations to include in CET 1 capital instruments that are issued after 1 January 2014 and that are issued within the context of recapitalisation measures pursuant to State aid rules, if, *inter alia*, the capital instruments are fully subscribed, held by the State and are able to absorb losses, there are adequate exit mechanisms for the State and the competent authority has granted its prior permission.[65]

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62 Article 483 CRR.

63 EBA, Single Rulebook Q&A, Question ID 2013_11.

64 ECB, Decision permitting Dexia Crédit Local S.A. on the basis of the consolidated situation of Dexia S.A. to include in Common Equity Tier 1 the instruments issued as a result of the conversion of the preferred shares into ordinary shares, 27 November 2017.

65 Article 31 CRR.

> It can be derived from the updated CET1 list that was published by the EBA on 17 November 2017, that Greece permits banks to include these instruments in their CET 1.

2.4.2.2 AT 1 capital

AT 1 capital items consist of (a) capital instruments where the conditions laid down in Article 52(1) CRR are met; and (b) the share premium accounts related to the capital instruments referred to in point (a). Certain deductions have to be applied to all AT 1 capital items.[66]

Pursuant to Article 52(1) CRR a list of conditions has to be met in order for capital instruments to qualify as AT 1. Those criteria are supplemented by Delegated Regulation (EU) No 241/2014. In order for capital instruments to qualify as AT 1 instruments, they must, *inter alia*, be issued and paid up, rank below Tier 2 instruments in the event of insolvency of the bank and be perpetual. In addition, the provisions governing the instrument have to specify that, upon the occurrence of a trigger event, the principal amount of the capital instruments has to be written down on a permanent or temporary basis or the instruments have to be converted in CET 1 instruments.[67] A trigger event occurs when the CET 1 capital ratio of the bank falls below 5.125% or a level higher than 5.125%, where determined by the bank and specified in the provisions governing the instrument. Additional trigger events may be specified in the provisions governing the instrument.[68]

> The EBA published a third update of the report on the monitoring of AT 1 instruments of EU institutions on 20 July 2018.[69] For the preparation of this report, the EBA reviewed 23 issuances, between May 2015 and December 2017, for a total amount of EUR 11.41 billion. 8 issuances were made under a conversion mechanism and 15 under a write-down mechanism. Since the publication of the first report, the EBA has reviewed in total 56 issuances of AT 1 instruments for a total amount of EUR 44.68 billion.

66 Article 56-60 and 79 CRR. See also Articles 73-76, 82, 83, 85-87 CRR.
67 Article 52(1) CRR. Please note that Article 52(1) CRR contains more conditions than set out here.
68 Article 54 CRR.
69 EBA, Report on the monitoring of Additional Tier 1 (AT1) instruments of European Union (EU) institutions – Third update, 20 July 2018.

Preferred shares and contingent convertible securities, otherwise known as 'CoCos' may qualify as AT 1 capital instruments. CoCos are hybrid securities issued by banks as debt instruments (e.g. bonds) and automatically converted into equity shares, if a contractually pre-defined 'trigger event' occurs. Their defining characteristics are a loss-absorption mechanism (conversion or write-down) and an activation trigger, either based on a mechanical rule or on supervisors' discretion.[70] CoCos start as debt, and convert to equity only upon the occurrence of a triggering event. They can thus facilitate balance sheet repair, or the orderly resolution of a bank, without the bank having to seek to issue extra equity under stressful conditions.[71] In order for a CoCo to qualify as AT 1 capital, it must, *inter alia*, be perpetual and include a minimum trigger level of 5.125%. If they do not meet this minimum trigger level, CoCos can qualify as Tier 2 capital.[72]

2.4.2.3 Tier 2 capital

Tier 2 capital items consist of (a) capital instruments and subordinated loans where the conditions laid down in Article 63 CRR are met;[73] (b) the share premium accounts related to instruments referred to in point (a); and (c) general credit risk adjustments (for banks that apply the so-called 'Standardised Approach' to calculate their TREA) or positive amounts (for banks that apply the so-called 'Internal Ratings Based Approach' to calculate their TREA).[74] Certain deductions have to be applied.[75]

Pursuant to Article 63 CRR, a list of conditions has to be met in order for capital instruments to qualify as Tier 2. These conditions include, *inter alia*, that the instruments are issued or the subordinated loans are raised, as applicable, and fully paid-up, the claim on the principal amount of the instruments or the subordinated loans, as applicable, is wholly subordinated to claims of all non-subordinated creditors and the instruments or subordinated loans, as applicable, have an original maturity of at least five years.[76]

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70 Delivorias 2016, p. 1. Cahn and Kenadjian 2015.
71 Delivorias 2016, p. 3.
72 Delivorias 2016, p. 5. Avdjiev, Kartasheva and Bogdanova, *BIS Quarterly Review* 2013, p. 46-49.
73 During the final five years of maturity Tier 2 instruments only qualify to a certain extent as Tier 2 items. This is further specified in Article 64 CRR.
74 As further specified in Article 62(c) and (d) CRR.
75 Article 66-70 and 79 CRR. See also Articles 73-76, 82, 83, 85, 87 and 88 CRR.
76 Article 63 CRR.

2.4.3 Combined buffer requirement

The combined buffer requirement involves the total CET 1 capital required to meet the requirement for the capital conservation buffer extended by the following, as applicable: (a) a bank-specific countercyclical capital buffer, (b) a G-SII buffer,[77] (c) an O-SII buffer,[78] (d) a systemic risk buffer.[79] The combined buffer requirement has to be met by CET 1 capital that is not used to meet the CET 1 capital ratio and therefore requires extra CET 1 capital to be maintained. The combined buffer requirement is being phased in from January 2016.[80]

2.4.4 Pillar 2 requirement

Pillar 2 refers to the possibility for competent authorities to impose a wide range of measures - including additional capital and liquidity requirements – on a bank on an individual or consolidated basis in order to address higher-than-normal risk. They do that on the basis of a supervisory review and

77 The G-SII buffer has to be maintained by global systemically important institutions (G-SIIs). Article 131 CRD IV provides for the identification of G-SIIs by the competent authorities. EU parent institutions, EU parent (mixed) financial holding companies or institutions, including banks, can qualify as G-SII. A G-SII cannot be a bank that is a subsidiary of an EU parent institution or EU parent (mixed) financial holding company. The identification of G-SIIs always takes place on a consolidated level. The methodology of identification and allocation of G-SIIs is based on five categories measuring the systemic significance of a bank for the global financial market, and is further specified by the Commission in Delegated Regulation (EU) No 1222/2014. The EBA maintains a list of G-SIIs and other large institutions with an overall exposure measure of more than EUR 200 billion and which are potentially systemically relevant on its website: www.eba.europa.eu. The indicators that are used to measure the systemic significance are total exposure, interconnectedness, substitutability of the services or of the financial infrastructure provided by the group, complexity of the group and cross-border activity of the group (See Article 131(2) CRD IV and the Annex to Delegated Regulation (EU) No 1222/2014).

78 The O-SII buffer has to be maintained by other systemically important institutions (O-SIIs). O-SIIs are institutions that, due to their systemic importance, are more likely to create risks to financial stability. O-SIIs can either be EU parent institutions, EU parent (mixed) financial holding companies, or institutions, including banks (Article 131(1) CRD IV). The identification of an O-SII can take place on an individual, sub-consolidated or consolidated basis (Article 131(1) CRD IV). The systemic importance of O-SIIs is assessed on the basis of size, importance for the economy of the EU or of the relevant Member State, significance of cross-border activities, and interconnectedness of the institution or group with the financial system in accordance with Article 131(3) CRD IV and the EBA O-SII Guidelines. The EBA maintains a list of O-SIIs on its website: www.eba.europa.eu.

79 Article 128 CRD IV. CRD V provides for several amendments with respect to the combined buffer requirement. Melis and Weissenberg 2019, p. 5.

80 Article 162(5) CRD IV.

evaluation process (SREP), during which they assess how banks are complying with CRD IV and CRR, the risks they face and the risks they pose to the financial system. Following this review, the competent authorities decide whether e.g. the bank's risk management arrangements and level of own funds ensure a sound management and coverage of the risks they face and pose. If the relevant competent authority finds that the bank faces higher risk, it can require the bank to hold more capital or meet stricter liquidity requirements than the Pillar 1 requirements.[81] In taking this decision, competent authorities should notably take into account the potential impact of their decisions on the stability of the financial system in all other Member States concerned.[82] The Pillar 2 requirement has to be met with at least 75% of Tier 1 capital, of which again at least 75% should be met with CET1 capital.[83]

In addition to the mandatory Pillar 2 requirement that competent authorities can impose following the SREP, they can – since 2016 – also communicate to a bank their non-legally binding expectations for such a bank to hold capital in excess of Pillar 1 and Pillar 2 capital requirement and the combined buffer requirement in order to cope with forward looking and remote situations. This is also called ‘capital guidance’.[84] Capital guidance can be used to address supervisory concerns in relation to the quantitative results of supervisory stress test outcomes. It has to be met fully in CET 1 capital.[85]

> CRD V further clarifies the conditions for the application of Pillar 2 capital add-ons stemming from CRD IV including capital guidance.[86] Some concerns have been raised that the required levels for banks may be excessive and pose an unjustified burden on banks, in particular as a result of Pillar 2 requirements.[87] Others acknowledge that Pillar 2 requirements represent the main response to banks’ shortcomings.[88]

81 Article 97 CRD IV in combination with Article 104 CRD IV.
82 EC, Capital Requirements - CRD IV/CRR – Frequently Asked Questions, MEMO 13-690, 16 July 2013.
83 Melis and Weissenberg 2019, p. 14. See Bevilacqua c.s. 2019, p. 6-16 for a description of the evolution of the Pillar 2 requirement.
84 EBA Pillar 2 Roadmap 2017, p. 1-2.
85 Melis and Weissenberg 2019, p. 6.
86 CRD V, Articles 104a and 104b. EC FAQ 2016.
87 Melis and Weissenberg 2019, p. 3.
88 Bevilacqua c.s. 2019, p. 26.

2.4.5 Leverage ratio

The leverage ratio is an additional prudential measure to enhance financial stability by determining capital requirements on the basis of non-risk weighted assets so as to prevent the building up of excessive leverage during economic upswings and to act as a backstop to internal model based capital requirements. It is essentially the amount of Tier 1 capital of a bank divided by its total assets.[89] According to Gleeson it is merely a backstop that exists to ensure that banks do not aggressively game the system.[90] There is no minimum requirement yet in relation to the leverage ratio.

> CRR II includes a binding leverage ratio of 3% which will prevent banks from excessively increasing leverage, e.g. to compensate for low profitability.[91]

2.4.6 Liquidity ratios

The GFC showed that the regulatory capital requirements by itself were insufficient to prevent a liquidity crisis.[92] Therefore, the liquidity coverage ratio and net stable funding ratio were introduced in CRR.[93] The liquidity coverage ratio is a supervisory minimum ratio of short-term liquidity that banks have to hold. In order to achieve the required liquidity coverage ratio of at least 100% (as from 1 January 2018)[94], a bank's available liquid assets have to surpass its expected cumulative net cash outflows over a period of at least 30 days. During a period of stress, banks can use their liquid assets to cover their net liquidity outflows.

> The liquidity coverage ratio is however by no means a fail-safe mechanism in case of a crisis affecting an individual bank, taking into account that a large share of liabilities needs to be rolled over daily.[95]

The net stable funding ratio aims to promote resilience over a longer time horizon by creating incentives for banks to fund their activities with more stable sources of funding on an ongoing basis. There is no finalized EU

89 Article 429 CRR. EC FAQ 2016.
90 Gleeson 2018, 383-384.
91 CRR II, amendments to Article 92 CRR. See also the Banking Package Note, II under s) and III under e).
92 Lehmann 2018, p. 7.
93 Article 412 and 413 CRR. Gleeson 2018, p. 349-382.
94 Article 460 CRR. See also Commission Delegated Regulation (EU) 2015/61.
95 Lehmann 2018, p. 8.

definition of the net stable funding ratio yet. The EBA therefore monitors compliance with the Basel III standards under which the total available stable funding should equal or exceed 100% of the total required stable funding in order to meet the required ratio.[96]

> CRR II introduces a harmonized definition of the net stable funding ratio.[97] The net stable funding requirement shall be equal to the ratio of the institution's available stable funding to the institution's required stable funding, and shall be at least 100%.

2.4.7 *Measures in case of breach of the regulatory capital requirements*

When the regulatory capital requirements are – likely to be – breached by a bank, several measures can be imposed by the ECB[98] or the national competent authorities.[99] This section focuses on the measures that can be imposed by the ECB, but it should be kept in mind that national competent authorities can impose the same or similar measures.[100]

2.4.7.1 Supervisory measures

Article 104 CRD IV provides for the possibility to impose supervisory measures when banks do not meet the regulatory capital requirements or are likely to breach these within 12 months.[101] These supervisory measures may, *inter alia*, consist of increasing own funds, reinforcing capital strategies, restricting operations and imposing liquidity requirements. The legal basis for the ECB to impose supervisory measures is laid down in Article 16 SSMR.

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96 EBA, CRDIV-CRR/Basel III monitoring exercise – results based on data as of 30 June 2017, 6 March 2018. See also the Banking Package Note, II under j) and k).

97 CRR II, Article 428b.

98 ECB, Newsletter Article – Enforcement, sanctions and reporting breaches, 16 May 2018.

99 The division of tasks between the ECB and the national competent authorities within the European Banking Union is set out in Article 6 SSMR. Outside the European Banking Union, the ECB plays no role in the supervision of the regulatory capital requirements.

100 See also De Serière *Ondernemingsrecht* 2011 and De Serière *Ondernemingsrecht* 2010 on the use of measures to address issues that arise when the regulatory capital requirements are – likely to be – breached by a bank.

101 Article 102(1) CRD IV.

CRD V amends Article 104 CRD IV. It also introduces Articles 104a, 104b and 104c that clarify the additional own funds requirement that can be imposed as a supervisory measure, provide for the possibility to give guidance on additional own funds and ensure cooperation with the resolution authorities in that respect.

2.4.7.2 Early intervention measures

The BRRD provides for a legal basis for the national competent authorities to impose early intervention measures when banks infringe the regulatory capital requirements or are likely to do so in the near future.[102] These early intervention measures include, *inter alia*, the measures to require the management body of a bank to implement one or more of the arrangements or measures set out in the recovery plan, the measure to require one or more members of the management body or the senior management to be removed, the measure to require the management body of the bank to draw up a plan for negotiation on restructuring of debt and the measure to require changes to the bank's business strategy.

It can be derived from the decision of the ECB dated 27 November 2017 in relation to the request of Dexia Crédit Local S.A. (Dexia) to include in CET 1 the preferred shares held by the Belgian and the French States that the ECB had imposed early intervention measures on Dexia by decision of 6 September 2017. To the author's knowledge, this decision is not publicly available.

It can be read in a letter from Ms Nouy, Chair of the Supervisory Board of the ECB, to Mr Lamberts, member of the European Parliament that the implementation of the early intervention measures has proved challenging for the ECB, because the early intervention measures (referred to as EIMs in the following fragment of her letter) are not included in the SSMR and there is a significant overlap between EIMs and the supervisory measures set out in Article 104 CRD IV:

"Although the ECB has made frequent use of the supervisory measures provided for in Article 16 SSMR, the implementation of EIMs has proved challenging so far, notably because: (i) the powers are not included in the SSMR and can only be exercised by the ECB on the basis of the respective transpositions of the Bank Recovery and Resolution

102 Article 27, 28 and 29 BRRD. Article 13 SRMR provides for the cooperation with the SRB in that respect.

Directive (BRRD); and (ii) there is significant overlap between EIMs and "regular" supervisory measures provided for in Article 104 CRD IV and Article 16 SSMR. This overlap means that some early intervention measures are also available as "regular" supervisory measures and are therefore usually adopted as such for proportionality reasons. In particular, a bank may be required to disclose early intervention measures, whereas this might not be the case for measures taken under Article 16 SSMR. To ensure that the toolkit available to supervisors in their crisis prevention role is effective and fully usable in practice, the ECB has expressed a wish for clarification of the early intervention measures available to the supervisors under the BRRD (reduction of the overlap with Article 16 SSMR) as well as their inclusion in a directly applicable regulation."[103]

The views of the ECB on the shortcomings in the architecture of the early intervention measures have been reiterated by Ms Nouy in a letter of 24 January 2018.[104] At the time of writing this dissertation, these shortcomings had not yet been addressed.

2.4.7.3 Enforcement measures

If a significant bank in the Eurozone fails to comply with the regulatory capital requirements or with measures adopted to address the failure, the ECB can impose enforcement measures to compel the bank to comply with the requirements. These enforcement measures include periodic penalty payments or other enforcement measures available in the national implementing legislation in the participating Member States.[105] It can also instruct the national competent authorities to adopt purely national enforcement measures.

Where significant banks in the Eurozone intentionally or negligently breach the regulatory capital requirements, the ECB has the power to impose administrative pecuniary penalties.[106] In accordance with Article 18(5)

103 Letter from D. Nouy, Chair of the Supervisory Board, to Mr Lamberts, member of the European Parliament, re: your letters (QZ-086 to QZ-089), 18 August 2017. See also, ECB, Annual Report on supervisory activities 2017, March 2018, p. 52-53.

104 Letter from D. Nouy, Chair of the Supervisory Board, to Mr Lamberts and Mr Urtasun, members of the European Parliament, re: your letters (QZ115-116), 24 January 2018. See also ECB, Opinion on revisions to the Union crisis management framework, 8 November 2017, CON/2017/47, par. 4 and EC Report on application and review resolution framework 2019, p. 6.

105 Article 18(7) SSMR and Article 129 Regulation (EU) 468/2014 of the ECB (SSM Framework Regulation). Pursuant to Article 122 of the SSM Framework Regulation, the ECB can also impose penalties on less significant banks in certain cases.

106 Article 18(1) SSMR. National competent authorities have the same power in relation to less-significant banks or banks outside the Eurozone based on the national implementation of Article 66 and 67 CRD IV. See also Article 122 SSM Framework Regulation.

SSMR and Article 134 SSM Framework Regulation, the ECB may also ask the relevant national competent authorities to open proceedings with a view to imposing penalties, if appropriate.

> For example, the ECB imposed a penalty of EUR 1.6 million on Banco de Sabadell for repurchasing its CET 1 instruments from 1 January 2014 to 7 November 2016 without the prior permission of the ECB. This constituted a continuous breach of regulatory capital requirements in that period.[107] In addition, the ECB imposed a penalty for an overall amount of EUR 2.5 million on Permanent TSB for breach of the specific liquidity requirements that were imposed by the ECB.[108] Also Crédit Agricole was fined by the ECB for an amount of EUR 4.3 million, because the bank classified capital instruments as CET 1, without having obtained the prior permission of the competent authority.[109]

The ECB can as an *ultimum remedium* also revoke the license of a bank in the Eurozone when it does not meet the regulatory capital requirements.[110]

> For example, the ECB revoked the license of Trasta Komercbanka AS by decision of 3 March 2016 following the proposal submitted to the ECB by the Financial and Capital Market Commission of Latvia (the FKTK). One of the reasons to revoke the license was the inability of the bank to realize a capital increase in order to end the failure to comply with the regulatory capital requirements. In addition, there

107 ECB, Imposition of an administrative penalty on Banco de Sabadell, S.A., 14 March 2018.

108 ECB, Imposition of administrative penalties on Permanent tsb Group Holdings plc, 13 July 2017.

109 Crédit Agricole lodged legal proceedings before the EU Courts (CI, T-576 - 578/18, Action brought on 25 September 2018 (*Crédit Agricole, Crédit agricole Corporate and Investment Bank and CA Consumer Finance v ECB*).

110 Article 14(5) and (6) SSMR in combination with Article 18 CRD IV. On the basis of the national implementation of Article 18 CRD IV national competent authorities have the same power to withdraw the license of banks outside the Eurozone.

were ongoing shortcomings with the bank's operations regarding prevention of money laundering and terrorist financing. After the license was revoked, it was put in liquidation. [111]

2.4.7.4 Special measures for breach of combined buffer requirement

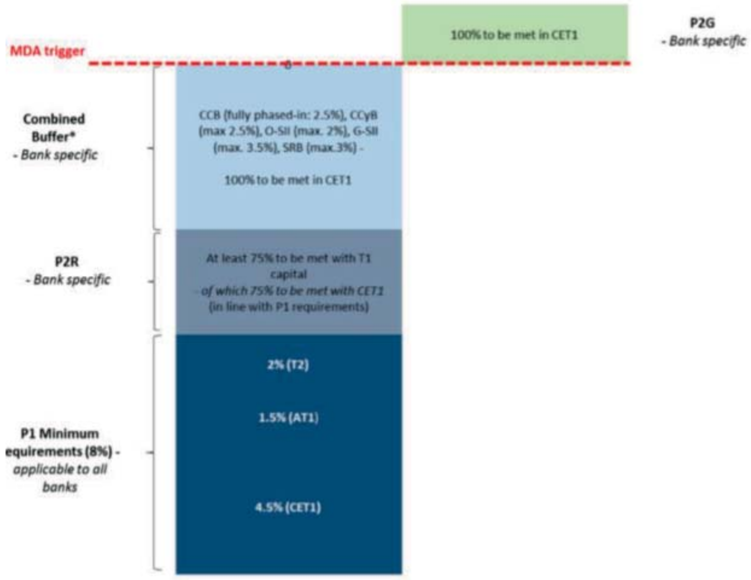
A special measure can be imposed in the situation of violation of the combined buffer requirement. Pursuant to Article 141 CRD IV a bank is prohibited from making a distribution in connection with CET 1 capital to an extent that would decrease its CET 1 capital to a level where the combined buffer requirement is no longer met. A distribution includes a payment of cash dividends.[112] If a bank in distress does not meet the combined buffer requirement, it has to calculate the so-called maximum distributable amount (MDA) and notify its competent authority thereof. Before the bank has calculated its MDA, it may not make a distribution in connection with CET 1 capital, create an obligation to pay variable remuneration or discretionary pension benefits or pay variable remuneration – but only, if the obligation to pay was created at a time when the bank failed to meet the combined buffer requirement – or make payments on AT 1 instruments.[113] In addition, the bank is prohibited from distributing more than the MDA while it fails to meet or exceed its combined buffer requirement. The MDA trigger moment is illustrated in the below figure.

111 Financial and Capital Markets Commission, 'Press Release – Withdrawal of authorisation of JSC "Trasta Komercbanka"', 3 March 2016. The withdrawal of this authorisation has been contested before the GC. The GC held that there was no need to adjudicate on Trasta Komercbanka's action for annulment of the decision of the ECB (GC, 12 September 2017, T-247/16, not published, EU:T:2017:623 (*Fursin and Others v ECB*). The ECB, Commission, Trasta Komercbanka and its shareholders lodged appeals against the decision of the GC. In a judgment of 5 November 2019, the ECJ set aside the order of the GC, judged that Trasta Komercbanka is admissible in its plea and referred the case back to the GC so that it may give a ruling on the action brought by Trasta Komercbanka (ECJ, 5 November 2019, Joined Cases C-663/17 P, C-665/17 P and C-669/17 P, ECLI:EU:C:2019:923 (*ECB and Others v Trasta Komercbanka and Others*). See Smits *European Law Blog* 2019 for a more elaborate discussion of this case.

112 Article 141(10(a) CRD IV.

113 Article 141(2) CRD IV.

Figure 4: MDA trigger



Source: Melis and Weissenberg 2019, p. 14.

The MDA is calculated by multiplying the sum of interim and year-end profits not included in CET 1 capital minus the amounts which would be payable by tax, if these profits were to be retained. Subsequently, a certain factor has to be applied, which can be 0, 0.2, 0.4 or 0.6, depending on the circumstances. The restrictions only apply to payments that result in a reduction of CET 1 capital or in a reduction of profits, and where a suspension of payment or failure to pay does not constitute an event of default or a condition for the commencement of proceedings under the insolvency regime applicable to the bank.[114]

Taking into account the above, it is important for the shareholders and holders of AT1 instruments issued by a bank that the bank restores its regulatory capital so that it can meet the combined buffer requirement, as a result of which there are no restrictions in relation to distributions (other than that these payments may not lead to a situation in which the combined buffer requirement is no longer met).

114 Article 141(7) CRD IV.

CRD V introduces a new provision that further clarifies when a bank is considered as failing to meet the combined buffer requirement. Such failure is considered to be present, when the bank does not have own funds and eligible liabilities in an amount and of the quality needed to meet at the same time the combined buffer requirement and each of the regulatory capital ratios in combination with the Pillar 2 requirement addressing risks other than the risk of excessive leverage.[115]

2.5 The MREL

The resolution framework introduced a further restriction in the freedom of banks to compose the equity and liabilities side of their balance sheet. In addition to the regulatory capital requirements included in CRR and CRD IV, the BRRD and SRMR require banks to comply with a minimum requirement for own funds and eligible liabilities (MREL). The MREL needs to safeguard that the bank, together with its shareholders and creditors is resolvable (that is, it is feasible and credible to either wind up the bank in normal insolvency proceedings or to resolve it by applying resolution tools and exercising resolution powers).[116]

2.5.1 Calculation of MREL

The MREL is set at the amount necessary to (i) absorb losses and (ii) recapitalise the bank, so that following resolution, it complies with the continuing authorisation requirements in accordance with CRD IV.[117] If the resolution strategy for a certain bank is liquidation instead of resolution, the recapitalisation amount may be zero.[118]

The minimum MREL ratio is not defined in the BRRD and the SRMR, but has to be determined by the resolution authorities for each bank (group) separately. In determining the MREL level, the resolution authorities have to take into account the amount of liabilities that are excluded from bail-in on the basis of Article 44(2) BRRD (Article 27(3) SRMR) or reasonably likely to be fully or partially excluded on the basis of Article 44(3) BRRD

115 CRD V, Article 141a.
116 Article 15(1), second paragraph BRRD. Article 10(3) SRMR.
117 Articles 1 and 2 Delegated Regulation (EU) 2016/1450.
118 Article 2(2) Delegated Regulation (EU) 2016/1450. See also Maragopoulos 2016 for an extensive discussion of the MREL.

(Article 27(4) SRMR).[119] Other factors that have to be taken into account are the business model, funding model and risk profile of the bank, the size of the bank and the likeliness that the bank poses a systemic risk in case of failure and the contributions that will be paid by deposit guarantee schemes to the financing of resolution.[120]

> It can be derived from a report from EBA dated 14 December 2016 that the average MREL ratio of a sample of 133 EU banks as of end December 2015 stood at approximately 15% of total liabilities and own funds or 37% of TREA.[121] The SRB considers that an MREL level of at least 8% of total liabilities and own funds would generally be required for all major banking groups within the European Banking Union.[122] The MREL approach of the SRB is further discussed in section 2.5.1.1.

The MREL should be included in the resolution plan of a bank, including a deadline to reach the required level set by the resolution authority, where applicable.[123] If it follows from the resolvability assessment of a bank[124] that there are substantive impediments to the resolvability of a bank, resolution authorities may require a bank to take other steps to meet the MREL, including in particular to attempt to renegotiate any eligible liability, additional Tier 1 instrument or Tier 2 instrument it has issued.[125]

2.5.1.1 MREL approach of the SRB

In 2017, the SRB set bank-specific binding consolidated MREL targets for the majority of the largest and most complex banks including all G-SIIs and banks with resolution colleges under its remit. For these banks, the SRB calculated the loss absorption amount based on the Pillar 1 and

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119 Article 3 Delegated Regulation (EU) 2016/1450. Article 44(3) BRRD – Article 27(4) SRMR – contains a discretionary power for resolution authorities to fully or partially exclude certain liabilities from bail-in in exceptional circumstances. Article 44(2) and (3) BRRD – Article 27(3) and (4) SRMR – are discussed in more detail in section 4.5.3.4.

120 Articles 4, 5 and 6 Delegated Regulation (EU) 2016/1450. See, critically, Tröger 2017.

121 EBA Final MREL Report 2016, p. 35.

122 SRB 2017 MREL Policy, p. 13. SRB 2018 First Wave MREL Policy, p. 9.

123 Article 10(7)(o) BRRD. Article 8(9)(o) SRMR.

124 The resolvability assessment entails the assessment by a resolution authority to which extent it is feasible and credible for a resolution authority to either wind up a bank in normal insolvency proceedings or to resolve it by applying the different resolution tools and powers to the bank while avoiding to the maximum extent possible any significant adverse effect on the financial system and with a view to ensuring the continuity of critical functions carried out by the bank. Article 15(1), last paragraph BRRD. Article 10(3) SRMR.

125 Article 17(5)(j) BRRD. Article 10(11)(j) SRMR.

Pillar 2 capital requirements as determined by the competent authority and the capital buffer requirement for a bank or the amount required to meet the Basel 1 floor. The calculation of the recapitalisation amount was based on the Pillar 1 and Pillar 2 capital requirements as determined by the competent authority or the amount required to meet the Basel 1 floor, complemented with a market confidence charge at the level of the fully-loaded capital buffer requirement less 125 basis points.[126]

At the end of 2018, the SRB published guidance for the first wave of resolution plans for the banks that did not have binding targets in 2017. For these banks, the MREL approach for 2017 was updated by catering for all resolution tools[127] and by removing the reference to the Basel 1 floor in the MREL formula.[128] The SRB also stated that it expects from banks a minimum level of subordinated instruments, depending on the size and systemic importance of banks.[129]

At the beginning of 2019, the SRB published guidance for the second wave of resolution plans which are those of the most complex groups. This guidance refines the MREL approach of 2017 and introduces a series of new elements strengthening the function of MREL as a key tool to achieve resolvability. It introduces a reduced perimeter of eligible liabilities for consolidated targets, binding subordination requirements at increased levels, binding targets at individual level and an additional step to tailor MREL to transfer strategies.[130]

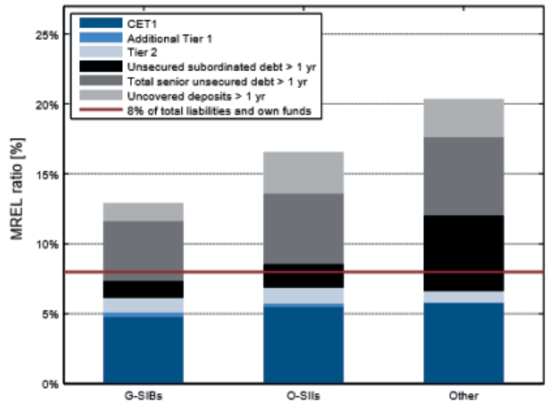
> On 16 October 2018, the Appeal Panel of the SRB rendered its decision on a case in which a decision taken by the SRB on the determination of the MREL at consolidated level for a banking group was contested. The SRB had adopted for the relevant banking group an MREL target below 8% departing from its 8% benchmark. The appeal against the decision was rejected. The Appeal Panel assesses that in the calibration of MREL requirements, the SRB enjoys a margin of technical discretion, because this calibration implies by its very nature a technical assessment of all specific factual circumstances and a balancing of interests.[131] In addition, the Appeal Panel considered that the MREL determination duly followed the principle of proportionality.[132]

126 SRB 2017 MREL Policy, p. 9-11.
127 In the SRB 2017 MREL Policy, the SRB calculated the consolidated MREL targets for all banks under bail-in strategy, be it the preferred or the variant resolution strategy.
128 SRB 2018 First Wave MREL Policy, p. 6.
129 SRB 2018 First Wave MREL Policy, p. 11.
130 SRB 2018 Second Wave MREL Policy, p. 22.
131 Appeal Panel, 16 October 2018, case 8/18 (*Appelant v SRB*), par. 30.
132 Appeal Panel, 16 October 2018, case 8/18 (*Appelant v SRB*), par. 36.

2.5.2 Composition of MREL

The MREL is calculated by the resolution authorities as the amount of own funds and eligible liabilities of the bank expressed as a percentage of the total liabilities and own funds of the bank.[133] The EBA has assessed the average composition of MREL-eligible instruments in its report dated 14 December 2016.[134] The outcome of the assessment is shown in the next figure.

Figure 5: Average composition of MREL-eligible instruments



Source: EBA Final MREL Report 2016, p. 38.

In this figure, the MREL ratio is set as a percentage of total liabilities and own funds and distinguishes between global systemically important banks (G-SIBs), O-SIIs and other banks (non-G-SIBs and non-O-SIIs).[135] The ECB explains in its report that capital instruments constitute the highest proportion of EU banks' MREL-eligible stack —on average, 43% of total MREL. On average, other banks (non-G-SIBs and non-O-SIIs) have the highest proportion of subordinated debt, at approximately 5% of total liabilities and own funds. O-SIIs have a lower proportion of subordinated debt than other banks and a higher proportion of MREL-eligible deposits than G-SIBs.[136]

133 Delegated Regulation (EU) 2016/1450 further specifies the calibration and composition of MREL.
134 EBA Final MREL Report 2016, p. 38.
135 See section 2.4.3 for the definitions of G-SII and O-SII.
136 EBA Final MREL Report 2016, p. 38.

The terms 'own funds' and 'eligible liabilities' are further discussed in the following sections.

2.5.2.1 Own funds

The own funds of a bank consist of the Tier 1 capital and Tier 2 capital of a bank, as described in section 2.4.2.[137]

2.5.2.2 Eligible liabilities

Eligible liabilities are the liabilities and capital instruments that:
1. do not qualify as Tier 1 or Tier 2 instruments of a bank, and
2. are not excluded from the scope of the bail-in tool by virtue of Article 44(2) BRRD (Article 27(3) SRMR).

   <u>Ad 2: Exclusion from bail-in</u>
   Liabilities that are excluded from the scope of the bail-in tool include, *inter alia*, deposits covered under deposit guarantee schemes, secured liabilities and liabilities that arise by virtue of the holding by the bank of client assets or client money. The exclusion of liabilities from the scope of the bail-in tool is further discussed in section 4.5.3.4.

Eligible liabilities can only be included in the MREL, if they comply with the conditions of Article 45(4) BRRD (Article 12(16) SRMR). These conditions include, *inter alia*, that instruments are issued and fully paid up, liabilities are not owed to or secured by or guaranteed by the bank itself, the purchase of the instrument was not funded directly or indirectly by the bank, the liability has a remaining maturity of at least one year, the liability does not arise from a derivative and the liability does not arise from a deposit which benefits from preference in the national insolvency hierarchy. Subordination is not a requirement to qualify a liability as an eligible liability. Resolution authorities may however require that the MREL is partially met by subordinated contractual bail-in instruments.[138] By contractually subordinating bail-in instruments, it is possible to create different layers of bail-in, thereby protecting senior eligible liabilities.

137 Article 2(1)(38) BRRD. Article 3(1)(40) SRMR.
138 Recital (5) of Delegated Regulation (EU) 2016/1450. Article 45(13) and (14) BRRD. Article 12(11) and (12) SRMR.

2.5.3 Changes under the Banking Package

The Banking Package provides for a thorough revision of the MREL provisions that are currently included in the resolution framework. This section discusses the changes under the Banking Package.[139]

2.5.3.1 Distinction between 'resolution entities' and 'entities that are not resolution entities'

The Banking Package makes a distinction between 'resolution entities' and 'entities that are not resolution entities' in respect of the applicable MREL provisions.

A 'resolution entity' is defined under BRRD II as (a) a legal person established in the EU, which, in accordance with Article 12 BRRD II, is identified by the resolution authority as an entity in respect of which the resolution plan provides for resolution action; or (b) an institution that is not part of a group that is subject to consolidated supervision pursuant to Articles 111 and 112 CRD IV, in respect of which the resolution plan drawn up pursuant to Article 10 CRD IV provides for resolution action.[140] Under SRMR II, a 'resolution entity' is defined as a legal person established in a participating Member State, which, in accordance with Article 8 SRMR II, is identified by the SRB as an entity in respect of which the resolution plan provides for resolution action.[141] Resolution entities will be obliged to issue eligible

139 See Tröger 2017 in respect of the consequences thereof for investors who seek to price relevant risks at the time of the purchase of MREL instruments.

140 BRRD II, Article 2(1)(83a).

141 SRMR II, Article 3(1)(24a). An interesting question is whether a bank can object against the qualification as resolution entity within a resolution plan. If one takes a closer look at the SRMR II, it can be derived from Article 8(6) SRMR II that only the information listed in Article 8(9)(a) SRMR II is disclosed to a bank. This is a summary of the key elements of the plan. It is unclear whether such summary shows which entities qualify as resolution entities, although this may be assumed, since this qualification determines against which entities resolution actions can be taken. But, even if a bank can derive from this summary which entities the resolution entities are, the SRMR (II) does not include any indication that the adoption of a resolution plan by the SRB qualifies as a decision of the SRB. An evaluation by the European Court of Auditors seems to indicate that these resolution plans are adopted by the SRB's internal resolution teams (European Court of Auditors, Special Report No 23/2017, par. 30). If the adoption of a resolution plan is not considered a decision by the SRB, this would not be a contestable act. It would in the author's view however still be possible to object against the qualification as resolution entity in relation to decisions by the SRB, e.g., on the determination of the MREL or on removal of impediments to resolvability. See also Article 85(2) BRRD.

(debt) instruments to external third party creditors that would be bailed-in should the resolution entity enter into resolution.

Entities which themselves are not resolution entities should issue eligible (debt) instrument internally within the 'resolution group'. The resolution group is defined as (a) the resolution entity and its subsidiaries that are not themselves resolution entities, that are not subsidiaries of another resolution entity and that are not entities established in a third country that are not included in the resolution group in accordance with the resolution plan and their subsidiaries or (b) credit institutions permanently affiliated to a central body and the central body itself when at least one of those credit institutions or the central body is a resolution entity, and their respective subsidiaries.[142]

In other words, eligible (debt) instruments issued by entities which are not resolution entities should be bought by the resolution entities. Where a resolution group entity which itself is not a resolution entity reaches the point of non-viability, these instruments are written down or converted into equity and losses of that entity are then up-streamed to the resolution entity. This is also called an 'internal MREL'. Under certain circumstances, the internal MREL could be replaced with collateralised guarantees between the resolution entity and other resolution group entities that could be triggered under the equivalent timing conditions of the instruments eligible for the internal MREL.[143]

2.5.3.2 Changes in the definition of eligible liabilities

BRRD II and SRMR II provide for a revised definition of eligible liabilities. In BRRD II and SRMR II 'eligible liabilities' is defined as:

a) bail-inable liabilities that;
b) fulfil, as applicable, the conditions of Article 45b or point (a) of Article 45f(2) BRRD II (Article 12c or point (a) of Article 12g(2) SRMR II) and Tier 2 instruments that meet the conditions of point (b) of Article 72a(1) CRR II.[144]

In short, this change entails that certain further eligibility criteria are introduced for liabilities in order to be able to qualify as eligible liabilities.

142 BRRD II, Article 2(1)(83b). SRMR II, Article 3(1)(24b).
143 SRMR II Proposal, p. 9. SRMR II, Article 12g(3). BRRD II, Article 45f(5).
144 BRRD II, Article 2(1)(71a). SRMR II, Article 3(1)(49a).

Bail-inable liabilities

Bail-inable liabilities are 'the liabilities and capital instruments that do not qualify as CET 1, AT 1 or Tier 2 instruments of a bank that are not excluded from the scope of the bail-in tool by virtue of Article 44(2) BRRD' (Article 27(3) SRMR). The new definition of 'bail-inable liabilities' is therefore the current definition of 'eligible liabilities'.[145]

Article 45b or point (a) of Article 45f(2) BRRD II (Article 12c or point (a) of Article 12g(2) SRMR II)

Article 45b BRRD II (Article 12c SRMR II) and point (a) of Article 45f(2) BRRD II (point (a) of Article 12g(2) SRMR II) further define the scope of bail-inable liabilities:

– Article 45b BRRD II (Article 12c SRMR II) specifies which eligible liabilities are included in the amount of own funds and eligible liabilities of 'resolution entities'.
– Point (a) of Article 45f(2) BRRD II (Point (a) of Article 12g(2) SRMR II) specifies which eligible liabilities are included in the amount of own funds and eligible liabilities of 'entities other than resolution entities'.

In accordance with Article 45b BRRD II (Article 12c SRMR II) eligible liabilities are included in the amount of own funds and eligible liabilities of resolution entities where:

1. they satisfy the conditions referred to in Article 72a CRR II, Article 72b CRR II, except for point (d) of Article 72b(2) CRR II (which contains a subordination requirement) and Article 72c CRR II; or
2. they arise from debt instruments with derivative features, such as structured notes, to the extent that the principal amount of the liability arising from the debt instrument is known at the time of issue, is fixed or increasing, and is not affected by an embedded derivative feature, and the total amount of the liability arising from the debt instrument, including the embedded derivative, can be valued on a daily basis by reference to an active and liquid two-way market for an equivalent instrument without credit risk or the debt instrument includes a contractual term that specifies that the value of the claim in cases of the insolvency of the issuer and of the resolution of the issuer is fixed or increasing, and does not exceed the initially paid-up amount of the liability.

145 BRRD II, Article 2(1)(71). SRMR II, Article 3(1)(49).

In accordance with point (a) of Article 45f(2) BRRD II (point (a) of Article 12g(2) SRMR II), eligible liabilities are included in the amount of own funds and eligible liabilities of 'entities other than resolution entities' where:

1. they are issued to and bought by the resolution entity;
2. they fulfil the eligibility criteria referred to in Article 72a CRR II, except for points (b), (c), (k), (l) and (m) of Article 72b(2) and Article 72b(3) to (5) CRR II;
3. they are ranking in normal insolvency proceedings below liabilities other than those eligible for own funds requirements that are issued to and bought by other entities than the resolution entity;
4. they are subject to the power of write down or conversion in accordance with Article 21 SRMR (Article 59 BRRD) that is consistent with the resolution strategy of the resolution group, notably by not affecting the control of the subsidiary by the resolution entity;[146]
5. the acquisition of ownership thereof is not funded directly or indirectly by the 'entity other than the resolution entity';
6. the provisions governing the eligible liabilities do not indicate explicitly or implicitly that the liabilities would be called, redeemed, repaid or repurchased early, as applicable, by the entity, other than in the case of the insolvency or liquidation of that entity, and that entity does not otherwise provide such an indication;
7. the provisions governing the eligible liabilities do not give the holder the right to accelerate the future scheduled payment of interest or principal, other than in the case of the insolvency or liquidation of the entity;
8. the level of interest or dividend payments, as applicable, due thereon is not amended on the basis of the credit standing of the entity or its parent undertaking.

<u>Tier 2 instruments that meet the conditions of point (b) of Article 72a(1) CRR II</u>

These are Tier 2 instruments with a residual maturity of at least one year, to the extent that they do not qualify as Tier 2 items in accordance with Article 64 CRR II. Pursuant to Article 64 CRR II the full

146 Article 59 BRRD (Article 21 SRMR) forms the basis for resolution authorities to write down or convert capital instruments.

amount of Tier 2 instruments with a residual maturity of more than five years shall qualify as Tier 2 items. Furthermore, these Tier 2 instruments should not fall into any of the categories of excluded liabilities laid down in Article 72a(2) CRR II and are subject to the amortisation provisions of Article 72c CRR II.

2.5.3.3 The introduction of the TLAC requirement for G-SIBs

On 9 November 2015, the FSB published the Total Loss-absorbing Capacity (TLAC) Term Sheet (the TLAC Standard) which requires G-SIBs to hold a sufficient amount of highly loss absorbing (bail-inable) liabilities to ensure smooth and fast absorption of losses and recapitalisation in resolution.[147] The introduction of a common minimum for G-SIBs was deemed necessary to help achieve a level playing field internationally and to ensure that there is market confidence that each G-SIB has a minimum amount of loss-absorbing capacity that would be available to absorb losses and recapitalise it in resolution.[148]

CRR II, BRRD II and SRMR II implement the TLAC standard for EU G-SIIs and integrate the TLAC requirement into the general MREL rules.[149] TLAC and MREL pursue the same regulatory objective (which is to enhance effectiveness of resolution by requiring banks to hold sufficient amounts of readily bail-inable liabilities). There are however some differences:

- The scope of application of MREL covers all banks and not only G-SIIs;
- The TLAC standard contains a harmonised minimum level – which is referred to as a Pillar 1 approach –, while the level of MREL is determined by resolution authorities on the basis of a case-by-case institution specific assessment – which is referred to as a Pillar 2 approach –;
- The minimum TLAC requirement should in principle be met with subordinated debt instruments, while for the purposes of MREL subordination of debt instruments can be required by resolution authorities on a case-by-case basis.[150]

The TLAC requirement for G-SIIs is included in Article 92a CRR II.[151] In accordance with Article 92a CRR II the TLAC requirement is a combination

147 SRMR II Proposal, p. 3.
148 See also Joosen *TvFR* 2019, p. 291-295.
149 SRMR II, Article 12e. BRRD II, Article 45d. CRR II, Article 92a.
150 See section 2.5.2 and 2.5.3.2 on the composition of MREL. See section 2.5.3.4 on the approach towards subordination under BRRD II and SRMR II.
151 CRR II, Article 92a.

of (i) a risk-based ratio of 18%, representing the own funds and eligible liabilities of the bank expressed as a percentage of the TREA, and (ii) a non-risk-based ratio of 6.75%, representing the own funds and eligible liabilities of the bank expressed as a percentage of the total exposure measure.[152]

The MREL for G-SIIs will be set at the same level as the TLAC. Article 45d BRRD II and Article 12e SRMR II specify that the MREL of a resolution entity that is a G-SII or part of a G-SII will consist of the TLAC requirement. In addition thereto the resolution authorities can determine to impose an additional requirement for own funds and eligible liabilities specific to the entity.[153] These may be imposed when the TLAC requirement is not sufficient to fulfil the regulatory objective of the MREL and to an extent that the amount of required own funds and eligible liabilities does not exceed a level that is necessary to fulfil the regulatory objective of the MREL.[154] See further the next section.

2.5.3.4 Changes to MREL under BRRD II and SRMR II

Under BRRD II and SRMR II, the MREL is still set at the amount necessary to (i) absorb losses and (ii) recapitalise the bank, so that following resolution, it complies with the continuing authorisation requirements in accordance with CRD V.[155] If the resolution strategy for a certain bank is liquidation instead of resolution, the recapitalisation amount may be zero.[156] The criteria that the resolution authorities need to take into account in determining the MREL level, as described in section 2.5.1, are also still the same.[157] Different is that BRRD II and SRMR II provide that the MREL should be expressed as a percentage of the TREA and of the total exposure measure[158] of the relevant bank, instead of the total liabilities and own funds of the bank.[159]

152 The total exposure measure is calculated in accordance with Article 429(4) CRR. The total exposure measure is also used to calculate the leverage ratio.
153 SRMR II, Article 12e(1)(b) and (3). BRRD II, Article 45d(1)(b) and (3).
154 In addition, the subordination requirement as will be discussed in section 2.5.3.4 should be met. See also Joosen *TvFR* 2019, p. 293-294.
155 BRRD II, Article 45b(2).
156 BRRD II, Article 45b(2) second paragraph.
157 BRRD II, Article 45c(1) and (8).
158 The total exposure measure is calculated in accordance with Articles 429 and 429a CRR II. Joosen clarifies that the MREL should be calculated as the highest of the percentage of the TREA *or* the total exposure measure (Joosen *TvFR* 2019, p. 301).
159 BRRD II, Article 45. SRMR II, Article 12a.

> As set out in section 2.4.1, the average ratio of TREA to total liabilities and own funds of a bank differs depending on the bank size. Expressing the MREL as (fixed) percentage of the TREA, instead of the total liabilities and own funds of the bank, will lead to relatively higher requirements for smaller banks.[160] In addition, according to Hellwig it seems clear that the choice between risk-weighted and total assets for MREL is likely to matter most for those institutions that have large portfolios of assets that are privileged in the regulation.[161]

In addition, BRRD II and SRMR II set further variables for the calculation of the MREL dependent on whether the relevant entity is a resolution entity or not. For certain resolution entities a minimum MREL level is determined. Furthermore, BRRD II and SRMR II set further restrictions in respect of the own funds and eligible liabilities that can be used to meet the MREL, including, in certain cases, a subordination requirement.

Table 2 provides an overview of the MREL provisions under BRRD II in respect of the eligible liabilities and funds that can be used to meet the MREL.

Table 2: Overview of provisions under BRRD II in respect of the eligible liabilities and own funds that can be used to meet the MREL[162]

	Resolution entities				**Entities that are not resolution entities**
	G-SIIs	*Resolution entities that are part of a resolution group of which the assets exceed EUR 100 billion*	*Resolution entities assessed as reasonably likely to pose a systemic risk in the event of its failure*	*Other resolution entities*	

160 Berger, Hüttl and Merler *Bruegel Policy Contribution* 2016, p. 5.
161 Hellwig 2016, p. 20.
162 This table and table 3 only refer to BRRD II in order to support the readability of the tables. Under SRMR II, the MREL provisions are included in Articles 12 to 12k. Article 45m BRRD II and Article 12k SRMR II provide for a transitional regime that is not included in this table.

Eligible liabilities and own funds	BRRD II, Article 45b(1) second paragraph Eligible liabilities as defined in Article 72k CRR and determined in accordance with Chapter 5a of Title I of Part Two CRR can be used to meet the MREL.	BRRD II, Article 45b(1), (2), (3) See section 2.5.3.2 for the eligible liabilities that are in scope of Article 45b(1) and (2) BRRD II. Article 45b(3) BRRD II specifies when liabilities that are issued by a subsidiary established in the EU to an existing shareholder that is not part of the same resolution group can be used to meet the MREL.	BRRD II, Article 45f(2) See section 2.5.3.2 for the eligible liabilities that are in scope of Article 45f(2) (a) BRRD II. Article 45f(2) (b) BRRD II specifies which own funds can be used to meet the MREL.
Subordination requirement	BRRD II, Article 45b(4), (7), (8), (9) 8 % of the total liabilities, including own funds, shall be met by using own funds, subordinated eligible instruments, or liabilities issued by a subsidiary in the EU to an existing shareholder that is not part of the same resolution group (MREL minimum Pillar 1 subordination policy). The resolution authority may permit otherwise. In addition, a sub-set of G-SIIs and top-tier and other systemic relevant banks[163] may be faced with an additional Pillar 2 subordination requirement. For resolution entities that are part of a resolution group of which the assets exceed EUR 100 billion the resolution authority has to limit the subordination requirement where this leads to a requirement greater than 27% of the TREA.	BRRD II, Article 45b(5), (9) The resolution authority can decide that subordination is required for liabilities in order to qualify as eligible liabilities	N/A

Table 3 provides an overview of provisions under BRRD II in respect of the MREL application and calculation.

163 These are the banks that are part of a resolution group of which the assets exceed EUR 100 billion or which the resolution authority has assessed as reasonably likely to pose a systemic risk in the event of its failure.

Table 3: Overview of provisions under BRRD II in respect of the MREL application and calculation[164]

	Resolution entities				**Entities that are not resolution entities**
	G-SIBs	*Resolution entities that are part of a resolution group of which the assets exceed EUR 100 billion*	*Resolution entities assessed as reasonably likely to pose a systemic risk in the event of its failure*	*Other resolution entities*	
MREL calculation	BRRD II, Article 45c, 45d, 45e	BRRD II, Article 45c(3), 45e			BRRD II, Article 45c(7), 45f
	G-SIBs should at all times meet the minimum MREL level.[165] The resolution authority can set an additional requirement.[166]	The MREL as a percentage of the TREA should be calculated as the sum of: (i) The loss absorption amount that corresponds to the total capital ratio of 8 % and the Pillar 2 requirement; and (ii) The recapitalisation amount that allows the resolution group resulting from resolution to restore compliance with the total capital ratio of 8 % and the Pillar 2 requirement after the implementation of the preferred resolution strategy.[167] The MREL as a percentage of the total exposure measure should be calculated as the sum of: (i) The loss absorption amount that corresponds to the leverage ratio requirement; and (ii) The recapitalisation amount that allows the resolution group resulting from resolution to restore compliance with the leverage ratio requirement after the implementation of the preferred resolution strategy.			

164 Article 45m BRRD II and Article 12k SRMR II provide for a transitional regime.
165 Unless Article 92a(2) or (3) CRR II is applicable. In addition, Article 494 CRR II provides for transitional provisions.
166 BRRD II, Article 45d(3).
167 This amount can be increased by an appropriate amount necessary to ensure that, following resolution, the entity is able to sustain sufficient market confidence for an appropriate period, which shall not exceed one year (BRRD II, Article 45b(3) sixth paragraph).

<table>
<tr><td rowspan="2">Minimum MREL level</td><td rowspan="2">BRRD II, Article 45d(1)(a)
- 18% of the TREA; and
- 6.75% of the total exposure measure</td><td>BRRD II, Article 45c(5)</td><td>BRRD II, Article 45c(6)</td><td rowspan="2">N/A</td><td rowspan="2">N/A</td></tr>
<tr><td colspan="2">- 13.5 % of the TREA; and
- 5% of the total exposure measure</td></tr>
</table>

2.5.4 Measures in case of breach of MREL

Although the BRRD and the SRMR are clear that MREL is a minimum requirement that must be met at all times,[168] they do not contain specific provisions covering the implications of an MREL breach. Nonetheless, there are a number of actions that could be envisaged under the BRRD/SRMR in case of a (likely) breach of the MREL.[169]

> As flagged by Philippon and Salord,[170] the balance sheets of banks may not be quite ready for the MREL. It can be read in the Quantitative Update of the EBA MREL Report that challenges relate both to the MREL amount and the MREL composition. The financing need of the 112 EU banks in the EBA sample (60% of the total EU banking sector's assets) to meet the MREL ranges between EUR 131.6 billion and EUR 250.8 billion depending on which scenario is used.[171] In addition, certain banks are characterized by the predominance of deposits covered by a deposit guarantee scheme or preferred retail deposits in the funding structure and limited or non-existent experience in issuing debt instruments. This affects the banks' abilities to meet the MREL and, in the end, the resolvability of these banks.[172]

The resolution authority could deal with a breach of the MREL as part of its powers to address or remove substantive impediments to resolvability. It can, for example, require a bank to issue eligible liabilities to meet the

168 Article 45(1) BRRD. Article 12(1) SRMR.
169 These are addressed by the EBA in EBA Final MREL Report 2016, p. 91-93.
170 Philippon and Salord 2017, p. 3.
171 The EBA, Quantitative Update of the EBA MREL Report, 20 December 2017, p. 13. This analysis was carried out with data as of end December 2016. See also EC Report on application and review resolution framework 2019, p. 3: "*Overall, banks are in a transitional phase and, while some banks at present still face MREL shortfalls, they are on their path towards fulfilling the objectives within the timeframes specified by SRB.*"
172 EBA Final MREL Report 2016, p. 26, 27. Recital (15) BRRD II.

MREL requirement or to renegotiate any eligible liability, AT1 or Tier 2 instrument it has issued to meet the MREL requirement.[173] This can however only be done after an assessment of the resolvability has been made and the bank has not removed the impediments itself within a four months' period. Additional powers may be available under the BRRD, such as the power to request a bank to submit a plan to restore compliance with the MREL requirement or to impose administrative penalties, but the scope of these additional powers is unclear and partly depends on the implementation in national law.[174] In addition, a significant deterioration in the MREL may be a trigger for the competent authorities to use the early intervention powers, as described in section 2.4.7.2.[175] Lastly, breach of the MREL may contribute to the finding that a bank is failing or likely to fail and should be put in resolution.[176]

> The EBA considered that these aforementioned measures are insufficient for resolution authorities to deal with MREL breaches in an efficient way. It therefore suggested that resolution authorities should be given enhanced powers to address breaches of the MREL.[177] BRRD II and SRMR II introduce the requirement for relevant authorities to address any breach of the MREL through at least one of the following: powers to address or remove impediments to resolvability, powers to prohibit certain distributions, supervisory measures, early intervention measures, administrative penalties or other administrative measures.[178]
>
> The powers to prohibit certain distributions is a new power introduced by BRRD II and SRMR II. The resolution authorities shall have the power to prohibit a bank from distributing more than the MDA related to the MREL (the M-MDA) through making a distribution in connection with CET 1 capital, through creating an obligation to pay variable remuneration or discretionary pension benefits or to pay variable remuneration – if the obligation to pay was created at a time when the entity failed to meet the combined buffer requirement –, or

173 Article 17(5)(i) and (j) BRRD. Article 10(11)(i) and (j) SRMR.
174 Article 110 BRRD. EBA Final MREL Report 2016, p. 92.
175 The EBA, Guidelines on triggers for use of early intervention measures pursuant to Article 27(4) of Directive 2014/59/EU, 28 July 2015, EBA/GL/2015/03, p. 8.
176 Article 32(4) BRRD. Article 18(4) SRMR. See also BRRD II, Article 45k(1) second paragraph (SRMR II, Article 12j(1) second paragraph).
177 EBA Final MREL Report 2016, p. 99.
178 BRRD II, Article 45k. SRMR II, Article 12j.

through making payments on AT 1 instruments. The resolution authorities can exercise this power when a bank does not have own funds and eligible liabilities in an amount and of the quality needed to meet at the same time the combined buffer requirement and the MREL, but it does not fail to meet the combined buffer requirement under CRD V.[179]

2.6 Restoring the balance sheet of a bank in financial difficulties

Banks can get into financial difficulties for many reasons, differing from inefficiency or excessive risk taking to difficulties in raising funds from external parties due to market restraints. Financial difficulties can appear in multiple ways on the balance sheet of a bank. It may for example be that the market value of loans is less than listed on the bank's balance sheet (e.g. in case of non-performing loans) as a result of which it is necessary to write-down the value of these loans. Such a reduction in the assets side of the balance sheet will automatically trigger a reduction in the liabilities and equity side of the balance sheet (e.g. by reducing the reserves, if any). It may also be that a bank is unable to attract capital in the market as a result of which it cannot (or no longer) meet the applicable regulatory capital requirements. Depending on the type and seriousness of the financial difficulties, a bank can use different tools to restore its balance sheet. These tools can be broadly categorized in funding instruments, addressing the equity and liabilities side of the balance sheet, and asset measures, addressing the asset side of the balance sheet.

2.6.1 Funding instruments in times of financial difficulties

A well-diversified funding structure is deemed crucial to guaranteeing banks’ capacity to withstand stress events. This implies avoiding overreliance on individual funding sources and, in particular, on secured funding.[180] Article 413 CRR provides that banks have to ensure that their long term obligations are adequately met with a diversity of stable funding

179 BRRD II, Article 16a. SRMR II, Article 10a.

180 ESRB Recommendation on funding of credit institutions 2012, p. 9; EBA, Guidelines on harmonised definitions and templates for funding plans of credit institutions under Recommendation A4 of ESRB/2012/2, 19 June 2014, EBA/GL/2014/04; ECB, Decision (EU) 2017/1198 of 27 June 2017 on the reporting of funding plans of credit institutions by national competent authorities to the European Central Bank (ECB/2017/21).

instruments under both normal and stressed conditions.[181] A well-diversified funding structure should contribute to a sustainable funding structure that can be perpetuated without public intervention and in which the prices paid for funding allow the viability of the bank. This eventually reduces the risk that a bank ends up in resolution.

This section briefly describes the (public) funding instruments that are available for a bank in order to restore the equity and liabilities side of the balance sheet after getting into financial difficulties.

2.6.1.1 Funding by new or existing market investors and lenders

If a bank is still attractive to market investors and lenders, that is to say a) market investors and/or lenders are willing to provide capital (either in equity or in debt form, depending on the bank's needs) to the bank, and b) they are willing to do so against a price and on terms that are acceptable for the bank, a bank may be able to restore its balance sheet by raising funds in the capital and money markets, including interbank markets.

> An example of a bank that raised funds in the financial markets to resolve its financial difficulties is Deutsche Bank. Its revised 2018 issuance plan of EUR 20-22 billion, comprising debt issuance with an original maturity in excess of one year, was completed and it concluded 2018 having raised EUR 19.8 billion in term funding. This funding was broadly spread across the following funding sources: senior non-preferred plain-vanilla issuance (EUR 9.4 billion), senior preferred plain-vanilla issuance (EUR 1.0 billion), covered bond issuance (EUR 2.5 billion), and other senior preferred structured issuance (EUR 6.9 billion). The investor base for 2018 issuances comprised asset managers and pension funds (40%), retail customers (19%), banks (8%), governments and agencies (5%), insurance companies (3%) and other institutional investors (18%).[182] This funding plan was however not sufficient, since Deutsche Bank continues to be in financial trouble.[183]

181 Article 413(1) CRR.
182 Deutsche Bank, Funding, available on the website of Deutsche Bank: www.db.com.
183 The Guardian, Deutsche Bank shares slump further as fallout from bad press continues, 23 May 2019. Bloomberg, Five Charts Show the Big Problems for German Banks, 22 May 2019.

In addition to capital raising, or instead of capital raising, the existing shareholders and creditors of a bank can enter into a 'voluntary' agreement to recapitalise the bank. This may entail the write down of equity instruments and/or conversion of debt into equity. For a voluntary recapitalisation the approval of the shareholders and/or creditors is necessary.[184]

> The Co-operative Bank p.l.c. (the Co-op Bank) announced on 28 June 2017 that it reached an agreement with its shareholders and creditors on the terms of an equity raise and recapitalisation. The recapitalisation involved the cancellation of certain notes and preference shares issued by the Co-op Bank and resulted in the following:
>
> – Existing shareholders of the Co-op Bank exchanged their shares in the bank for shares (A Shares) issued by a new holding company of the Bank (Holdco) equivalent in aggregate to 5% of the pro forma A Shares outstanding in Holdco.
> – Retail noteholders (individual persons with a holding of an aggregate principal amount of £100,000 or less) received cash, at a level equivalent to up to 45% of the nominal value of their notes and subject to an overall cap of £13.5 million on the aggregate cash amount to be paid to retail noteholders and potential downward adjustment to the cash amount to be paid to retail noteholders, if such a cap is reached.
> – Other holders of notes who are not retail noteholders received A Shares equivalent to 17.4% of the pro forma A Shares outstanding in Holdco in aggregate and allocated among these noteholders pro rata to their holdings in the notes.
> – Based on a total conversion of approximately £426 million of notes and an assumed principal amount held by retail noteholders of approximately £30 million, the recapitalisation was used to generate at least £443 million of CET 1 capital.
>
> The recapitalisation has been implemented by way of a creditors' scheme of arrangement that required, amongst other

184 Although you can say that the shareholders and creditors can decide not to approve such recapitalisation, they will often not have a real choice. The relevant competent authority will urge the bank to restore its balance sheet in order to avoid any intervention by such authority, including, as an *ultimum remedium*, the withdrawal of the authorisation of the bank.

> things, the approval by a majority in number of the class members of each relevant class and the sanction of the court.[185]

> Another example is the recapitalisation of the Italian bank UniCredit. Its shareholders gave UniCredit permission for a EUR 13 billion rights offer. The shareholders meeting also approved the conversion of every 10 shares into one new share after the stock dropped more than 45% in 2016.[186]

As a consequence of the introduction of the resolution regime, recapitalisation of a bank by the existing shareholders and creditors can now also be forced.[187] A forced recapitalisation entails that the regulatory capital of the bank is written down and/or conversed through the exercise of the 'PONV conversion power' by the resolution authority.[188] If the write down and conversion of regulatory capital through the exercise of the PONV conversion power is not sufficient to recapitalise the bank, the resolution authority can decide to use the bail-in tool to write down and/or convert eligible liabilities.[189] The exercise of the PONV conversion power and the application of the bail-in tool are discussed in more detail in sections 4.5.2 and 4.5.3.

2.6.1.2 Member State support

Another – since the GFC more controversial – funding instrument is Member State support. This can e.g. be granted in the form of loans, guarantees or capital injections. Not all funding by or through Member States qualifies as State aid that requires the authorisation of the Commission pursuant to Articles 107-108 TFEU. In order for a measure to qualify as

185 Agreement on the Terms of a Capital Raising Plan to Secure the Long Term Future of the UK's Leading Ethical Bank, 28 June 2017. Co-op bank, Successful Completion of Restructuring and Recapitalization, 1 September 2017.

186 EC, State aid: Commission clearance of Portuguese recapitalisation of Caixa Geral de Depósitos (CGD) - how the rules apply to bank recapitalisations, 10 March 2017, MEMO/17/557.

187 Some national resolution regimes of Member States already provided for write down and/or conversion powers prior to the introduction of the BRRD and SRMR. See De Serière *Ondernemingsrecht* 2012 in respect of (the lack of) forced recapitalisation under the Dutch resolution regime (*Interventiewet*) that applied prior to the BRRD and SRMR. The PONV conversion power was available per 1 January 2015 under the BRRD and per 1 January 2016 under the SRMR. The bail-in tool became available under the BRRD and SRMR per 1 January 2016.

188 Article 59 BRRD. Article 21 SRMR.

189 Article 2(1)(57), Article 43 and Article 44 BRRD. Article 3(1)(33), Article 27 SRMR.

State aid, it should be an intervention by a Member State or through Member State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods and that affects trade between Member States.[190] If a Member State provides funding to banks in financial difficulties in line with market conditions, this does not qualify as State aid and no prior authorisation from the Commission is required. This is discussed in more detail in section 3.3.2.

> For example, the Portuguese recapitalisation of the fully state-owned bank Caixa Geral de Depósitos in March 2017 was carried out on market terms and therefore did not involve State aid in favour of the bank.[191] Another example of a market-conform intervention in favour of the banking sector is the Hungarian asset management company MARK to which solvent financial institutions in Hungary can, on a voluntary basis, sell non-performing loans at market price.[192]

2.6.1.3 Central bank support

Beyond general refinancing interventions, which are classified as monetary operations and seek to accommodate the liquidity needs of the banking system as a whole, national central banks of the Member States may also provide lending of last resort to banks on an individual basis, so called ELA.[193] The objective of ELA is to avoid a bank slipping into an insolvency situation because of a liquidity gap, creating a domino effect resulting in many insolvencies.[194] ELA concerns the provision of central bank money and/or any other assistance that may lead to an increase in central bank money to banks or banking groups faced with temporary liquidity problems.[195]

> ELA to banks established in Eurozone Member States was repeatedly granted during the GFC, but also thereafter: in the 2010-2013 period by Ireland, Greece, and Cyprus, in 2014 by Portugal, and in 2015 again by Greece.[196]

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190 Article 107(1) TFEU. The concept of State aid is further discussed in section 3.3.
191 EC Caixa Factsheet 2017.
192 EC Caixa Factsheet 2017.
193 Hadjiemmanuil *EE* 2016, p. 95. Busch, Van Rijn, Louisse *EBLR* 2019, p. 602-603.
194 Zilioli 2015, p. 50.
195 Gortsos 2015, p. 58.
196 Gortsos 2015, p. 57.

2.6.1.4 Contributions by deposit guarantee schemes

Each Member State has to ensure that within its territory one or more deposit guarantee schemes are introduced.[197] Deposit guarantee schemes guarantee the repayment of 'covered deposits'[198] when deposits become unavailable, e.g. because the bank enters insolvency proceedings.[199] The deposit guarantee schemes can also be used to finance resolution of a bank or to finance alternative measures in order to prevent the failure of a bank.[200] The deposit guarantee schemes are funded by their members, which are the banks in the respective Member States.[201]

2.6.1.5 National resolution funds

The resolution framework requires each Member State to establish one or more national resolution funds for the purpose of ensuring the effective application by the resolution authorities of the resolution tools and powers.[202] The national resolution funds may, *inter alia*, be used to guarantee the liabilities of a bank in resolution, to make loans to the bank in resolution, or to pay compensation to shareholders or creditors.[203] The national resolution funds are funded by banks and investment firms that are in scope of the resolution framework (BRRD investment firms)[204], including branches of third country banks and BRRD investment firms.[205]

2.6.1.6 Supranational funding instruments

There is a number of funding instruments available at supranational level, most notably within the SRM and therefore at Eurozone level. These funding instruments concern contributions by the SRF and the direct recapitalisation instrument of the ESM (hereinafter referred to as ESM DRI).[206]

197 Article 4(1) DGS Directive.
198 Covered deposits are eligible deposits that do not exceed the coverage level of EUR 100,000 per depositor. Eligible deposits are deposits that are not excluded from the protection pursuant to Article 5 DGS Directive. Article 2(1) under 4 and 5 DGS Directive.
199 Article 2(1) under 8 DGS Directive in combination with Article 11(1) DGS Directive.
200 Article 11(3) DGS Directive.
201 Article 10 DGS Directive. See also Grünewald 2014, p. 135-153.
202 Article 100(1) BRRD.
203 Article 101(1) BRRD.
204 Article 2(1) under 3 BRRD. The term 'BRRD investment firm' is further explained in section 4.3.4.1.
205 Article 100(3) and (4) BRRD.
206 See also Busch, Van Rijn and Louisse *EBLR* 2019, p. 597-600.

The SRMR provides that the SRF is built up to support the SRM.[207] It is established for the purpose of ensuring the efficient application of the resolution tools and exercise of the resolution powers within the scope of the SRM.[208] It is therefore only available to support the resolution of banks and banking groups that are established in the participating Member States in the SSM.[209] The SRF is built up over a period of 8 years with contributions from banks and banking groups that are established in the Eurozone. For these banks, the SRF replaced the national resolution funds as from 1 January 2016. They are therefore not obliged to contribute to the national resolution funds.

> An intergovernmental agreement has been entered into by the participating Member States of the SSM in respect of transferring the funds raised at national level towards the SRF as well as on a progressive merger of the different funds raised at national level to be allocated to national compartments of the SRF (the SRF Agreement). These compartments shall cease to exist at the end of the transitional period (at the beginning of 2024).[210] The target level of the SRF is 1% of covered deposits by 2024.[211]

The ESM was established in 2012 by the Eurozone Member States in the ESM Treaty. The mission of the ESM is to provide financial assistance to Eurozone Member States experiencing or threatened by severe financing problems.[212] In order to accomplish its mission, the ESM can use six different instruments. It can grant a loan within a macroeconomic adjustment programme, it can conduct primary or secondary market purchases, it can provide a precautionary credit line, it can grant loans to a Eurozone Member State which are subsequently channelled to the beneficiary bank(s) by the relevant Member State (indirect recapitalisation) or it can directly recapitalise systemic banks. While the first five instruments are

207 Article 1 SRMR. According to Lo Schiavo the SRF expresses a new dimension of organic financial solidarity in the EMU legal order, albeit to a limited extent (Lo Schiavo 2018, p. 188).
208 Article 67(2) SRMR.
209 Article 67(4) SRMR. Országhová and Mišková *Banking Supervision* 2015, p. 15.
210 Article 1(1) under b SRF Agreement.
211 Article 69 SRMR. This is estimated to be EUR 55 billion. See also Busch *EBLR* 2017, p. 464.
212 The establishment of the ESM was not without controversy. See Lo Schiavo 2018, p. 167-172. The ECJ however held that the ESM is compatible with EU law and, in particular, with the no bailout clause under Article 125 TFEU. ECJ, C-370/12, 27 November 2012, ECLI:EU:C:2012:756 (*Pringle v Government of Ireland*).

directed at and entered into with the Eurozone Member States, the sixth instrument (the ESM DRI) entails a direct recapitalisation by the ESM of a systemic bank established in the Eurozone. The ESM DRI is operational as of December 2014.

> At the time of writing this dissertation, the ESM DRI had not yet been used by the ESM. This is different for the indirect bank recapitalisation tool. In the case of indirect recapitalisation, the ESM provides funds to a Eurozone Member State whose government then uses the funds to recapitalise a bank. This tool has been applied by the ESM in relation to Spain. The ESM made available to Spain up to EUR 100 billion in assistance, although, in the end, Spain only needed EUR 41.3 billion. Two disbursements were made: in December 2012 and in February 2013. The funds were lent to the Spanish government – no ESM cash was disbursed directly to the banks. Spain used the ESM cash to modernise the banking sector. Ownership structures were reformed and risk management practices were improved.[213]

The ESM has a lending capacity of EUR 500 billion, of which EUR 60 billion is available for the ESM DRI. The ESM raises money it needs for lending operations in financial markets by issuing bills and bonds and through other funding tools. Investors in ESM securities are mainly institutional investors, such as commercial and central banks, pension funds, sovereign wealth funds, asset managers, and insurance companies. The ESM has a total capital of nearly EUR 705 billion. This consists of over EUR 80 billion in paid-in capital provided by the participating Member States and approximately EUR 624 billion in committed callable capital. A capital call will take place when the Board of Governors so decides by mutual agreement, to replenish paid-in capital to covers losses, or to avoid default on an ESM payment obligation to its creditors.[214]

213 ESM, Spain: a fast and effective programme, available on the website of the ESM: www.esm.europa.eu.

214 Articles 8, 9 and 21 ESM Treaty. ESM, Explainers, available on the website of the ESM: www.esm.europa.eu/explainers.

2.6.2 Asset measures in times of financial difficulties

The previous section discussed the *funding instruments* that are available for banks in times of financial difficulties. These funding instruments address and improve the equity and liabilities side of the balance sheet of a bank in difficulties. There are also measures that help restore the assets side of the balance sheet, hereinafter referred to as *asset measures*.

It is generally recognised that non-performing assets (NPAs) translate into lower interest income and higher loan loss provisions, eventually leading to a deterioration in banks' profitability and regulatory capital. It is therefore important that NPAs are identified in a timely way and measured efficiently. In April 2018, the Financial Stability Institute of the BIS recommended to introduce a regulatory definition of NPA, to harmonise NPA entry and exit criteria and to gain powers, if not yet available, to impose prudential backstops (as a downward adjustment in regulatory capital) to deal with situations where accounting provisions on NPAs are deemed inadequate from a supervisory perspective.[215] These recommendations followed on the Guidelines on prudential treatment of problem assets of the BIS published in April 2017.

In the EU, a common definition of non-performing exposures (NPE) was introduced in 2014 by the EBA and is based on a combination of 'past due' (90 days) and the forward-looking 'unlikely to pay' criteria.[216] This definition is also used by the Commission in its package to address non-performing loans (NPLs), as mentioned in section 1.4.1.4.

> NPLs denote loans where the borrower is unable to make the scheduled payments to cover interest or capital reimbursements. When the payments are more than 90 days past due, or the loan is assessed as unlikely to be repaid by the borrower, it is classified as an NPL.[217]

NPLs can weigh on bank performance by generating less income. This may reduce the bank's profitability and, in the most severe cases, jeopardize the viability of a bank. In addition, NPLs tie up significant amounts of a bank's resources. This reduces the bank's capacity to lend.[218] Accelerating the resolution of NPLs is therefore a top priority for the EU. One of the

215 BIS Report 2018, p. 1-2.
216 Annex V to Implementing Regulation (EU) No 680/2014.
217 NPL Proposal, footnote 3.
218 NPE Proposal, p. 1.

key policy areas in this context is the development of secondary markets for distressed debt so that banks can deliberately and sustainably reduce NPLs in their balance sheets.[219]

> There is a consensus that Europe is over-banked, and that this is evident in the imbalance between bank assets and relatively under-developed capital markets, in the slow progress of bank consolidation and in often unfocused business models that have contributed to low profitability.[220] Creating a secondary market for NPL portfolios may be beneficial to refocusing the business strategy and creating a better balance between bank assets and capital markets (when the investors are outside the banking sector).

This section discusses the asset measures that can be taken to address NPAs on the balance sheet of a failing bank.

2.6.2.1 NPE strategy options

The EBA Guidelines on management of non-performing and forborne exposures set out that banks should have in place an adequate NPE strategy to target a time-bound reduction of NPEs over a realistic but sufficiently ambitious time horizon. As part of this NPE strategy, banks should consider including options to achieve this objective. These options could include a hold/forbearance strategy, active portfolio reductions through sale, securitisation or write-offs, changes of type of exposure or collateral or legal options, including insolvency proceedings or out-of-court solutions.[221]

2.6.2.2 Member State support

If the NPE strategy options do not work, Member States can support banks through so-called asset relief measures (or impaired asset measures). These include aid in the form of guarantees (under which – part of the – losses on assets are guaranteed) or asset purchases.

> For example, Banco CEISS benefitted from an impaired asset measure whereby it transferred assets to an asset management company. The aim of that measure was to remove uncertainty about the future

219 ECB, Guidance to banks on non-performing loans, 20 March 2017.
220 Lehmann *Bruegel Policy Contribution* 2018, p. 8.
221 EBA, Guidelines on management of non-performing and forborne exposures, EBA/GL/2018/06, par. 37. The guidelines apply from 30 June 2019.

> value of its most problematic asset portfolio and to allow Banco CEISS to concentrate on the implementation of its restructuring plan.[222]

2.6.2.3 National resolution funds

The national resolution funds, as discussed in section 6.1.5, may also be used to guarantee the assets of a bank in resolution or to purchase assets of the bank in resolution.[223] National resolution funds can for example be used to finance asset management vehicles that purchase assets from the bank in resolution.

> In the resolution of Banco Internacional do Funchal S.A. (BANIF), impaired assets were transferred to an Asset Management Company (AMC). The AMC was financed by share capital provided by the Portuguese resolution fund, the sole and controlling shareholder of the AMC and the issuance of bonds guaranteed by the resolution fund and counter-guaranteed by Portugal, subscribed by BANIF and subsequently transferred to the private sector purchaser.[224]

2.6.2.4 Supranational asset measures

The SRF may also be used to guarantee the assets of a bank in resolution or to purchase assets of the bank in resolution, where this bank is established in the Eurozone.

> At the time of writing this dissertation, the SRF had not yet been used. Some authors have argued that a supranational asset management company should be established for the Eurozone to resolve bank fragility and spur economic recovery.[225] The Commission has however not embraced this idea in its package to address NPLs. Instead, the package provides for a technical blueprint for how to set up national asset management companies.

222 EC, 20 December 2012, COM(2012) 9878 final (SA.34536 – Banco CEISS), par. 33.
223 Article 101(1) BRRD.
224 EC, 21 December 2015, C(2015) 9763 final (SA.43977 – BANIF), par. 67-68, 76-80.
225 Avgouleas and Goodhart *EE* 2017. Beck *VoxEU.org* 2017. Haben and Quagliariello *Centralbanking.com* 2017.

2.7 Conclusion

This chapter started with taking a closer look at the definition of credit institution in banking regulation in order to further understand the term 'bank'. Interestingly, this term is not as clear as one may expect. Due to a lack of clarification of certain elements of the definition of credit institution at EU level, there remains a degree of divergence between the Member States as to the interpretation of this term. A further complicating factor in understanding what a bank is, is the variety of activities and business models of banks within the EU. Although, ultimately, the purpose of banking intermediation is transforming short-term deposits into a stable and sustainable supply of long-term credit to the real economy, banks involve in all kinds of activities. Some banks have total assets of such an amount that they qualify as global systemically important. Other banks have a more modest balance sheet. While business models and balance sheets of banks differ, they have in common that they all need to comply with the regulatory capital requirements and the MREL.

As a result of the regulatory capital requirements and the MREL, each bank needs to maintain a certain composition of its balance sheet. This should safeguard that the reliance of banks on short-term wholesale funding to finance the expansion of their balance sheets, together with the use of high leverage, supports economically useful banking activities that serve the general interest, while banks are resolvable when they are failing. The balance sheets of banks may however not be quite ready for that, because of challenges relating both to the MREL amount and the MREL composition. Banks have a financing need to meet the MREL. In addition, certain banks are characterized by the predominance of deposits covered by a deposit guarantee scheme or preferred retail deposits in the funding structure and limited or non-existent experience in issuing debt instruments. This affects the banks' abilities to meet the MREL and, in the end, the resolvability of these banks.

If the level of own capital and eligible liabilities is insufficient to absorb losses and recapitalise a failing bank, other funding resources will be necessary to resolve the bank. These may be provided by private market parties, but also by Member States, national central banks, deposit guarantee schemes, national resolution funds, the SRF and/or the ESM. Taking into account that banks are currently still in the initial stage of implementing the MREL, it may be realistic to assume that it will be necessary to use alternative resources in the resolution of banks, in any event, as long as the

MREL has not been fully implemented. The MREL requirement is still developing in terms of the minimum required MREL. In addition, although competent authorities have a full set of powers available when regulatory capital requirements are (likely to be) breached, this still needs to evolve in relation to the MREL requirement.

This chapter lastly touched on the tools that a bank can use to restore its balance sheet. Besides funding instruments that address and improve the *equity and liabilities side* of the balance sheet of a bank in difficulties, there is increased attention for measures that help restore the *assets side* of the balance sheet. As a result of asset quality reviews and stress tests conducted by the competent authorities, it became clear that banks experience high levels of NPLs. It is generally recognised that NPLs translate into lower interest income and higher loan loss provisions, eventually leading to a deterioration in banks' profitability and regulatory capital. A number of initiatives have therefore been taken to target a reduction of NPLs.

CHAPTER 3

THE STATE AID REGIME FOR THE BANKING SECTOR

> *"At the start of the crisis, ten years ago, there was no European framework to deal with troubled banks. All we had, to defend fair competition and protect taxpayers, was the state aid rules. And for the last ten years, those rules have been there to make sure bailing out banks doesn't allow them to compete unfairly with their rivals, or cost taxpayers any more than it has to."*
>
> *Vestager 2017*

3.1 Introduction

While the application of the State aid rules in the banking sector was often neglected prior to the GFC, this completely changed when Member States started to award mind-blowing amounts of State aid to their banking sectors in order to keep them alive after the fall of Lehman Brothers in 2008. Although the EU did not know – at that time – a resolution framework, such as in the US, State aid control was and is a unique feature of the EU. As Gambaro and Mazzocchi mention, the State aid regime for the banking sector filled what had previously been, in substance, a regulatory vacuum, and foreshadowed some areas of the European Banking Union regulation that would follow. The fundamental objective of avoiding public resources being used to confer on particular undertakings or categories of undertakings advantages distorting competition in the internal market has remained constant, but the State aid rules have shown great flexibility in their ability to respond to the major changes that have impacted the EU.[1] It is thanks to the exercise of State aid control by the Commission that a certain level playing field could be protected within the internal market during the GFC.

By exercising State aid control in the banking sector, the Commission had – and still has – to balance the necessity and the proportionality of an aid measure in achieving an EU objective versus the distortion of competition

1 Gambaro and Mazzocchi *IAR* 2016, p. 60-61.

brought about it. The Commission has continuously stressed that financial stability is the overriding goal of State aid policy in the banking sector, whilst ensuring that State aid and distortions of competition between banks and across Member States are kept to the minimum. To find the right balance between the two is key to the State aid regime for the banking sector as discussed in this chapter.

This chapter starts with a description of the development of the State aid regime for the banking sector in section 3.2. It subsequently discusses the concept of State aid in section 3.3. Section 3.4 describes the legal outline and scope of the current State aid regime for the banking sector. Section 3.5 provides more insight in the assessment by the Commission of State aid awards in the banking sector. Section 3.6 discusses the peculiarities of granting State aid to a banking group. Sections 3.7 and 3.8 describe the treatment of the beneficiary bank and third parties (such as shareholders and creditors of a bank) in the State aid award and assessment process. Section 3.9 describes the judicial protection of beneficiary banks and third parties against decisions from the Commission. Section 3.10 concludes this chapter.

3.2 The development of a State aid regime for the banking sector

The Commission attended the banking sector for the first time in its Eight Report on Competition Policy of 1978. The Commission noticed that Member States exempted the banking sector wholly or partially from the national competition regulatory frameworks by reason of the special regulatory framework that applied in this sector arising out of the constraints imposed by the financial policies of the governments in question. The Commission emphasised in its Eight Report that the competition rules also enclose the banking sector in spite of the special regulatory framework in this sector.[2] This was confirmed by the ECJ in its judgment in the *Züchner* case.[3]

> In the *Züchner* case, The Bayerische Vereinsbank was sued by a client as a result of a service charge that Bayerische Vereinsbank charged for an international payment from a German bank account to an Italian bank account. Bayerische Vereinsbank argued that the EEC

2 EC, Eight Report on Competition Policy (1978), p. 36.
3 ECJ, 14 July 1981, C-172/80, ECLI:EU:C:1981:178, (*Züchner v Bayerische Vereinbank*).

> Treaty provisions on competition did not apply, at least to a great extent, to banking undertakings. It maintained that by reason of the special nature of the services provided by these undertakings and the vital role which they play in transfers of capital they must be considered as undertakings "*entrusted with the operation of services of general economic interest*" within the meaning of Article 90(2) of the EEC Treaty (nowadays Article 106(2) TFEU) and thus were not subject, pursuant to that provision, to the rules on competition in Articles 85 and 86 of the EEC Treaty (nowadays Article 101 and 102 TFEU). The ECJ however ruled otherwise and recognised that the EU competition rules are also applicable to the banking sector.

In the 1980s, the Commission had to deal with the liberalized and deregulated banking sector that formed part of the internal market that was to be realized.[4] A strict control by the Commission of the competition rules seemed to be necessary, because of the expected strengthening of competition on this market.[5] In its Thirteenth Report on Competition Policy of 1983, the Commission again stressed that the specific characteristics of the banking sector did not exclude this sector from the working of the general competition rules.[6] The strict control by the Commission of aid measures was meant to lead to an increase of the economic and social cohesion inside the European Economic Community (EEC) and, besides, to the diminishing of the exorbitant budget deficits of some Member States.[7]

In 1994, after the formation of the EU in 1993, the Commission intensified its attention on the application of the State aid rules in the banking sector. According to the Commission, this framework should take into account the special characteristics of the banking sector, which could make State intervention necessary in order to avoid bank runs or systemic crises. The Commission clarified that it had no objections against aid that prevented a crisis from starting, that restored faith in the stability of the banking sector or that stimulated the adequate working of the payment system. State intervention could be justified, if a systemic crisis was very likely to occur. But, if just one or several banks were in difficulty, restructuring or

4 EC, Twenty-first Report on Competition Policy (1991), p. 37. The liberalization process did not affect all countries. Germany and France still had a highly nationalized banking sector, while Italy just started liberalization in the late 1990s.
5 EC, Twenty-second Report on Competition Policy (1992), p. 39.
6 EC, Thirteenth Report on Competition Policy (1983), p. 65.
7 EC, Twenty-first Report on Competition Policy (1991), p. 23; EC, Twenty-second Report on Competition Policy (1992), p. 27.

liquidation should be the solution.[8] In 1994, the first important banking case for the Commission's policy on State aid took place. This case is referred to as the *Banesto* case.[9] In this case, the Commission decided that the rescue of Banesto, one of the largest Spanish banks at that time, did not constitute State aid, because the 'market economy investor principle' had been fulfilled.[10] The Commission also considered that the peculiarities of the banking sector with respect to the other economic sectors required the Commission to carefully verify how to apply the State aid rules to banks.[11]

After the *Banesto* case, and prior to the onset of the GFC in 2008, many more cases followed in which the Commission had to decide on the granting of State aid to banks.[12] In its decisions, the Commission has often stressed that the State aid regulatory framework applies to the banking sector, while it recognises at the same time that it is necessary, when applying free market laws to the banking sector, to take account of the particular characteristics of the sector and, especially, of the fact that a certain level

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8 EC, Twenty-fourth Report on Competition Policy (1994), p. 232-233.

9 There is not a lot of information about this case, seen the fact that only a press release mentions this case.

10 Ehlermann et al 2001, p. 256. The 'market economy investor principle' is further discussed in section 3.2.1.

11 EC, press release IP/94/1226 of 15 December 1994. The decision has not been published.

12 The author refers to the rescue and/or restructuring of Crédit Lyonnais (95/547/EC: Commission decision, Official Journal L 308, 21/12/1995 p. 0092 – 0119, 96/C 390/03: Commission notice, Official Journal C 390, 24/12/1996, p. 0007-0025, 98/490/EC: Commission decision, Official Journal L 221, 8/8/1998, p. 0028-0080), Banque Hervet (Not published, see C.D. Ehlermann a.o., 2001, p. 260), Comptoir des Entrepreneurs (Commission press release IP/96/80 of 24/01/1996), Société Marseillaise de Credit (97/C 49/02, Commission Notice, Official Journal C 49, 19/2/1997, p. 0002-0017, 99/508/EC: Commission decision, Official Journal L 198, 30/7/1999, p. 0001-0014), GAN Insurance Group (97/C 149/05, Commission Notice, Official Journal C 149, 17/5/1997, p. 0006-0022, 98/204/EC: Commission decision, Official Journal L 78, 16/3/1998, p. 0001-0029), Agrobanka and GE Capital Bank (1998/C 297/03, Commission Notice, Official Journal C 297, 25/9/1998, p. 0003-0023, 2005/C 10/08, Commission Notice, Official Journal C 10, 14/1/2005, p. 0009-0022), Banco di Napoli (99/288/EC: Commission decision, Official Journal L 116, 4/5/1999, p. 0036-0056), Banco di Sicilia and Sicilcassa (2000/600/EC: Commission decision, Official Journal L 256, 10/10/2000, p. 0021-0043), Crédit Foncier de France (2001/89/EC: Commission decision, Official Journal L 34, 3/2/2001, p. 0036-0054), Bankgesellschaft Berlin (2005/345/EC: Commission decision, Official Journal L 116, 4/5/2005, p. 0001-0054), Bank Burgenland (2005/691/EC: Commission decision, Official Journal L 263, 8/10/2005, p. 0008-0019), BAWAG (2008/263/EC: Commission decision, Official Journal L 263, 26/3/2008, p. 0007-0034), Postabank (2009/174/EC: Commission decision, Official Journal L 62, 6/3/2009, p. 0014-0027).

of protection of depositors and debtors might be necessary in order to avoid more serious consequences, such as the risk of a general crisis.[13] In 2008, this risk became reality. As a result of the GFC, the Commission was faced with the challenge to deal with the threat to financial stability, while maintaining strict controls on the granting of State aid.[14] It was under these circumstances, that it developed a number of sectoral communications in which it laid down its guidance on the application of the State aid rules in relation to failing banks. But before doing so, the Commission applied the Guidelines on State aid for rescuing and restructuring firms in difficulty that were in effect as of 2004 (the 2004 R&R Guidelines).[15]

3.2.1 *The 2004 R&R Guidelines as a first resort*

The 2004 R&R Guidelines set out the Commission's policy for State aid control in the situation of rescuing and restructuring firms in difficulty. They applied to firms in all sectors, except for coal and steel, that were in difficulty. The assessment by the Commission of rescue and restructuring aid under the 2004 R&R Guidelines took place on the basis of Article 87(3)(c) EC Treaty (the predecessor of Article 107(3)(c) TFEU). On the basis of Article 87(3)(c) EC Treaty, the Commission could consider State aid compatible with the internal market, if it was aid to facilitate the development of certain economic activities or of certain economic areas, where this aid did not adversely affect trading conditions to an extent contrary to the common interest.

The 2004 R&R Guidelines contained a number of conditions that the Commission took into consideration in its assessment whether an aid measure could be considered compatible with the internal market as rescue or restructuring aid.

The conditions for rescue aid provided that:
a) the rescue aid should be granted in the form of loans or loan guarantees;[16]
b) within six months from the date of granting the rescue aid a restructuring or liquidation plan or proof of full reimbursement of the loans and cessation of the guarantees should be submitted;

13 EC, Twenty-second Report on Competition Policy (1992), p. 40.
14 See also Hellwig 2017-1, p. 7-10.
15 The 2004 R&R Guidelines have been replaced by the 2014 R&R Guidelines with effect from 1 August 2014.
16 Although it was possible to deviate from this condition for support in the banking sector (see 2004 R&R Guidelines, footnote 3).

c) the aid measure should be restricted to the amount needed to keep the firm in business for the period of six months;
d) the aid measure was justified on grounds of serious social difficulties and did not have unduly adverse effects which spill over into other Member States; and
e) the beneficiary bank had not benefited from rescue or restructuring aid in the past (one time, last time principle).[17]

In relation to restructuring aid, the 2004 R&R Guidelines required that:
a) the restructuring would restore the long-term viability of the failing entity;
b) the aid had been limited to the minimum and was accompanied by a significant own contribution: at least 25% in the case of small enterprises, at least 40%, for medium-sized enterprises and at least 50% for large firms;[18]
c) sufficient measures were being taken to mitigate as far as possible any adverse effects of the aid on competitors; and
d) the beneficiary bank had not benefited from rescue or restructuring aid in the past (one time, last time principle).[19]

The 2004 R&R Guidelines were applied in relation to the granting of rescue and/or restructuring aid to the Danish Roskilde Bank,[20] the German banks IKB[21] and SachsenLB[22] and the UK bank Northern Rock.[23]

3.2.2 *Difficulties in the application of the 2004 R&R Guidelines in banking cases*

Although the 2004 R&R Guidelines had been used with some success in a small number of cases involving State aid to banks before and in the early days of the GFC, they were not ideally suited to address large-scale interventions in the banking sector. Rescue and restructuring aid were often two parts of a single operation to deal with the problems in the banking

17 2004 R&R Guidelines, point 25.
18 2004 R&R Guidelines, point 44.
19 2004 R&R Guidelines, point 72.
20 EC, 31 July 2008, C(2008)4138 final (NN 36/2008 - Roskilde Bank).
21 EC, 27 February 2008 (C10/2008 – IKB).
22 EC, 27 February 2008, C(2008)/ 711 def. (C9/2008 – SachsenLB) and EC, 4 June 2008, C(2008) 2269 final (C9/2008 – SachsenLB).
23 EC, 5 December 2007, C(2007) 6127 final (NN 70/2007 – Northern Rock) and EC, 2 April 2008, C(2008)1210 final (C14/2008 – Northern Rock).

sector during the financial crisis.[24] It was therefore not always easy to make a strict distinction between rescue and restructuring. Sometimes it was required to already take certain restructuring measures in the rescue phase.[25]

In addition, the 2004 R&R Guidelines generally applied to all sectors.[26] As a consequence, they did not cater for the particularities of the banking sector, such as the overriding importance of the cost of funds in determining the competitiveness of banks. They were designed to deal with a situation in which rescue and restructuring aid would harm competitors of the aided firm by denying them the additional market share that they could have won, if that firm had been allowed to collapse. In the banking industry, however, the failure of one bank, far from benefiting its competitors, is more likely to threaten their stability through contagion effects, meaning that individual banks could not be treated separately without also considering their interconnections.[27] First, as banks have extensive exposures to one another, losses of one will be borne by the others. Losses can spread directly through interbank exposures or indirectly through guarantees, credit lines, or insurance against credit risks that are being called. Secondly, pure informational contagion can arise such that the failure of one bank leads to an adjustment in the expectations regarding the viability of other banks that are perceived to be 'similar'.[28] Furthermore, the 2004 R&R Guidelines were drafted for the situation in which one individual firm was in difficulty. They did not anticipate the contagion effects inherent in financial crisis.[29] The 2004 R&R Guidelines did also not cater for the granting of rescue and restructuring aid to banks that were otherwise fundamentally sound, but that had become unable to access credit on the financial markets.[30]

24 2004 R&R Guidelines, point 14.
25 2004 R&R Guidelines, point 6. See e.g. EC, 27 February 2008, (C10/2008 – IKB).
26 Except to the coal or steel sector and without prejudice to any specific rules relating to firms in difficulty in the aviation sector (2004 R&R Guidelines, point 18 and footnote 3).
27 Mamdami *ERA Forum* 2012, p. 244-245; Psaroudakis *ECFR* 2012, p. 198; Dewatripont *IJoIO* 2014, p. 40.
28 EC Staff Working Paper 2011, p. 25.
29 Gardella 2015, p. 378. Although one could argue that social considerations, which formed the basis for the assessment of aid under Article 87(3)(c) EEC Treaty could also include the objective of avoiding a banking crisis (Ahlborn and Piccinin *EStAL* 2010, p. 54).
30 Quigley 2015, p. 466.

The conditions set out in the 2004 R&R Guidelines turned out to be impossible to comply with for banks that had to rely on rescue and/or restructuring aid. For example, given the fact that it was almost impossible to obtain contributions from third party investors in the markets, the requirement of an own contribution by the bank of 50% was deemed unrealistic by the Commission. In addition, it was the experience of the Commission that banks generally needed more than 2 years for the implementation of the restructuring plan due to the market circumstances.[31] Also, the one-time-last-time was set aside.[32] Lastly, the GFC required the swift adoption of decisions by the Commission on complete notification, if necessary within 24 hours and over a weekend.[33] This implied a substantial shortening of the assessment period for the preliminary examination – which is normally two months. In order to cater for the needs of the banking sector, the Commission adopted the Crisis Communications.

3.2.3 The development of the Crisis Communications

Between 2008 and 2011, the Commission published six communications (the Crisis Communications) containing a tailored framework for State aid control for banks in difficulty based on the 2004 R&R Guidelines.[34] The Crisis Communications included the 2008 Banking Communication, the Recapitalisation Communication, the Impaired Assets Communication, the Restructuring Communication, the 2010 Prolongation Communication and the 2011 Prolongation Communication. The Crisis Communications provided for the conditions for assessment of rescue aid and restructuring aid in the banking sector during the GFC. The conditions for approval followed the general principles laid down in the 2004 R&R Guidelines, but allowed adjustment and sharpening of the Commission's practice under these guidelines.[35]

While the contours of the European Banking Union were given shape, the Commission started with its review of the Crisis Communications.[36] With this review, the Commission intended to ensure that future State interventions were consistent with the principles of the European Banking Union

31 See e.g. EC, 7 May 2009, C(2009) 3708 final, (N244/2009 – Commerzbank), par. 85.
32 Gray and De Cecco 2017, p. 30-32.
33 2008 Banking Communication, point 53.
34 See also Lannoo 2010, p. 32-36; Botta *JEI* 2016, p. 275.
35 2008 Banking Communication, point 10. EC Staff Working Paper 2011, p. 31.
36 2013 Banking Communication.

(or rather, the resolution framework).[37] On 30 July 2013, the Commission published the 2013 Banking Communication.[38] The 2013 Banking Communication replaces the 2008 Banking Communication, adapts and complements the Recapitalisation and Impaired Assets Communications and supplements the Restructuring Communication. The Commission applies the principles set out in the 2013 Banking Communication from 1 August 2013.[39] The 2013 Banking Communication, for example, provides more detailed guidance on burden-sharing by shareholders and subordinated creditors, establishes the principle that no recapitalisation or asset relief measure can be granted without prior authorisation of a restructuring plan (except in the case that financial stability considerations require otherwise), proposes a procedure for the permanent authorisation of these measures and provides guidance on the compatibility requirements for liquidation aid.[40]

Although the 2013 Banking Communication has a temporary nature as it is justified "*as long as the crisis situation persists, creating genuinely exceptional circumstances where financial stability at large is at risk*", it still applies today.[41]

3.3 The concept of State aid

Not all public funding qualifies as State aid within the meaning of Article 107(1) TFEU. In accordance with Article 107(1) TFEU State aid is an intervention by a Member State or through Member State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods and that affects trade between Member States. In order for a measure to be categorised as 'State aid', all the conditions set out in Article 107(1) TFEU must be fulfilled. The Commission has no margin of discretion to decide that a measure is not State aid, if it meets these conditions.[42] A Commission decision categorising a national measure as State aid must however set out

37 EC DG Competition Management Plan 2015, p. 45.
38 2013 Banking Communication.
39 Notifications registered by the Commission prior to 1 August 2013 are examined in the light of the criteria in force at the time of notification.
40 2013 Banking Communication, point 24. See for the development of the Crisis Communications and the 2013 Banking Communication: Iftinchi 2017, p. 58-74.
41 The continuous application of the 2013 Banking Communication is not appreciated by everyone. See e.g. Bloomberg, Italy's Bank Funeral Shows EU Still Using Crisis Playbook, 3 July 2017.
42 EC State Aid Manual of Procedures, section 1-3.

the reasons why the Commission takes this view.[43] It must disclose in a clear and unequivocal fashion the reasoning followed by the Commission in such a way as to enable the persons concerned to ascertain the reasons for the measure and to enable the competent court to exercise its power of review.[44]

> It is in the first place up to the Member State that intends to grant public funding to make the assessment whether this qualifies as State aid. Only if the outcome of the assessment is positive, it needs to obtain the approval of the Commission prior to awarding the public funding.[45] With a view to contributing to an easier, more transparent and more consistent application of the notion of State aid across the EU, the Commission published a Notice on the notion of State aid on 19 June 2016.[46] Given that the notion of State aid is an objective and legal concept defined directly by the TFEU, the Notice clarifies the Commission's understanding of Article 107(1) TFEU, as interpreted by the ECJ, in order to assist Member States in making the correct qualification.[47]

The following sections set out and discuss the different elements of the concept of State aid with a focus on the State aid measures that have been implemented in the banking sector.

3.3.1 Intervention by a Member State or through Member State resources

The first condition that should be met in order for a measure to qualify as State aid, is that the measure should be an intervention by a Member State or through Member State resources. In addition, the measure should be imputable to the Member State involved. The granting of an advantage directly or indirectly through State resources and the imputability of such a

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43 ECJ, 5 March 2015, C-677/13, ECLI:EU:C:2015:151 (*Estado português v Banco Privado Português and Massa Insolvente do Banco Privado Português*), par. 45; ECJ, 2 September 2010, , C-399/08 P, ECLI:EU:C:2010:481 (*Commission v Deutsche Post*), par. 38 and the case-law cited; ECJ, 9 October 2014, C-522/13, ECLI:EU:C:2014:2262 (*Ministerio de Defensa and Navantia v Concello de Ferrol*), par. 19.

44 ECJ, 5 March 2015, C-677/13, ECLI:EU:C:2015:151 (*Estado português v Banco Privado Português and Massa Insolvente do Banco Privado Português*), par. 44; ECJ, 15 April 2008, C-390/06, ECLI:EU:C:2008:224 (*Nuova Agricast v Ministero delle Attività Produttive*), par. 79 and the case-law cited.

45 The procedural outline of the State aid assessment by the Commission is set out in section 3.5.1.

46 EC Notice on the notion of State aid.

47 EC Notice on the notion of State aid, point 3.

measure to the State are two separate and cumulative conditions for State aid to exist.[48] However, they are often considered together when assessing a measure under Article 107(1) TFEU, as they both relate to the public origin of the measure in question.[49]

3.3.1.1 State resources

State resources include all resources of the public sector, including resources of intra-State entities (decentralised, federated, regional or other) and 'public undertakings'[50] and can include under certain circumstances, resources of private bodies and transfers within a public group. Resources of private bodies can qualify as State resources if, under application of national legislation, the State exercises control and influence to ensure that the use of resources of a private body fulfils a public policy objective with which that body is entrusted.[51]

The notion of State resources is not limited to direct grants. It also comprises, *inter alia*, guarantees, investment in the capital of companies and benefits in kind.[52] Hence, State aid also includes measures, which may not involve direct payment to a beneficiary, but which nevertheless alleviate charges which the latter would otherwise have to bear.[53] A firm and concrete commitment to make State resources available at a later point in time is also considered a transfer of State resources. A positive transfer of funds does not have to occur; foregoing State revenue is sufficient.[54]

> Impaired asset relief measures are for example State aid inasmuch as they free the beneficiary bank from (or compensate for) the need to register either a loss or a reserve for a possible loss on its impaired assets and/or free regulatory capital for other uses. This would notably be the case where impaired assets are purchased or insured at

48 GC, 19 March 2019, T-98/16, T-196/16 and T-198/16, ECLI:EU:T:2019:167 (*Italy, Banca Popolare di Bari and Fondo interbancario di tutela dei depositi v Commission*), par. 70. Louisse *JOR* 2019-2.

49 EC Notice on the notion of State aid, point 38.

50 See section 3.3.1.2 for the definition of public undertaking.

51 ECJ, 30 May 2013, C-677/11, ECLI :EU:C:2013:348 (*Doux Élevage*), par. 39. GC, 19 March 2019, T-98/16, T-196/16 and T-198/16, ECLI:EU:T:2019:167 (*Italy, Banca Popolare di Bari and Fondo interbancario di tutela dei depositi v Commission*), par. 64-69.

52 EC Notice on the notion of State aid, point 51.

53 D'Sa 1998, p. 58-60. ECJ, 15 December 2005, C-66/02, ECLI:EU:C:2005:768 (*Italian Republic v Commission*), par. 77-82.

54 EC Notice on the notion of State aid, point 51.

a value above the market price, or where the price of the guarantee does not compensate the State for its possible maximum liability under the guarantee.[55]

The origin of the resources is not relevant for the qualification as State resources, provided that they come under public control and are therefore available to the public authorities, even if the resources do not become the property of the public authority.[56] In particular, State resources are generally considered to be involved where funds come from contributions made compulsory by State legislation and are managed and apportioned in accordance with that legislation, even if they are administered by institutions separate from the State.[57] In other words, the mere fact that resources are financed in part by private contributions is not sufficient to rule out the public character of those resources since the relevant factor is not the direct origin of the resources, but the degree of intervention of the public authority within the definition of the measure and its method of financing.[58]

State resources can also be present, if these are at the joint disposal of several Member States who decide jointly on the use of those resources.[59] Also resources coming from the EU[60] (for example, from structural funds) or from international financial institutions, such as the International Monetary Fund (IMF), can be considered State resources, but only if national authorities have discretion as to the use of the resources, in particular the selection of the beneficiaries. By contrast, if these resources are awarded directly by the EU, with no discretion on the part of the national authorities, they do not constitute State resources.[61]

55 Impaired Assets Communication, point 15.
56 EC Notice on the notion of State aid, point 57.
57 EC Notice on the notion of State aid, point 57-58. See also ECJ, 2 July 1974, Case 173/73, ECLI:EU:C:1974:71 (*Italy v Commission*), par. 16.
58 GC, 27 September 2012, T-139/09, ECLI:EU:T:2012:496 (*France v Commission*), par. 63 and 64.
59 EC Notice on the notion of State aid, point 59. The qualification of SRF contributions and the ESM DRI is discussed in section 5.2.1.1
60 See for a discussion of the different EU funds Nicolaides 2018, p. 9-15.
61 EC Notice on the notion of State aid, point 60.

3.3.1.2 Imputability

In order for State resources to qualify as State aid, they have to be imputable to a Member State. In cases where a *public authority* grants an advantage to a beneficiary, the measure is by definition imputable to the State, even if the authority in question enjoys legal autonomy from other public authorities. The same applies, if a public authority designates a private or public body to administer a measure conferring an advantage. [62]

Imputability is less evident however, if the advantage is granted through *public undertakings* instead of public authorities. A public undertaking is any undertaking over which the public authorities may exercise directly or indirectly a dominant influence by virtue of their ownership of it, their financial participation therein, or the rules which govern it.[63] In such cases, it is necessary to determine whether the public authorities can be regarded as having been involved, in one way, or another, in adopting the measure.[64] In the Notice on the notion of State aid, the Commission has set out a number of indicators to establish whether a measure taken by a public undertaking is imputable to the State.[65] These indicators include, *inter alia*, the fact that the public undertaking could not take the contested decision without taking account of the requirements of the public authorities, the degree of supervision that the public authorities exercise over the management of the public undertaking, and any other indicator showing the involvement of the public authorities in adopting the measure in question or the unlikelihood of their not being involved, taking account of the scope of the measure, its content or the conditions it contains.

> In the case of Norddeutsche Landesbank Girozentrale (Nord/LB), the Commission had to make the assessment whether a change in the coupon terms by Nord/LB constituted State aid to the holders of the notes. Nord/LB was a German banking group owned by German States and Savings Banks' associations. It had four silent participation contracts with single purpose companies for the issuance of certain tier-1 instruments (the Fürstenberg hybrids or the notes). Due to the change of regulatory conditions, the hybrids had lost their quality as core tier-1 capital. In that context, Nord/LB changed the terms of the hybrids as a result of which the payment of the

62 EC Notice on the notion of State aid, point 39.
63 Article 2b Commission Directive 2006/111/EC, p. 17.
64 EC Notice on the notion of State aid, point 39 and 40.
65 EC Notice on the notion of State aid, point 42 and 43.

coupon became independent of the dividend payment to the public shareholders. Even though it was evident that the noteholders received a benefit, the Commission found no evidence that the provision of that advantage was imputable to the State. The Commission considered that, although Nord/LB was a public undertaking, its by-laws stipulated that it must conduct the banking business independently from public authorities and must be operated like a private sector company. The business management was the responsibility of the executive board which independently carried out its tasks and did not in principle have to act on instructions. In addition, the Commission found no evidence that the State actively influenced the decision-making process or was decisively involved in the course of the action. The Commission had no evidence that the management decision in relation to the coupon terms was determined by anything other than purely commercial considerations.[66]

In the case of the rescue of the German bank IKB by its shareholder, the Commission came to a different conclusion. KfW, being the main shareholder of IKB had provided a 'risk shield' to IKB assuming the obligations under certain liquidity facilities provided by IKB. The Commission considered that this measure was imputable to the German State. This followed, apart from the fact that KfW was publicly owned, from the strong involvement of the German banking authority BaFin and the Ministry of Finance. It appeared that, without the strong pressure imposed by the German banking authority and the Ministry of Finance on the KfW management during the days preceding the granting of the risk shield, KfW would not have taken engagements to such an extent.[67]

In addition, when the aid is provided by a *private undertaking* or an undertaking that has autonomy in respect of, inter alia, the management of its funds, the Commission has the obligation to carefully elaborate and substantiate why it concludes that the Member State has significant control over the used resources and that these resources are imputable to

66 EC, 22 August 2013, C(2013) 5515 final (SA.34381 – Nord/LB), par. 26-32. A separate consideration was that none of the investors held an amount of Fürstenberg hybrids for which the coupon payments would exceed the *de minimis* threshold.

67 EC, 27 February 2008, (C 10/2008 – IKB), par. 35.

the Member State. The Commission has to demonstrate not only that the Member State can exercise control on the undertaking that awards the aid, but also that it has actually exercised this control in the case at hand.[68]

Imputability is also less evident, if the advantage is granted through *supranational bodies*. The Notice on the notion of State aid does not provide for specific indicators for imputability in that respect. Taking into account the line that has been developed by the EU Courts in relation to public undertakings, one could however argue that it should be assessed whether the public authorities of the Member States can be regarded as having been involved, in one way, or another, in adopting the measure by the supranational body.[69]

If a Member State is under an obligation to implement an aid measure under EU law without any discretion, the measure stems from an act of the EU legislature and is not imputable to the State.[70] However, this is not the case in situations where EU law simply allows for certain national measures and the Member State enjoys discretion (i) as to whether to adopt the measures in question or (ii) in establishing the characteristics of the concrete measure which are relevant from a State aid perspective.[71]

3.3.1.3 Qualification of support measures in the banking sector as State resources imputable to a Member State

During the GFC, support to failing banks was not only granted by Member States directly, but also through other means. In a substantial number of cases, the Commission was confronted with the question whether support measures qualify as State resources imputable to a Member State. This section discusses examples of these cases and the guidance that has been provided by the Commission in that respect.

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68 GC, 19 March 2019, T-98/16, T-196/16 and T-198/16, ECLI:EU:T:2019:167 (*Italy, Banca Popolare di Bari and Fondo interbancario di tutela dei depositi v Commission*), par. 67, 69.

69 Bacon 2017, p. 66. Quigley 2015, p. 45. EC, Commission Staff Working Document – Guidance on State aid in European Structural and Investment (ESI) Funds Financial Instruments in the 2014-2010 programming period, SWD(2017) 156 final, 2.5.2017, par. 3.1.

70 EC Notice on the notion of State aid, point 44.

71 EC Notice on the notion of State aid, point 45.

National central bank support

According to the Notice on the notion of State aid, funds provided by the national central bank of a Member State to specific credit institutions generally imply the transfer of State resources.[72] The ordinary activities of central banks related to monetary policy, such as open market operations and standing facilities, do however not fall within the scope of State aid rules, because they cannot be considered to be imputable to the State and/or involving State funds.[73] ELA does only not qualify as State aid, if it meets the following cumulative conditions set out in the 2013 Banking Communication:

a) the bank is temporarily illiquid but solvent at the moment of the liquidity provision which occurs in exceptional circumstances and is not part of a larger aid package;
b) the facility is fully secured by collateral to which appropriate haircuts are applied, in function of its quality and market value;[74]
c) the central bank charges a penal interest rate to the beneficiary;[75]
d) the measure is taken at the central bank's own initiative, and in particular is not backed by any counter-guarantee of the State.[76]

The policy set out in the 2013 Banking Communication followed on prior Commission decisions addressing the topic of ELA.

> For example, in the case of ELA provided by the central bank of Belgium to Fortis, the Commission decided that, since the activities of this central bank were controlled by the Belgian State, its resources were State resources. In addition, the Commission considered in this case that this was particularly true since as a result of a counter-guarantee by the Belgian State any losses as a result of the liquidity assistance would be borne directly by the Belgian State.[77] In the case of Northern Rock, the Commission assessed that the ELA provided by the Bank of England did not concern State aid, because this was done at a moment when the bank was solvent, the facility was secured against high quality collateral to which 'margins'

72 EC Notice on the notion of State aid, point 48.
73 2013 Banking Communication, point 62. Laprévote and Coupé 2017, p. 116.
74 In general, national central banks have a certain level of discretion to accept an asset as collateral for ELA purposes even if it is ineligible under the normal monetary framework (Fernandez de Lis and Garcia 2018, p. 9).
75 Section 7 ELA Agreement contains minimum rates that should in principle be applied by national central banks within the Eurosystem.
76 2013 Banking Communication, point 62. See also Grünewald 2014, p. 129-130.
77 EC, 3 December 2008, C(2008) 8085 final (NN 42/2008 – Fortis Bank), par. 46.

> were applied against the risk of falls in the price of the collateral and against a penal interest rate. In addition, the ELA was granted at the own initiative of the Bank of England independent of and before other measures. [78]

There are authors that argue that central bank support – in any event in the Eurozone – should never qualify as State aid to the extent that central banks act on their own initiative and subject to the Eurosystem rules of governance.[79]

<u>Deposit guarantee schemes interventions</u>
Whilst deposit guarantee schemes are funded by the private sector (that is, banks), contributions by deposit guarantee schemes may qualify as State aid. A distinction must be made between the pay-out of covered deposits by deposit guarantee schemes in case of the winding up of banks in normal insolvency proceedings, and other use of the deposit guarantee schemes. This other use could, for example, consist of resolution financing, alternative measures taken by a deposit guarantee scheme in order to prevent the failure of a bank or financial assistance in relation to the rescue, restructuring or liquidation of a bank.[80] With regard to the pay-out function of deposit guarantee schemes no State aid is involved, because the pay-out is mandatory under the DGS Directive and therefore not imputable to a Member State.[81] When deposit guarantee schemes are applied for another purpose, State aid may be involved, if the intervention fulfils a public policy mandate at the discretion of the Member State (or the resolution authority) involved.[82]

> Examples of cases in which the Commission concluded that the use of a deposit guarantee scheme consisted of a transfer of State resources and was imputable to the State, are the rescue of Banca Tercas, which involved the use of alternative measures,[83] the Danish winding

78 EC, 5 December 2007, C(2007) 6127 final (NN 70/2007 – Northern Rock), par. 32-34.
79 Laprévote and Coupé 2017, p. 118.
80 Article 11(2) and (3) DGS Directive.
81 Article 11(1) DGS Directive.
82 2013 Banking Communication, point 63. Bacon 2017, p. 369. Recital (3) and (16) DGS Directive. EC, 2 July 2015, C(2015) 4599 final (SA.41924 – Banca Romagna), par. 34-35. See also Grünewald 2014, p. 130-132.
83 EC, 27 February 2015, C(2015) 1404 final (SA.39451 – Banca Tercas), par. 50.

up scheme,[84] the Polish orderly liquidation scheme,[85] the rescue of Caja Castilla la Mancha[86] and Caja de Ahorros del Mediterraneo[87] and the liquidation of Italian bank Banca Romagna.[88] In these cases the Commission concluded that, although the deposit guarantee schemes were funded by banks, their use was imputable to the State. The Commission notably argued that contributions were compulsory and that governments had crucial influence on the decisions of those deposit guarantee schemes.[89] Another example in which the use of the deposit guarantee scheme was qualified as State aid, is the extension of the Belgian Deposit Guarantee Scheme protecting shares held by individual shareholders in certain 'recognised cooperatives' (the ARCO cooperatives). According to the Commission, this could not be seen as a transposition of the DGS Directive but stemmed from an initiative from Belgium itself. The Commission also concluded in its decision that the aid was incompatible with the internal market and had to be recovered from the ARCO cooperatives, being the beneficiaries of the aid. [90] The decisions in respect of Banca Tercas and the ARCO cooperatives have been contested before the GC as discussed below.

<u>The use of the IDFF in the case of Barca Tercas</u>
Banca Popolare di Bari (the holding company of Banca Tercas), the Italian Interbank Deposit Protection Fund (IDFF) and Italy have brought actions before the GC in relation to the decision of the Commission in respect of Banca Tercas. They complain that the Commission has infringed and misapplied Article 107(1) TFEU by

84 A Financial Stability Company (FSC) was set-up to establish subsidiary banks to acquire the assets of distressed banks. Any loss arising in a subsidiary bank of the FSC was covered via a loss guarantee from a new Winding up Department, which was created as a 'sub-fund' of the Danish Deposit Guarantee Fund. The Winding up Department was financed by contributions from member banks which were mandatory and determined by law. Against that background and taking into account that the winding up scheme was implemented in the context of a public interest mission defined by Denmark and did not have a purely commercial objective, the Commission considered that the measure involved State resources in the meaning of Article 107(1) TFEU. EC, 30 September 2010, C(2010) 6788 final (N 407/2010 – Danish winding-up scheme), par. 29.

85 EC, 18 February 2014, C(2014) 1060 final, (SA.37425 – Poland), par. 45.

86 EC, 29 June 2010, C(2010) 4453 final (NN 61/2009 – Caja Castilla-La Mancha), par. 97-105.

87 EC, 30 May 2012, C(2012) 3540 final (SA.34255 – CAM), par. 77, 78 and 79.

88 EC, 2 July 2015, C(2015) 4599 final (SA.41924 – Banca Romagna), par. 34-35.

89 EP Bail-in Analysis 2016, p. 5.

90 EC, 3 July 2014, C(2014) 1021 final (SA.33927 - Belgium), par. 99.

failing to provide any and/or adequate reasons as regards whether the necessary requirements relating to 'State resources' and 'imputability to the State' have been met, in so far as the Commission gives priority to the analysis of the State resources criterion over the analysis of the imputability criterion and fails to verify independently whether the requirement relating to State resources, one of the criteria for establishing the existence of State aid for the purpose of Article 107(1) TFEU, has been met.

The GC assesses that the Commission has failed to make the required distinction between the imputability to the State and the question whether the aid measure is funded through State resources.[91] First, it should be assessed whether Italy was involved in the adoption of the measure. The GC states that the aid awarded by the IDFF to Banca Tercas mainly aimed to serve the private interests of the banks that are a member of the IDFF. These interests can collide with the public interest, but this does not form an indication of involvement of the Member State. In addition, the GC concludes that the aid was not granted on the basis of a public mandate imposed by Italian law. The Italian Banking Act only requires that deposit guarantee schemes, such as the IDFF, have to make payments in the event of winding up a bank in normal insolvency proceedings, but does not oblige the IDFF to carry out other support measures. Furthermore, the GC assesses whether the IDFF was autonomous in its decision. It states that the IDFF is a private law body of which the management exists of representatives of the banks that are members of the IDFF. There was therefore no organic factor linking the IDFF and Italy. The fact that Banca d'Italia approved the aid granted by the IDFF is no indication that this aid is imputable to Italy. Also, the fact that representatives of Banca d'Italia were present at meetings of the management of the IDFF does not form such indication. Moreover, the Commission has not sufficiently demonstrated that Banca d'Italia has had decisive influence on the negotiations between the IDFF and Banca Popolare di Bari. Lastly, the fact that the trustee of Banca Tercas, which was appointed by Banca d'Italia, can request for aid at the IDFF does not mean that the IDFF has no autonomy in its decision to grant this aid. As a result, the GC

91 GC, 19 March 2019, T-98/16, T-196/16 and T-198/16, ECLI:EU:T:2019:167 (*Italy, Banca Popolare di Bari and Fondo interbancario di tutela dei depositi v Commission*), par. 70.

assesses that the Commission has not sufficiently demonstrated that Italy had significant control over the adoption of the measure by the IDFF.[92] Secondly, it should be assessed whether the resources that are used by the IDFF qualify as State resources. The GC takes into account that there is no public task for deposit guarantee schemes to intervene at banks that are in financial difficulty. The only public task that exists in Italy for deposit guarantee schemes is the payout function in case the bank is wound up in normal insolvency proceedings. Also, the role of Banca d'Italia, as described above, does not make that the resources should qualify as State resources. Lastly, the GC assesses that the contributions paid by the banks to IDFF were not compulsory on the basis of a provision of the law, but on the basis of the articles of association of the IDFF, which safeguards the discretion of the members. As a result, the resources should not be qualified as State resources. The GC annuls the decision of the Commission.[93]

<u>The extension of the Belgian Deposit Guarantee Scheme protecting shares in ARCO cooperatives</u>

The decision of the Commission to qualify the extension of the Belgian Deposit Guarantee Scheme protecting shares held by individual shareholders in the ARCO cooperatives as incompatible State aid was challenged in three instances. First, private parties brought an action before the Belgium Council of State on the basis of violation of the constitutional equality principle, because a difference in treatment was created between shareholders that were covered by the guarantee and other shareholders. The Council of State subsequently posed preliminary questions to the Constitutional Court, which, in its turn, posed preliminary questions to the ECJ. The ECJ subsequently assessed that Member States are not obliged to adopt the extension as adopted by Belgium on the basis of the DGS Directive, but are also not prevented to do so, as long as this

92 GC, 19 March 2019, T-98/16, T-196/16 and T-198/16, ECLI:EU:T:2019:167 (*Italy, Banca Popolare di Bari and Fondo interbancario di tutela dei depositi v Commission*), par. 83-132.

93 GC, 19 March 2019, T-98/16, T-196/16 and T-198/16, ECLI:EU:T:2019:167 (*Italy, Banca Popolare di Bari and Fondo interbancario di tutela dei depositi v Commission*), par. 133-161. See Nicolaides *State Aid Hub.eu* 2019 for a critical note. In his view, the IDFF was not free from the State's influence in making the decision to award the alternative measures, since it would have been obliged to compensate covered deposit holders if Banca Tercas was wound up in normal insolvency proceedings. The Commission lodged an appeal against the judgment of the GC (C-425/19 P).

is not detrimental to the effective operation of the deposit guarantee scheme and is not in violation of the TFEU, including the State aid provisions.[94] The Constitutional Court subsequently determined that the decision by the Belgian State to adopt the extension is unconstitutional, because it qualifies as unlawful aid. The Council of State annulled this decision.[95] Secondly, the ARCO cooperatives brought proceedings before the GC contesting the decision of the Commission. The ARCO cooperatives contested that the aid measure qualified as State aid and that Belgium was prohibited to pay-out the amounts under the extended deposit guarantee scheme. The GC upheld the decision from the Commission and partly dismissed the action as being inadmissible (insofar it contested the prohibition to pay-out the amounts).[96] This ties into the third action that was brought by the Belgian State before the GC in which the Belgian State also contested this prohibition on the basis of violation of the proportionality principle. The GC assessed that the prohibition was not suitable to repair the distortion of the competition as a result of the aid award. It therefore annulled the decision of the Commission insofar it related to this prohibition.[97]

National resolution fund contributions

Contributions by national resolution funds to the resolution of banks under the resolution framework involve State resources and are imputable to the State, even when financed through private contributions.[98] The management and use of these funds is decided upon in accordance with the national implementation of the BRRD with the aim of providing financial assistance to the application of resolution measures adopted by the resolution authorities for banks that have passed the public interest test. The use of the national resolution funds is triggered by the resolution measure adopted by the resolution authority.[99]

94 ECJ, 21 December 2016, C-76/15, ECLI:EU:C:2016:975 (*Vervloet c.s.*).

95 GC, 7 December 2018, T-664/14, ECLI:EU:T:2018:890 (*Belgium v Commission*), par. 26-29.

96 GC, 9 February 2018, T-711/14, ECLI:EU:T:2018:80 (*Arcofin and Others v Commission*), not published.

97 GC, 7 December 2018, T-664/14, ECLI:EU:T:2018:890 (*Belgium v Commission*), par. 84-100.

98 2013 Banking Communication, point 64. Iftinchi 2017, p. 76.

99 See for example EC, 5 October 2016, C(2016) 6417 final (SA.46066 – Croatia), par. 43 and 44; EC, 18 December 2015, C(2015) 9681 final (SA.43367 – Cooperative Central Bank Ltd), par. 70; EC, 16 December 2015, C(2015) 9349 final (SA.40441 - Magyar Kereskedelmi Bank), par.82.

For example, the measures taken by the Portuguese resolution fund in the resolution of Banco Espírito Santo, S.A. (BES), consisting of a guarantee of the capital position of Novo Banco (the bridge bank) and the underwriting of a capital instrument, which puts at risk the resources of the resolution fund to be used to buy those capital instruments, were considered by the Commission to constitute State aid.[100]

Contributions by privately managed funds

In certain Member States privately managed funds, financed on a voluntary basis by the banking sector, were set up to deal with failing banks. In order for a privately managed fund to not qualify as a State resource, the fund should not be established by the State, the State should not impose levies to finance the fund or mandate the way in which the proceeds are to be distributed to the beneficiaries and the fund should not be regarded as under public control and available to the State.[101]

In Italy, the privately managed Atlante Fund and Atlante Fund II have been put in use to recapitalise banks and to purchase portfolios of NPLs. Atlante Fund and Atlante II Fund are closed-end alternative investment funds regulated by Italian law reserved for professional investors. The funds are managed by Quaestio Capital Management SGR S.p.A. Atlante Fund's investors are 67 Italian and foreign institutions, including banks, insurance companies, banking foundations and the Cassa Depositi e Prestiti.[102] Atlante Fund may invest in banks with a lower capital ratio than the minimum established in the context of the SREP and that therefore, on request by the Italian supervisory authority, implement initiatives to reinforce capital by means of a share capital increase, and/or, the purchase of NPLs originating from a variety of Italian banks. The Atlante Fund has already been put in use to bail out two small banks (Banca Popolare di Vicenza and Veneto Banca) and to purchase portfolios of NPLs. The fund's financial objective is to realize a return of approximately 6% per annum for its investors.[103] Atlante II Fund invests

100 EC, 11 October 2017, C(2017) 6896 final (SA.49275 - BES), par. 129-132.

101 Bacon 2017, p. 63. Hadjiemmanuil *EE* 2016, p. 114.

102 Cassa Depositi e Prestiti is a joint-stock company under public control, with the Italian government holding 80.1% and a broad group of bank foundations holding 18.4%, the remaining 1.5% in treasury shares. Cassa Depositi e Prestiti manages a major share of the savings of Italians, which represent its main source of funding.

103 Quaestio Capital Management SGR S.p.A., Atlante Fund Presentation, 29 April 2016, p. 4-6.

in so-called mezzanine and junior financial instruments, issued by vehicles constituted for purchasing NPL portfolios originating from a variety of Italian banks. It is also made possible for the Atlante II Fund to take advantage of the re-rating of the originator banks. Both the Italian State and the Commission do not consider the bailouts by the Atlante Fund to qualify as State aid.[104] The Atlante II Fund was involved in the recapitalisation of the Italian bank Monte dei Paschi di Siena (MPS).[105] It bought 95% of the mezzanine notes relating to the securitization of MPS Group's bad debts portfolio.

The use of a private investor protection scheme in the rescue of Roskilde Bank was also not considered to constitute the transfer of State resources imputable to the State. Det Private Beredskab, an association created by the Danish Bankers Association,[106] agreed to provide a guarantee to Danish National Bank for a loan that was provided to Roskilde Bank by the Danish National Bank. Given that Det Private Beredskab was exclusively based on the voluntary membership of private institutions, that the members of its highest authority came from the private sector, that the members from the private banks had the right of veto in the decision-making body and that the commitment assumed by Det Private Beredskab's members was nothing like so large as their potential commitment under the Deposit Guarantee Fund, the Commission considered that no State resources were involved in the financing of the guarantee provided by Det Private Beredskab to the Danish National Bank on 11 July 2008.[107]

104 The involvement of the Atlante Fund was cleared under State aid rules, since the Commission concluded that Cassa di Depositi e Prestiti (a public shareholder) invested pari passu with private investors. EP, Briefing – The orderly liquidation of Veneto Banca and Banca Popolare di Vicenza, 25 July 2017, PE.602.094, p. 4.

105 EC, 4 July 2017, C(2017) 4690 final (SA.47677 – MPS), par. 54.

106 This was not a deposit guarantee scheme within the meaning of the DGS Directive.

107 EC, 31 July 2008, C(2008)4138 final (NN 36/2008 – Roskilde Bank), par. 31.

3.3.2 Advantage

State aid constitutes an economic advantage that the recipient would not have obtained under normal market conditions, that is to say in the absence of State intervention.[108] An advantage therefore only qualifies as State aid, if this concerns a non-market conform advantage. Only the effect of the measure on the undertaking is relevant, and not the cause or the objective of the State intervention. To assess this, the financial situation of the undertaking following the measure should be compared with its financial situation, if the measure had not been taken.[109] In order to assess whether actions by public authorities give an advantage to an undertaking, the '*market economy operator principle*' has been developed by the EU Courts under which the actions of a Member State are compared with a hypothetical private market participant in comparable market circumstances.[110] Depending on the type of transaction, the market economy operator principle applies in different forms. Where the Member State acts as an investor, the '*market economy investor principle*' is applied. The '*market economy creditor principle*' has been developed for cases where the Member State acts as a creditor. Lastly, the '*private vendor principle*' applies when the Member State acts as the seller.

> With the introduction of the resolution framework, the political sensitivity of the market economy operating principle has increased, taking into account that, when Member State support qualifies as State aid, it may trigger resolution.[111] Examples of aid measures that were granted after the introduction of the resolution framework and that did not qualify as State aid according to the Commission, because there was no advantage to the aid beneficiary are: the additional aid measures to HSH Nordbank,[112] the recapitalisation of CEC Bank,[113] the recapitalisation of Nord/LB, including the award of guarantees,[114] the

108 Notice on the notion of State aid, point 66. Hancher, Ottervanger and Slot 2016, p. 502.
109 Notice on the notion of State aid, point 67.
110 Heimler and Jenny *Oxford Review of Economic Policy* 2012, p. 353.
111 See section 5.3.2.
112 EC, 2 May 2016, C(2016) 2689 final (SA.29338 and SA.44910 – HSH Nordbank), par. 63-121.
113 EC, State aid: Commission approves market conform recapitalisation of Romanian CEC Bank, 29 October 2019, IP/19/6190.
114 EC, 5 December 2019, C(2019) 8821 final (SA.49094 – NordLB), par. 108-211.

Italian securitization scheme,[115] and the Greek Hellenic asset protection scheme (Hercules, based on the Italian securitization scheme).[116] In the author's view, these decisions should be met with scrutiny, as they are diametrically opposed to the promise of the resolution framework to obviate the need for the use of taxpayers' money for saving failing banks to the greatest extent possible.[117]

3.3.2.1 Market economy investor principle

The EU Courts have developed the '*market economy investor principle*' to identify the presence of State aid in cases of public investment (in particular, capital injections).[118] To determine whether a public body's investment constitutes State aid, it is necessary to assess whether, in similar circumstances, a private investor of a comparable size operating in normal conditions of a market economy could have been prompted to make the investment in question.[119] In most obvious cases, the State invests *pari passu* with private investors, meaning those private investors and the State share the same risks and rewards.

This was, for example, the case in relation to a capital injection by the Austrian State in Hypo Steiermark. This injection was held not to be aid where private investors subscribed to 75% of the capital increase.[120]

115 EC, 10 February 2016, C(2016) 873 final, (SA.43390 – Italian Securitization Scheme), paras. 79-80.

116 EC, 10 October 2019, C(2019) 7309 final (SA.53519 - Hellenic Asset Protection Scheme).

117 Recital (1) BRRD. FT, EU's green light for NordLB rescue provokes backlash, 8 December 2019. In a speech on 25 January 2016, the Commission also acknowledged the delicacy of the market economy operator principle. It was then stated that "*(…) the Commission will continue applying a clear and consistent definition of State aid to preserve equality of treatment and a level playing field between all member States. If we don't do that rigorous examination, then the whole system of resolution, and consequently the whole Banking Union, will be undermined, to the detriment of all.*" (EC, Banking Union and Competition "From Bail out to bail in: laying foundations for a restructured banking sector in Europe", speech in Lisbon, 25 January 2016).

118 See for an extensive discussion of the market economy investor principle Nicolaides 2017, p. 87-106.

119 Notice on the notion of State aid, point 74.

120 EC, 22 June 2009, C(2009) 5802 final (NN 40/2009 – Hypo Steiermark), par. 15-16.

In less obvious cases, the Commission has to determine, on the basis of relevant benchmarks, whether the terms of the transaction are acceptable to private investors.[121]

> In the case of ING, it was in debate whether the amendment to the repayment terms of the capital injection by the Netherlands constituted State aid. The Commission decided that the amendment constituted State aid, because it would result in an additional advantage for ING. The Netherlands and ING brought actions against this decision before the GC. The GC held in a judgment of 2 March 2012 that the Commission cannot evade its obligation to assess the economic rationality of the amendment to the repayment terms in the light of the private investor test solely on the ground that the capital injection subject to repayment itself already constituted State aid.[122] The Commission appealed the judgment before the ECJ, but also took a new decision in which it concluded that a market economy private investor would not have agreed to those new terms. It therefore decided, again, that the amendment constituted State aid.[123] The ECJ upheld the judgment of the GC. It assessed that an economic advantage must be assessed in the light of the private investor test, if it appears that the Member State concerned has conferred that advantage in its capacity as shareholder of the undertaking belonging to it. Where it appears that the private investor test may be applicable, the Commission is under a duty to ask the Member State concerned to provide it with all relevant information enabling it to determine whether the conditions governing the applicability and the application of the test are met. It furthermore considers that any holder of securities in whatever amount and of whatever nature may wish or agree to renegotiate the conditions of their redemption. It is, consequently, meaningful to compare the behaviour of the State in that regard with that of a hypothetical private investor in a comparable position. What is decisive in the context of that comparison is whether the amendment to the repayment terms of the capital injection has satisfied an economic rationality test, so that a private investor might also be in a position to accept such an amendment,

121 EP Bail-in Analysis 2016, p. 11.
122 GC, 2 March 2012, T-29/10 and T-33/10, ECLI:EU:T:2012:98 (*Netherlands and ING v Commission*), par. 99.
123 EC, 11 May 2012, C(2012) 3150 final (SA.28855 – ING), par. 117-156.

in particular by increasing the prospects of obtaining the repayment of that injection.[124]

Another example of the application of the market economy investor principle is the participation of the State and private investors in Dexia. In this case, the Commission decided, albeit that the State and private investors participated on the same terms, that these terms were accepted at the height of the financial crisis under entirely abnormal conditions. The Commission subsequently considered that the market economy investor principle only applies under normal market conditions and considered the participation of the State to be State aid.[125] This approach has however been criticized in literature.[126]

Another – more recent – example concerns the Italian securitization scheme designed to assist Italian banks to move NPLs off their balance sheets. The Commission assessed that this scheme did not qualify as State aid, since the pricing structure provided was in line with market conditions. The risk taken by the State by guaranteeing the senior notes issued by the securitization vehicle buying the non-performing loans was remunerated at a level which a market operator would require, including a strong link between the risk taken and the composition of the benchmark basket as well as between the time during which that risk was retained and the remuneration paid.[127]

3.3.2.2 Market economy creditor principle

Similarly, the EU Courts have developed the '*market economy creditor principle*' to examine whether debt renegotiations by public creditors involve State aid, comparing the behaviour of a public creditor to that of hypothetical private creditors that find themselves in a similar situation.[128] In the

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124 ECJ, 3 April 2014, C-224/12 P, ECLI:EU:C:2014:213 (*Commission v Netherlands and ING*), par. 29-38. See also Panero Rivas *EStAL* 2014; Nicolaides 2017, p. 97-99 with a critical note on the application of the private investor principle in this case; Cyndecka *EStAL* 2019 on the burden of proof.

125 EC, 26 February 2010, C(2010) 1180 final (C9/09 – Dexia), par.126. Bacon 2017, p. 368.

126 Bacon 2017, p. 368. See also, Gilliams *E.L. Rev.* 2011, p. 4-5.

127 EC, 10 February 2016, C(2016) 873 final, (SA.43390 – Italian Securitization Scheme), paras. 79-80.

128 Notice on the notion of State aid, point 74.

case *Commission v FIH Holding*, the ECJ had to assess whether Denmark acted as a market economy creditor.[129]

> By its appeal in this case, the Commission requested the ECJ to set aside the judgment of the GC[130] in which it annulled the decision from the Commission that the asset transfer from FIH Group to the Danish Financial Stability Company constituted State aid. This asset transfer took place following a previous capital injection and guarantee by the Danish State that were both authorized as compatible State aid by the Commission. The GC annulled the decision from the Commission, because it assessed that the Commission had used an incorrect reference framework for its analysis. In its judgment the GC stressed that: "*64 […] an economic operator in a situation such as that in the present case, in which it has previously granted a capital injection and a guarantee to the company concerned, is akin to a private creditor seeking to minimise its losses rather than a private investor seeking to maximise the profitability of the funds that it might invest where it so wishes.*"
>
> In the appeal, the ECJ considered that the risks to which the State is exposed and which are the result of State aid that it previously granted are linked to its actions as a public authority and are not among the factors that a private operator would, in normal market conditions, have taken into account in its economic calculations. This consideration applies, in particular, to the obligations arising for the State from loans and guarantees previously granted to an undertaking and constituting State aid. Taking those obligations into account in the assessment of State measures adopted in favour of the same undertaking would be liable to prevent those measures from being classified as State aid even though they do not satisfy normal market conditions, on the sole ground that they prove economically more advantageous for the State than if they had not been adopted. Such a consequence would compromise the objective of ensuring undistorted competition.[131] The Commission was therefore correct in not taking into account the risks attached to the previous capital injection and guarantee in its assessment of the asset transfer. The ECJ set aside the judgment of the GC.

129 ECJ, 6 March 2018, C-579/16, ECLI:EU:C:2018:159 (*Commission v FIH Holding*).
130 GC, 15 September 2016, T-386/14, ECLI:EU:T:2016:474 (*FIH Holding v Commission*).
131 ECJ, 6 March 2018, C-579/16, ECLI:EU:C:2018:159 (*Commission v FIH Holding*), par.58-59.

This judgment is not undisputed. According to Nicolaides the ECJ does not seem to consider that the aid-equivalent may be less than the total amount of the measures taken, in which case the risks to which the State is exposed as a result of the non-State aid element can be taken into account when assessing the economic rationality of the measure. [132] Van Lambalgen on the other hand approves on the approach of the ECJ, taking the general market economy operator principle as a starting point without specifying whether it concerns the application of the market economy investor principle or the market economy creditor principle. In his view, the true attention point is that risks attached to previous measures cannot be taken into account, when a private market operator would never have taken such previous measures.[133] The author tends to concur with the view of Van Lambalgen.

3.3.2.3 Private vendor principle

Finally, the EU Courts have developed the '*private vendor principle*' to assess whether a sale carried out by a public body involves State aid, considering whether a private vendor under normal market conditions, could have obtained the same or a better price. [134] The scope of the private vendor principle has been further elaborated in the judgment of the ECJ that was rendered on 24 October 2013 in *Land Burgenland v Commission*.[135]

This case concerned the decision from the Commission that Austria had granted incompatible aid in the process of the privatisation of Bank Burgenland to its buyer GRAWE. GRAWE was one of the two bidders in the public tender. It made a lower bid than the other bidder, but Bank Burgenland was nonetheless sold to GRAWE. The Commission examined whether the seller of Bank Burgenland, which was Land Burgenland, had behaved like a seller operating in a market economy. The Commission considered that a private vendor might accept a lower bid, in case the sale to the highest bidder is not realisable or consideration of factors other than the price is

132 Nicolaides *State Aid Hub.eu* 2018.

133 Van Lambalgen *NTER* 2018, p. 111. See also Cyndecka *EStAL* 2018, p. 552 and Cyndecka *EStAL* 2018.

134 Notice on the notion of State aid, point 74. See also EC, 21 January 2019, C(2019) 168 final (SA.51650 – Hypo Steiermark), par. 16-25.

135 ECJ, 24 October 2013, C-214/12 P, C-215/12 P and C/223/12 P, ECLI:EU:C:2013:682 (*Land Burgenland, Austria and GRAWE v European Commission*).

justified. In this case however, the Commission found no justification for excluding the bidder with the higher bid as a buyer. The ECJ recalled in its judgment in relation to this case that only the benefits and obligations linked to the situation of the State as shareholder – to the exclusion of those linked to its situation as a public authority – are to be taken into account. In this case, the choice of Austria to sell Bank Burgenland to GRAWE was based on the expectation that a sale to GRAWE would less likely result in reliance on a legal guarantee provided by Austria in the case of insolvency. This was however an obligation of Austria that was linked to its situation as a public authority, which therefore should not be taken into account in applying the private vendor principle. In addition, if a Member State relies on a test, such as the private vendor test, it must, where there is doubt, establish unequivocally and on the basis of objective and verifiable evidence that the measure implemented is to be ascribed to the State acting as shareholder.[136] Land Burgenland failed in providing this evidence. [137]

3.3.3 Selectivity

To fall within the scope of Article 107(1) TFEU, a State measure must favour 'certain undertakings or the production of certain goods'. Measures of purely general application which do not favour certain undertakings or the production of certain goods do not fall within the scope of Article 107(1) TFEU.

To clarify the element of selectivity under State aid law, one should distinguish between material and regional selectivity. The material selectivity of a measure implies that the measure applies only to certain (groups of) undertakings or certain sectors of the economy in a given Member State. Material selectivity can be established *de jure* or *de facto*. *De jure* selectivity results directly from the legal criteria for granting a measure that is formally reserved for certain undertakings only. *De facto* selectivity can be established in cases where, although the formal criteria for the application of the measure are formulated in general and objective terms, the structure of the measure is such that its effects significantly favour a particular group of undertakings. General measures which *prima facie* apply to all

136 ECJ, 24 October 2013, C-214/12 P, C-215/12 P and C/223/12 P, ECLI:EU:C:2013:682 (*Land Burgenland, Austria and GRAWE v European Commission*), par. 57.
137 See also Nicolaides 2017, p. 99-103.

undertakings but are limited by the discretionary power of the public administration are selective. This is the case where meeting the given criteria does not automatically result in an entitlement to the measure.[138] In addition, in principle, only measures that apply within the entire territory of a Member State escape the regional selectivity criterion laid down in Article 107(1) TFEU.[139]

> Where a Member State reacts to a banking crisis not with selective measures in favour of individual banks, but with general measures open to all comparable market players in the market (e.g. lending to the whole market on equal terms), these general measures are often outside the scope of the State aid rules and do not need to be notified to the Commission. The Commission considers for instance that activities of central banks related to monetary policy, such as open market operations and standing facilities, are not caught by the State aid rules because they are not selective in favour of individual banks.[140] This does however not mean that aid schemes cannot be selective. They can be selective and qualify as State aid, if they are targeted at a certain sector, such as the financial sector.[141]

3.3.4 Undertakings

The State aid rules only apply where the beneficiary of the measure is an undertaking. Undertakings are entities engaged in economic activity, regardless of their legal status and the way in which they are financed.[142] An economic activity is an activity consisting in offering goods and services on a market. Where the activity in question forms part of the essential functions of the State or is connected with those functions by its nature, its aim and the rules to which it is subject, the State aid rules do not apply.[143]

> The question whether or not the beneficiary of an aid measure is an undertaking was addressed by the Commission in relation to the liquidation of the Bank of Peloponnese. The Bank of Peloponnese was

138 Notice on the notion of State aid, point 120-123.
139 However, measures with a regional or local scope of application may not be selective, if certain requirements are fulfilled. Notice on the notion of State aid, point 142-143.
140 2008 Banking Communication, point 51. Bacon 2017, p. 368.
141 See section 3.5.7.
142 Notice on the notion of State aid, point 7.
143 Notice on the notion of State aid, point 17.

put in liquidation as a result of which it would no longer carry out economic activities on the banking market. Its customer and bank deposits were transferred to a third party. The Greek Resolution Fund covered the funding gap (that is, the difference between the value of the assets and the value of the liabilities transferred from the Bank of Peloponnese to the buyer). The support by the resolution fund, that is to say the financing of the funding gap, would constitute aid to the transferred assets and liabilities within the meaning of Article 107(1) TFEU, but only if they together constituted an undertaking. In order to conclude whether there is aid to an undertaking, it should be assessed whether the transfer of the assets and liabilities entails the transfer of an economic activity. The Commission considered that the fact that loans were not transferred to the buyer but remained with the Bank of Peloponnese into liquidation, the fact that no branch was transferred and the lack of automatic transfer of labour contracts contributed to the conclusion that there was no transfer of an economic activity. The transferred liabilities (that is to say deposits) could not be considered to be the beneficiary of State support, as they do not constitute an 'undertaking'. Therefore, the resolution support constituted neither aid to the liquidated entity nor aid to the transferred assets and liabilities.[144] The Commission also considered that no State aid was provided to the buyer, since (i) the sale process was open, unconditional and non-discriminatory; (ii) the sale took place on market terms; and (iii) the bank or the government maximised the sale price for the assets and liabilities involved.[145]

3.3.5 *Distorts or threatens to distort competition and affect trade between Member States*

A measure granted by a Member State is considered to distort competition when it is liable to improve the competitive position of the recipient compared to other undertakings with which it competes. A distortion of competition is generally found to exist when a Member State grants a financial advantage to an undertaking in a liberalised sector where there is, or could be, competition. Public support is liable to distort competition even if it

144 EC, 17 December 2015, C(2015) 9682 final, (SA.43886 – Cooperative Bank of Peloponnese), par. 35-39. See Nicolaides *State Aid Hub.eu* 2016 for a critical note.

145 EC, 17 December 2015, C(2015) 9682 final, (SA.43886 – Cooperative Bank of Peloponnese), par. 40-43.

does not help the recipient undertaking to expand and gain market share. It is enough that the aid allows it to maintain a stronger competitive position than it would have had if the aid had not been provided.[146]

As regards the conditions relating to the effect on trade between Member States and the distortion of competition capable of being caused by the aid, it should be noted that, for the purpose of categorising a national measure as State aid, it is not necessary to establish that the aid has a real effect on trade between Member States and that competition is actually being distorted, it being necessary only to examine whether that aid is liable to affect trade and distort competition.[147]

Public support can be considered capable of having an effect on trade between Member States even if the recipient is not directly involved in cross-border trade.[148] However, an effect on trade between Member States cannot be merely hypothetical or presumed. It must be established why the measure is liable to have an effect on trade between Member States, based on the foreseeable effects of the measure.[149]

> The Commission and the EU Courts generally consider the banking sector a sector characterised by intense international competition. State aid in the banking sector is therefore generally considered by the Commission to have the potential to distort competition and affect trade within the EU.[150]

146 Notice on the notion of State aid, point 187, 189.

147 Notice on the notion of State aid, point 190. ECJ, 5 March 2015, C-667/13, ECLI:EU:C:2015:151 (*Estado português v Banco Privado Português SA and Massa Insolvente do Banco Privado Português SA*), par. 46; ECJ, 15 December 2015, C-148/04, ECLI:EU:C:2005:774 (*Unicredito Italiano*), par. 54; ECJ, 10 January 2006, C-222/04, ECLI:EU:C:2006:8 (*Cassa di Risparmio di Firenze and Others*), par. 140; ECJ, 8 May 2013, C-197/11 and C-203/11, ECLI:EU:C:2013:288 (*Libert and Others*), par. 76; ECJ, 14 January 2015, C-518/13, ECLI:EU:C:2015:9 (*Eventech*), par. 65; ECJ, 21 December 2016, C-76/15, ECLI:EU:C:2016:975 (*Paul Vervloet cs v Ministerraad*), par. 102.

148 Notice on the notion of State aid, point 191.

149 Notice on the notion of State aid, point 195.

150 ECJ, 21 December 2016, C-76/15, ECLI:EU:C:2016:975 (*Paul Vervloet cs v Ministerraad*), par. 105. ECJ, 5 March 2015, C-667/13, ECLI:EU:C:2015:151 (*Estado português v Banco Privado Português SA and Massa Insolvente do Banco Privado Português SA*), par. 51. ECJ, 10 January 2006, C-222/04, ECLI:EU:C:2006:8 (*Cassa di Risparmio di Firenze and Others*), par. 142, 145. Bacon 2017, p. 369-370. Nicolaides 2017, p. 96.

3.4 The State aid regime for the banking sector

This section describes the legal outline and scope of the current State aid regime for the banking sector.

3.4.1 The legal outline

The legal outline of the State aid regime for the banking sector is described in this section along the lines of the primary and secondary law sources of EU law.[151]

3.4.1.1 The primary law sources

The primary law sources for the State aid regime for the banking sector are Articles 107, 108 and 109 TFEU.

Article 107 TFEU
The basic substantive rules on the control of State aid in the EU are set out in Article 107 TFEU. Article 107(1) TFEU prohibits any form of State aid that distorts competition by favouring certain firms or the production of certain goods in so far as it affects trade between EU Member States. This prohibition is directed to the Member States and has been put in place to avoid subsidy races and to ensure a level playing field in the single market.[152] The prohibition is not absolute. Article 107(2) and 107(3) TFEU provide a basis for the Commission to approve on the award of State aid.

The exemptions under Article 107(2) TFEU are mandatory. If State aid falls within one of these exemptions, the Commission has to approve the aid. It has no discretion in that respect. For example, aid making good the damage caused by natural disasters or exceptional occurrences falls under the exemptions of Article 107(2) TFEU. Another example would be aid having a social character, granted to individual consumers, provided that this aid is granted without discrimination related to the origin of the

151 The main sources of primary law are the treaties establishing the EU (the TFEU, TEU and Treaty establishing the European Atomic Energy Community), the protocols and annexes to the treaties, the treaties on accession of Member States to the EU and other treaties. Secondary law sources are legal instruments based on the Treaties and include regulations, directives, decisions, recommendations and opinions.

152 OECD Report 2007, p. 119-120.

products concerned.[153] Despite the fact that the exemptions in Article 107(2) TFEU are 'automatic' exemptions, the Commission still has to verify that the conditions laid down in Article 107(2) are met.[154]

On the basis of Article 107(3) TFEU the Commission *may* consider State aid compatible with the internal market. The Commission has a wide discretion in making an assessment whether any adverse effects are outweighed by other benefits under Article 107(3) TFEU. The categories of aid that may be considered compatible with the internal market under Article 107(3) TFEU are:

a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of the regions referred to in Article 349 TFEU, in view of their structural, economic and social situation;
b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;
c) aid to facilitate the development of certain economic activities or of certain economic areas, where this aid does not adversely affect trading conditions to an extent contrary to the common interest;
d) aid to promote culture and heritage conservation where this aid does not affect trading conditions and competition in the EU to an extent that is contrary to the common interest;
e) such other categories of aid as may be specified by decision of the Council on a proposal from the Commission.

The Council may also specify by decision, on a proposal from the Commission, categories of aid that may be considered compatible with the internal market under Article 107(3) TFEU, other than the categories set out under (a) to (d) of Article 107(3) TFEU.[155]

> An example of the use of this power was Council Directive 90/684/EEC of 21 December 1990 on aid to shipbuilding. This Council Directive applied until 31 December 1995.

153 See for an example: EC, 28 June 2016, C(2016) 3929 final (SA.45004 – Cyprus).
154 State Aid Manual of Procedures, section 1-4.
155 Article 107(3)(e) TFEU.

Article 108 TFEU
Article 108 TFEU sets out the procedures for the examination of State aid. These are different, depending on whether the aid is existing or new.

Under Article 108(3) TFEU *new* State aid must be notified to the Commission in sufficient time and may not be implemented until the assessment by the Commission has led to a final decision (the 'standstill obligation'). If the Commission, following its assessment, considers that a State aid measure is not compatible with the internal market, having regard to Article 107 TFEU, the Member State concerned will have to abolish or alter this aid within a period of time to be determined by the Commission (Article 108(2) TFEU).[156] The standstill obligation does not apply where aid falls within the scope of the General Block Exemption Regulation[157], can be classified as *de minimis* aid[158] or is covered by an authorised aid regime.[159] The procedures that are followed by the Commission in order to assess new State aid are further specified in the Procedural Regulation of the Council[160] and the Implementing Regulation of the Commission,[161] as further discussed in section 3.4.1.2, and the case-law of the EU Courts.

Under Article 108(1) TFEU *existing* aid may be lawfully implemented as long as the Commission has made no finding of incompatibility.[162] 'Existing aid', *inter alia,* includes authorised aid, that is to say, aid schemes and individual aid which have been authorised by the Commission.[163] The Commission, in cooperation with Member States, keeps under constant review all systems of existing aid.[164] That review may prompt the Commission to propose to the Member State concerned the appropriate measures required by the progressive development or by the functioning of the internal market and, if necessary, to decide to abolish or alter aid which it considers to be incompatible with the internal market.[165]

156 Article 108(2) TFEU.
157 See section 3.4.1.2.
158 See section 3.4.1.2.
159 See section 3.5.7. Nicolaides 2008, p. 93. State aid Manual of Procedures, sections 5-3 up to 5-5.
160 Council Regulation (EU) 2015/1589, which replaced as of 14 October 2015 Council Regulation (EC) No 659/1999 (the Procedural Regulation).
161 Commission Regulation (EC) No 794/2004, as lastly amended by Commission Regulation (EU) 2015/2282 (the Implementing Regulation).
162 ECJ, 29 November 2012, C-262/11, ECLI:EU:C:2012:760 (*Kremikovtzi*), par. 49.
163 Article 1(b) Procedural Regulation.
164 Article 108(1) TFEU.
165 ECJ, 18 July 2013, C-6/12, ECLI:EU:C:2013:525 (*Korkein hallinto-oikeus*), par. 40.

Article 108(2) TFEU forms the basis for the State aid assessment by the Council, which can take place in exceptional circumstances, as further discussed in section 3.5.1.3.

Article 109
Article 109 TFEU enables the adoption of Council regulations, as further discussed in section 3.4.1.2.

3.4.1.2 The secondary law sources

The secondary law sources for the State aid regime for the banking sector consist of Council and Commission regulations and soft-law instruments.

Council and Commission regulations
Pursuant to Article 109 TFEU, the Council may make any appropriate regulations for the application of Articles 107 and 108 TFEU on a proposal from the Commission and after consulting the European Parliament. It may in particular determine the conditions in which Article 108(3) TFEU (the standstill obligation) shall apply and the categories of aid exempted from this procedure. In its regulations, the Council can empower the Commission to adopt regulations.

In the late 1990s two Council Regulations were proposed by the Commission and adopted by the Council. The first is the Enabling Regulation[166] which gives the Commission the authority to exempt entire categories of aid from the notification requirement. That is, it allows the Commission to issue its own regulations within limits established by the Council. On the basis of the Enabling Regulation the Commission has published the General Block Exemption Regulation (GBER)[167] and the *De Minimis* Regulation.[168] These regulations are not of much importance to the application of the State aid rules in the banking sector, since the GBER does not apply to aid to undertakings in difficulty[169] and the aid granted to failing banks normally exceeds the thresholds in the *De Minimis* Regulation.[170]

166 Council Regulation (EU) 2015/1588 (the Enabling Regulation).
167 Commission Regulation (EU) No 651/2014, as amended by Commission Regulation (EU) 2017/1084 (the GBER).
168 Commission Regulation (EU) No 1407/2013 (the *De Minimis* Regulation).
169 Article 1(4)(c) GBER, as amended.
170 See Article 3 *De Minimis* Regulation.

The second Council regulation is the Procedural Regulation that codifies the decision-making procedures that apply to State aid policy. This regulation is of much importance to the application of the State aid rules in the banking sector, since it sets out the procedure that is followed by the Commission in its assessment of State aid measures in the banking sector, as further discussed in section 3.5. The Procedural Regulation is accompanied by the Implementing Regulation of the Commission setting out detailed implementing rules as regards the form and content of notifications, time limits and annual reports.

Soft law instruments

The Commission is not empowered to lay down general and abstract binding rules governing the conditions for application of Article 107 TFEU. Commission policy therefore derives from (the predecessors of) the TFEU, case-law of the EU Courts and the Commission's own rules and experience.[171] These own rules take the form of guidelines, frameworks, communications, codes and even at times letters (together referred to as 'soft law'). Soft law is used by the Commission to clarify its approach to nationally granted aid and to structure discretion in this policy area.[172] The adoption of this soft law must be solely for the purposes of making the State aid rules transparent and cannot be used for other purposes, in particular the promotion of other EU policies.[173] Soft State aid law mainly concretizes the Commission's approach towards possible exceptions to the State aid prohibition. In addition, it further substantiates procedural aspects of the Commission's assessment of State aid.

In relation to the application of the State aid rules to the banking sector, the main instrument of soft law that is used by the Commission is the 2013 Banking Communication. The Commission is bound by the 2013 Banking Communication, meaning that it may not depart from it, unless giving a valid reason for doing so, provided that it is not contrary to the TFEU or other applicable legislation.[174] This has been confirmed by the ECJ in the *Kotnik* case.[175] In accordance with settled case-law, in adopting the 2013 Banking Communication and announcing by publishing it that it will apply to the cases to which it relates, the Commission imposes a limit on the exercise of its discretion and cannot, as a general rule, depart from the

171 Cini 2000, p. 8.
172 Cini 2000, p. 17.
173 Quigley 2015, p. 265.
174 Micossi. Bruzzone and Cassella *CEPR* 2016, p. 13.
175 ECJ, 19 July 2016, C-526/14, ECLI:EU:C:2016:570 (*Kotnik v Slovenia*).

2013 Banking Communication, at the risk of being found to be in breach of general principles of law, such as equal treatment or the protection of legitimate expectations. That said, the Commission cannot waive, by the adoption of the 2013 Banking Communication, the exercise of the discretion that Article 107(3)(b) TFEU confers on it. The adoption of the 2013 Banking Communication does not therefore relieve the Commission of its obligation to examine the specific exceptional circumstances relied on by a Member State, in a particular case, for the purpose of requesting the direct application of Article 107(3)(b) TFEU, and to provide reasons for its refusal to grant such a request.[176]

The ECJ confirmed in the *Kotnik* case that the 2013 Banking Communication, being soft law, is not binding on the Member States. The 2013 Banking Communication is not capable of imposing independent obligations on the Member States. It does no more than establishing conditions, designed to ensure that State aid granted to the banks in the context of the financial crisis is compatible with the internal market, which the Commission must take into account in the exercise of the wide discretion that it enjoys under Article 107(3)(b) TFEU.[177]

> Taking into account that soft-law is not binding on the Member States, the Commission uses the following two mechanisms to make soft law practically binding for Member States: (1) soft law can be enforced indirectly via individual State aid decisions; and (2) Member States can be forced into explicit approval of soft State aid rules which then become formally binding (by opening formal investigations into all existing State aid measures that fall under the new rules, if the Member State does not act in compliance with the soft law when granting State aid).[178]

Although the 2013 Banking Communication forms the core of the State aid regime for the banking sector, there also are other instruments of soft law that are of importance for this regime, most notably in relation to the procedural rules. One could, for example, think of the Notice on the notion of State aid, the Enforcement Notice and the EC Code of Best Practices.

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176 ECJ, 19 July 2016, C-526/14, ECLI:EU:C:2016:570 (*Kotnik v Slovenia*), par. 40 and 41.

177 ECJ, 19 July 2016, C-526/14, ECLI:EU:C:2016:570 (*Kotnik v Slovenia*), par. 49.

178 Blauberger 2008, p. 17.

3.4.2 *The geographical scope*

The framework for State aid control, as contained in Articles 107 and 108 TFEU applies to 'undertakings' established in the EU. Undertakings in EFTA States participating in the EEA (Norway, Iceland and Liechtenstein) are therefore not covered by the framework for State aid control as contained in Articles 107 and 108 TFEU. The State aid rules for these countries are contained in Part IV, Chapter 2 of the EEA Agreement. These State aid rules are broadly equivalent to the State aid rules in the TFEU. The State aid rules in the EEA Agreement are enforced by the EFTA Surveillance Authority. In its enforcement of the rules, the EFTA Surveillance Authority has equivalent powers and similar functions to those of the Commission.

> In relation to the EFTA State that does not participate in the EEA (Switzerland) there is no single, centralized State aid control. One exception is the aviation sector, where the Swiss Competition Commission monitors compliance with State aid rules, as a consequence of a bilateral air transport agreement with the EU. In addition, a free trade agreement between Switzerland and the EU dating from 1972 contains a State aid prohibition modelled on the EU State aid prohibition.[179]

3.4.3 *The material scope*

The material scope of the State aid regime for the banking sector can be determined based on (i) the type of aid beneficiaries, and (ii) the type of aid measures that are in scope of this regime.

3.4.3.1 State aid beneficiaries

The State aid regime for the banking sector does actually not only apply to banks, but also to insurers:

> "25. *The Commission will apply the principles set out in this Communication and all Crisis Communications to 'credit institutions' (also referred to as 'banks') (…).*

179 Article 23(1)(iii), EC Switzerland Free Trade Agreement, 22 July 1972, OJ L300, 31/12/1972, p. 189. Peretz and Bacon 2016.

> *26. The Commission will apply the principles set out in this Communication and all Crisis Communications where appropriate mutatis mutandis to insurance companies within the meaning of Article 6 of Directive 74/239/EEC, Article 4 of Directive 2002/83/EC or Article 1(b) of Directive 98/78/EC.*
>
> *27. All aid to such institutions incorporated in a Member State, including subsidiaries of such institutions, and having significant activities in a Member State will be examined under this Communication."*[180]

Two examples of cases in which State aid was granted not to banks, but to insurers and that were assessed on the basis of the Crisis Communications are the cases of the Dutch insurance group of Aegon and the Irish insurer Quinn Insurance Ltd (QIL).

Support for Aegon

The Netherlands provided a loan of EUR 3 billion to the Aegon Association, which was subsequently transferred to Aegon N.V. (Aegon) in exchange for non-voting convertible capital securities. Aegon is the holding company of the Aegon Group, which is a global life insurance and pension group and provider of investment products. The objective of the loan was to strengthen Aegon's capital base. After the demise of Lehman Brothers, Aegon became subject to a dramatic increase in its credit default swap (CDS) spreads. Aegon incurred EUR 350 million losses from its exposure to Lehman Brothers and Washington Mutual and was forced to revalue its corporate bond portfolio by EUR 2.5 billion. In addition, it was relatively sensitive to stock market dynamics as it had sold insurance contracts that protected the policy holders against stock market losses. On the basis of the 2008 Banking Communication, the Commission considered the loan granted by the Netherlands to constitute State aid that is compatible with the internal market pursuant to Article 87(3)(b) EC Treaty. It temporarily approved the loan as rescue aid for six months on the condition that a viability plan was submitted for Aegon.[181] The Commission considered the viability plan that was subsequently submitted by the Netherlands compatible pursuant to Article 107(3)(b) TFEU, since it fulfilled the relevant criteria of the Restructuring Communication.[182]

180 2013 Banking Communication, point 25-27.
181 EC, 27 November 2008, C(2008) 7734 final (N569/2008 – Aegon N.V.).
182 EC, 17 August 2010, C(2010) 5740 final, (N372/2009 – Aegon N.V.).

Support for QIL
The Irish insurer QIL was put into administration on 30 March 2010 following the establishment of an ongoing breach of the regulatory capital requirements and issues surrounding QIL's ability to comply with supervisory regulation and the way it was being managed. The administrators applied to the High Court of Ireland for a contribution of EUR 738 million by the Insurance Compensation Fund (ICF) to enable them to restructure QIL by selling its viable activities, continue a limited part of the UK operations until the end of 2012 and immediately discontinue the non-viable product lines. The Commission considered the contribution by the ICF to constitute State aid that is compatible with the internal market pursuant to Article 107(3)(b) TFEU. In order to come to that conclusion, the Commission applied the Impaired Assets Communication and Restructuring Communication.[183]

The 2013 Banking Communication also applies to the examination of aid to subsidiaries of banks (and insurers) having significant activities in a Member State. It is not specified when a subsidiary has significant activities in a Member State.[184]

In order for cases to be assessed on the basis of the State aid regime for the banking sector, it is however not necessary that the bank, insurer or subsidiary is the aid *beneficiary*. This is the entity that has the advantage of, or benefits from, the State aid. There can be multiple aid beneficiaries at the same time.

In the case of the restructuring of Kaupthing Bank Luxembourg, the interbank creditors, the economic activities that were taken over by Blackfish Capital and Kaupthing Bank Luxembourg were considered the beneficiaries of a loan from the Luxembourg State to Kaupthing Bank Luxembourg. The bank's depositors, the SPV to which commercial loans were transferred, the Belgian branch's operations and the buyers were not considered aid beneficiaries. [185]

183 EC, 12 October 2011, C(2011) 7266 final, (SA.33023 – Quinn Insurance Ltd). Other examples can be found in EIOPA Opinion 2017, p. 58.
184 To the best of the author's knowledge this term has not further been explained in the decisions taken by the Commission in the banking sector. It could be that this term is meant to follow the explanation given thereto in Article 51(1) CRD IV.
185 EC, 9 July 2009, C(2009) 5640 final (N 344/2009 and N 380/2009 – Kaupthing Bank Luxembourg), par. 36-51.

Eligibility criteria

Under the 2004 R&R Guidelines rescue and restructuring aid was only available for banks that were 'in difficulty'. The Commission considered a bank as being in difficulty where it was unable, whether through its own resources or with the funds it was able to obtain from its owners/shareholders or creditors, to stem losses which, without outside intervention by the public authorities, would almost certainly condemn it to going out of business in the short or medium term.[186]

> In the case of Northern Rock, the UK authorities assert the Commission that the bank would fulfil the criteria under domestic law for being the subject of collective insolvency proceedings, if it were not for the measures granted by the Bank of England. The Commission agreed with this statement and considered Northern Rock to qualify as a firm in difficulty.[187]

The 2013 Banking Communication does not contain a similar criterion. Indeed, during the GFC many banks were supported not because they were in difficulty, but in order to prevent them from further restricting their lending exposure to the real economy.[188] The 2013 Banking Communication does however provide that certain State aid measures are only available for banks without a 'capital shortfall'. A capital shortfall refers to a capital shortfall established in a capital exercise, stress-test, asset quality review or an equivalent exercise at EU, Eurozone or national level, where applicable confirmed by the competent authority (being a national competent authority or the ECB).[189] Funding schemes and liquidity support schemes must, for example, be restricted to banks which have no capital shortfall. If

186 2004 R&R Guidelines, point 9. In particular, a bank was, in principle and irrespective of its size, regarded as being in difficulty in the following circumstances: (a) in the case of a limited liability company, where more than half of its registered capital had disappeared and more than one quarter of that capital had been lost over the preceding 12 month, (b) in the case of a company where at least some members had unlimited liability for the debt of the company, where more than half of its capital as shown in the company accounts had disappeared and more than one quarter of that capital had been lost over the preceding 12 months; or (c) whatever the type of company concerned, where it fulfilled the criteria under its domestic law for being the subject of collective insolvency proceedings. 2004 R&R Guidelines, point 10.

187 EC, 5 December 2007, C(2007) 6127 final (NN 70/2007 – Northern Rock), par. 41.

188 Hancher, Ottervanger and Slot 2016, p. 556.

189 2013 Banking Communication, point 28.

a bank with a capital shortfall is in urgent need of liquidity, an individual notification to the Commission is required.[190]

> Regarding the definition of 'capital shortfall' in the context of a request for a State guarantee, the ECB understands that this definition encompasses, in line with pre-existing supervisory decisions and practice, the threshold used in the relevant national, Union or SSM-wide stress test or asset quality review which combines own funds requirements under Article 92 CRR with the additional benchmarks established by the competent authority.[191]

3.4.3.2 State aid measures

The State aid measures that are in scope of the State aid regime for the banking sector are rescue aid, restructuring aid and liquidation aid.

Rescue aid

Rescue aid is by nature temporary and reversible assistance. Its primary objective is to make it possible to keep an ailing firm afloat for the time needed to work out a restructuring or liquidation plan. The Member State concerned should notify rescue aid to the Commission before it actually grants the rescue aid. Because of urgency this appears to be a rule that is rarely observed in practice.[192] One of the conditions for the temporary approval of rescue aid, is that it is accompanied, on notification, by an undertaking given by the Member State applying for the approval of the aid to communicate to the Commission, a restructuring or liquidation plan or proof that the rescue aid has been reimbursed in full and/or terminated.

Restructuring aid

Once a restructuring plan for which aid has been requested has been established and is being implemented, all further aid will be considered as restructuring aid.[193] This includes aid which was already temporarily authorised by the Commission as rescue aid.[194] Restructuring is, in many cases, the follow-up of rescue aid.

190 2013 Banking Communication, point 58.
191 ECB Opinion 2017, par. 3.4.
192 Quigley 2009, p. 300, 302.
193 2004 R&R Guidelines, point 16.
194 Restructuring Communication, footnote 1.

Liquidation aid

The 2008 Banking Communication introduced the concept of liquidation aid. Liquidation can take place as a second step, after rescue aid to a bank when it becomes clear that the latter cannot be restructured successfully, or in one single action. Liquidation aid can be required in order to safeguard an orderly liquidation procedure.[195] If the liquidation of the bank involves the sale of (parts of) this bank, the liquidated entity, the economic activity to be sold or the buyer can be the beneficiary of the State aid.

Rescue, restructuring and liquidation aid can be granted in the form of:

1. Liquidity measures: Liquidity assistance can be provided in a number of forms, such as credit lines or loans.

2. Funding guarantees: Funding guarantees can be used to protect retail deposits (and debt held by retail clients), certain types of wholesale deposits and even short and medium-term debt instruments.[196]

> Liquidity measures and funding guarantees are considered by the Commission to be *non-structural* in nature, because their aim is to temporarily support a company confronted with an important deterioration of its financial situation reflected by an acute liquidity crisis or technical insolvency. This non-structural aid support should allow time to analyse the circumstances which gave rise to the difficulties and to develop an appropriate plan to remedy those difficulties by stabilizing the liability side of the balance sheet of the bank.[197] Rescue aid normally takes the form of liquidity measures or funding guarantees.

3. Recapitalisation: Recapitalisation implies the provision of public funds so as to strengthen the capital base of the banks directly or to facilitate the injection of private capital by other means. Recapitalisation measures take the form of the purchase by a Member State of equity (voting or non-voting), other Tier 1 capital or Tier 2 capital.[198]

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195 2008 Banking Communication, points 43 – 50.
196 2008 Banking Communication, points 19-23.
197 2004 R&R Guidelines, point 15. Laprévote and Coupé 2017, p. 110.
198 2008 Banking Communication, points 17 and 34. See Iftinchi 2017, p. 69 about the use of hybrid instruments for recapitalisation.

4. Asset relief measures: Asset relief measures (or impaired asset measures) include aid in the form of guarantees or asset purchases. Asset relief measures are State aid inasmuch as they free the beneficiary bank from (or compensate for) the need to register either a loss or a reserve for a possible loss on its impaired assets and/or free regulatory capital for other uses. This would notably be the case where impaired assets are purchased or insured at a value above the market price, or if the price of the guarantee does not compensate the State for its possible maximum liability under the guarantee.[199]

> Recapitalisations and asset relief measures are considered to be *structural*, because they are designed to address deficiencies in the recipient's balance sheet. During the GFC, the Commission also approved recapitalisations and impaired assets measures on a temporary basis as rescue aid in order to meet the desire of Member States to act quickly. Under the 2013 Banking Communication, the Commission restored the principle that recapitalisation and asset relief measures are in principle only authorised once the bank's restructuring plan is approved.[200] However, these measures can still exceptionally be authorised by the Commission to be granted by a Member State on a temporary basis as rescue aid before a restructuring plan is approved, but only, if these measures are required to preserve financial stability.[201] This dissertation refers to these recapitalisations and asset relief measures as 'rescue recapitalisations' and 'rescue asset relief measures' (as opposed to recapitalisations and asset relief measures that are granted as restructuring aid).

3.5 The State aid assessment by the Commission

This section discusses the State aid assessment conducted by the Commission in respect of State aid to rescue, restructure or liquidate a bank. It first describes the procedural outline of this assessment. Subsequently, it discusses the specific principles governing the assessment by the Commission of State aid granted to banks under Article 107(3)(b) TFEU and the assessment criteria used by the Commission. Finally, it discusses the differences between ad hoc cases, individual cases and aid schemes.

199 Impaired Assets Communication, point 23.
200 2013 Banking Communication, point 23.
201 2013 Banking Communication, point 50.

3.5.1 The procedural outline

The State aid assessment by the Commission normally starts with the request of a Member State for approval to award State aid. Any State aid granted without the required prior approval of the Commission, is considered 'unlawful aid'. Following a decision from the Commission, the Member State concerned should take all necessary measures to recover the unlawful aid from the beneficiary.[202] In case of (alleged) unlawful aid, the Commission may initiate an assessment. [203]

> EU law does not in itself determine the content of national State aid provisions, so that it remains for each Member State to determine the circumstances in which it wishes to grant State aid and the beneficiaries to whom this aid is to be granted.[204] In granting State aid Member States have to comply with the State aid rules. How they do varies. In some Member States it is compulsory that all State aid measures are assessed by an independent authority for advice before they can be notified to the Commission, if needed. In many other Member States there are no official structures specifically in charge for organizing a policy in line with the State aid obligations.[205]

The assessment by the Commission of a State aid award notification by a Member State follows a two-stage procedure of preliminary examination and formal investigation.[206]

3.5.1.1 Preliminary examination

In accordance with the Procedural Regulation, the Commission first makes a preliminary examination of a State aid notification by a Member State in which it considers whether the State measure constitutes State aid and whether there are any doubts regarding its compatibility with the internal market.

202 Article 16 Procedural Regulation.
203 Article 12 Procedural Regulation.
204 Quigly 2015, p. 256.
205 Buts, Joris and Jegers *EStAL* 2013, p. 333.
206 EC State aid Manual of Procedures, sections 4-2 and 4-5. EC Code of Best Practices, paragraph 3.

> Prior to filing a notification, a Member State can file a so-called 'pre-notification'. In case of pre-notification, the Commission will conduct a non-binding assessment of the aid measure on the basis of a draft notification by the Member State. This non-binding assessment is not an official position of the Commission, but informal guidance on the completeness of the draft notification and the *prima facie* compatibility of the planned project with the internal market. The Commission recommends involving the beneficiaries of individual measures in pre-notification contacts. Nevertheless, the decision on whether or not to involve the beneficiary rests with the Member State. [207]

Should the Commission, after a preliminary examination, find that the notified measure does not constitute State aid, it records that finding by way of a decision. Where no doubts are raised, the Commission decides that the measure is compatible with the internal market. This is also referred to as 'a decision not to raise objections'. The Member State may then implement the aid measure. If the Commission finds that there are doubts as to the compatibility with the internal market of a State aid measure, it may initiate the formal investigation procedure.[208]

The Commission has two months for the preliminary examination. This begins on the day following the receipt of a complete notification. The notification is considered complete if, within 2 months from its receipt, or from the receipt of any additional information requested, the Commission does not request any further information. If the Commission does not take a decision within two months following receipt of a complete notification, the aid is deemed to have been authorized by the Commission. The relevant Member State may then implement the State measure after giving the

207 The Member State has then the option to withdraw the notification or, if the Member State insists on a decision for legal certainty, the Commission adopts a decision not to raise objections. EC State aid Manual of Procedures, sections 5-12 and 5-13.

208 Article 4 Procedural Regulation. The decision to initiate or extend the formal investigation procedure takes the form of a 'Letter to the Member State'. The legal standing of a decision in the form of a letter and that of a final decision is the same (EC State aid Manual of Procedures, section 1-10).

Commission prior notice thereof, unless the Commission takes a decision within 15 working days following receipt of such notice.[209]

> These timelines are normally considerably shorter in relation to the assessment of State aid awards in the banking sector.[210] As a result of the extremely short timelines during the GFC, the Commission developed the practice of immediately approving notified aid (not only in the form of guarantees and liquidity support, but also in the form of the more structural measures of recapitalisations and impaired asset measures) on a temporary basis subject to a six months review clause.[211] The 2013 Banking Communication has restricted this practice again.[212] After the Commission approves rescue aid, normally a restructuring plan should be provided (unless it concerns certain aid measures for which this obligation does not exist, see section 3.5.4.1). In such a case, but also if a Member State intends to grant restructuring aid without having granted rescue aid, the Commission assesses the compatibility of the restructuring aid in light of the restructuring plan. This can still all take place in the preliminary examination procedure. Only, if the Commission has doubts as to the compatibility with the internal market of the restructuring aid, the formal investigation procedure may be started.[213]

3.5.1.2 Formal investigation

As noted above, the Commission may initiate the formal investigation procedure if it has doubts regarding the compatibility of a State aid measure with the internal market. The aim of the decision to initiate the formal investigation procedure is to summarize the relevant issues of fact and law, to include a preliminary assessment as to the qualification of the aid

209 Article 4(5) and (6) Procedural Regulation. If a case is straightforward and certain conditions are fulfilled, the Commission may agree to handle it under a streamlined procedure. In such cases, the Commission will, within 25 days from the date of notification, endeavour to adopt a short-form decision finding that the notified measure does not constitute aid or a decision not to raise objections (Article 4(2) or 4(3) Procedural Regulation).

210 See Botta *JEI* 2016, p. 269-271 for a good insight in the decision-making practices adopted by the Commission to deal with the time pressure related to State aid awards in the banking sector. See also Grünewald 2014, p. 125-126.

211 Botta *JEI* 2016, p. 271. Van Lambalgen 2018, p. 73. See e.g. EC, 23 December 2009, C(2009) 10672 final (C 16/2009 and N 698/2009 – BayernLB and Hypo Group Alpe Adria).

212 See sections 3.5.4.2 and 3.5.4.3.

213 Van Lambalgen 2018, p. 74.

as State aid, and to set out the doubts regarding the compatibility with the internal market.[214] The formal investigation procedure is closed by means of one of the following decisions by the Commission where appropriate, following modification of the aid measure by the Member State concerned: 1) the aid measure does not constitute State aid, 2) the doubts as to the compatibility of the aid measure with the internal market have been removed (positive decision), 3) the doubts as to the compatibility of the aid measure with the internal market have been removed, taking into account the conditions stipulated by the Commission (conditional decision), or 4) the aid is not compatible with the internal market and may not be granted (negative decision).[215] The Commission should, as far as possible, endeavor to adopt a decision within a period of 18 months.[216]

> During the period 2008 to 2016, the Commission only initiated the formal investigation procedure in relation to 9 banks.[217] The Commission has continued its practice of approving aid without the need for formal investigation procedures in many resolution cases.[218]

3.5.1.3 Council assessment in exceptional circumstances

If justified by exceptional circumstances, the Council may also decide, on application by a Member State and acting unanimously, that aid which that State is granting or intends to grant shall be considered to be compatible with the internal market, in derogation from the provisions of Article 107 TFEU or from the regulations provided for in Article 109 TFEU. If, regarding the aid in question, the Commission has already initiated its assessment, the fact that the State concerned has made its application to the Council has the effect of suspending that procedure until the Council has made its attitude known. If the Council has not made its attitude known within three months of the said application being made, the Commission may give its decision on the case.[219]

214 Article 6(1) Procedural Regulation.
215 Article 9 Procedural Regulation. EC State aid Manual of Procedures, section 6-15.
216 Article 9(6) Procedural Regulation.
217 EC Memo 2016.
218 Bacon 2017, p. 394.
219 Article 108(2) TFEU.

> Gray and De Cecco mention this possibility for Member States to request the Council to decide on the compatibility of State aid as a reason for the Commission to not adopt a too rigid interpretation of the State aid rules during the GFC. If the Council had made use of its power to override a Commission State aid decision, this would have led to undermining the normative authority of State aid control.[220]

The case-law of the EU Courts gives the Council an extensive margin of discretion in deciding whether or not exceptional circumstances exist. Nevertheless, the procedure is exceptional, and it must not be abused by the Council. In particular, the Council cannot intervene after the Commission has adopted a final decision that the aid concerned is incompatible with the internal market. Nor can the Council seek to neutralize the effects of a recovery decision by declaring a new aid to be compatible with the internal market. Council decisions are rare, because of the difficulty of reaching unanimity.[221]

> The Council has, for example, used this power on request of the authorities of the Republic of Latvia to authorise aid for the purchase of agricultural land.[222] Another example is the use of this power on request of the Government of Portugal to authorise the provision of aid to Portuguese pig farmers. The decision by the Council was, however, annulled by the ECJ on request of the Commission.[223] In September 2008, French President Sarkozy put forward the proposal to make use of Article 108(2) TFEU in relation to the award of crisis aid to the banking sector. However, the unanimity requirement was not met.[224]

220 Gray and De Cecco 2017, p. 29.
221 Article 107(3)(e) TFEU. EC State Aid Manual of Procedures, section 1-6 and 1-7.
222 Council Decision 2009/991/EU of 16 December 2009. See also ECJ, 4 December 2013, C-118/10, ECLI:EU:C:2013:787 (*Commission v Council*), par. 43-46, 49, 50, 52, 54, 55, 66, 67, 73, 80, 104-106.
223 Council Decision 2002/114/EC of 21 January 2002. See ECJ, 29 June 2004, C-110/02, ECLI:EU:C:2003:667 (*Commission v Council*). The ECJ considered that the Council does not have the power to rule on the compatibility with the internal market of an aid in relation to which the Commission has already definitively ruled.
224 Botta *JEI* 2016, p. 269.

3.5.2 The legal basis for the State aid assessment

The 2008 Banking Communication established a new legal basis for the assessment of granting State aid to banks. In the light of the level of seriousness of the crisis in the financial markets, the Commission considered that Article 107(3)(b) TFEU was available as a legal basis for aid measures undertaken to address the systemic crisis. Pursuant to Article 107(3)(b) TFEU aid to "*remedy a serious disturbance in the economy of a Member State*" may be compatible with the internal market. What this means is further discussed in section 3.5.3.1.

Both in the 2010 Prolongation Communication and the 2011 Prolongation Communication, the Commission considered that the requirements for State aid to be approved under Article 107(3)(b) TFEU continued to be fulfilled in view of the reappearance of stress in financial markets and the risk of wider negative spillover effects. The high volatility of financial markets and the uncertainty about the economic outlook justified maintaining, as a safety net, the possibility for Member States to argue the need to have recourse to crisis-related support measures on the basis of Article 107(3)(b) TFEU.[225] In the 2013 Banking Communication, the Commission considered that the requirements for the application of Article 107(3)(b) TFEU continued to be fulfilled, but only for as long as the crisis situation persisted.[226] At the time of writing this dissertation, there are no indications that the Commission is going to return to Article 107(3)(c) TFEU as the basis for the assessment of State aid grants in the banking sector.

> Article 107(3)(b) TFEU was, until the GFC, rarely used as a basis for allowing aid granted by Member States. An example can be found in the granting of State aid in the context of privatisation of hundreds of Greek firms and public-sector banks as part of a national

225 2010 Prolongation Communication, points 5-6.
226 Banking Communication, point 6.

economic recovery plan.[227] In addition, during the recession in the mid-1970s, the Italian government provided temporary aid approved under (the predecessor of) article 107(3)(b) TFEU to small and medium-sized undertakings to offset the effects of a 'business slowdown'.[228] The Commission stressed in its decisions that the exceptions provided for in (the predecessors of) article 107(3) TFEU have to be constructed narrowly when aid schemes or individual aid awards are scrutinised. In particular they may only be invoked when the Commission is satisfied that without the aid, market forces alone would be insufficient to guide recipients towards patterns of behavior that would serve one of the objectives of the said exceptions.

227 Quigley 2015, p. 206-208. D'Sa, 1998, p. 141-142. EC, 22 March 1988, 88/167/EEC, OJ L 76, p. 0018-0022; Evans 1997, p. 13-14. Greece adopted a law (1386/1983) that created an organization (Business Reconstruction Organization: BRO) for the financial reconstitution of undertakings. The financial resources of the BRO were obtained directly from the State. An undertaking was made subject to the application of the law and controlled by the BRO by decision of the Minister for the National Economy. This occurred when any one or more of the following conditions were met: a) The company had suspended or ceased trading for financial reasons; b) It had stopped making payments; c) It had been placed in receivership or was under temporary administration or in any form of liquidation; d) It had debts five times the sum of its company capital and visible reserves and was manifestly unable to meet its obligations; e) it was of interest to national defence or of vital importance in the exploitation of sources of national wealth; f) it was requested to be made subject to this law. The Commission considered this arrangement to constitute State aid. The Commission emphasized that the exception provided for in the first phase of article 93(3)(b) EEC Treaty , aid to promote the execution of an important project of common European interest, could not apply, as the aid did not intend to promote the execution of such a project. In this case it was orientated purely towards the development of the Greek economy. However, the second part, aid to remedy a serious disturbance in the economy of a Member State, could apply. The economic situation in Greece had been constantly deteriorating. Both internal and external imbalances had created a difficult situation. The Greek authorities were confronted with very serious external payments and pressures on the exchange rate. The European Community granted Greece a Community loan of 1,750 million ECU and also permitted Greece to continue the grant of subsidies to exports for a limited period of time. Law 1386/1983 and the operations of the BRO could be regarded as an integral part of a stabilization program. The individual interventions of the BRO covered 45 companies. Of these, 22 had been placed into liquidation as being beyond redemption. The remaining 23 accounted for approximately 20% of the industrial employment of Greece and a considerably larger percentage of its industrial output and international trade. If such a large section of Greek industry were to be allowed to go into liquidation, it would have had major negative effects on the possible success of the stabilization program. The Commission therefore concluded that the conditions of Article 92(3)(b) EEC Treaty, second part, could be applied to Law 1386/1983 and the operations of the BRO.

228 Evans, 1997, p.12.

> Moreover, in its crisis decisions in relation to IKB and SachsenLB, the Commission pointed out that the GC had stressed that (the predecessor of) article 107(3)(b) TFEU needs to be applied restrictively so that aid cannot benefit only one company or one sector, but that it must tackle a disturbance of the entire economy of a Member State. The Commission consequently argued in these cases that a serious economic disruption is not remedied by an aid that "*resolve[s] the problems of a single recipient […], as opposed to the acute problems facing all operators in the industry*." The Commission observed that the problems of IKB and SachsenLB were both due to company-specific events. Therefore, the cases seemed rather to be based on individual problems, and thus required tailor made remedies, which could be addressed on the basis of Article 107(3)(c) TFEU and the 2004 R&R Guidelines.[229] It was not until the fall of 2008 (when Lehman Brothers collapsed[230]), that the Commission abandoned its narrow view on the scope of (the predecessor of) Article 107(3)(b) TFEU and decided to use (the predecessor of) Article 107(3)(b) TFEU as a basis for the assessment of the compatibility of aid in the banking sector.[231]

It is settled case-law that the Commission is not bound by its earlier decisional practice in the application of Article 107(3) TFEU. Legality of a Commission decision declaring that new aid does not fulfil the conditions under which the exemption in Article 107(3) TFEU applies must be assessed solely in the context of that article, and not in the light of the Commission's earlier decision-making practice, assuming that this is established. Therefore, comparisons with other State-aid proceedings are irrelevant for the purpose of the outcome of the assessment by the Commission.[232]

229 EC, 27 February 2008, (C10/2008 – IKB), par. 59 and 60. EC, 4 June 2008, C(2008) 2269 final, (C9/2008 – SachsenLB), par. 94 and 95.

230 The failure of Lehman Brothers caused such severe shocks to confidence across the whole banking system that banks were reluctant to lend money to each other. As a result, the interbank market virtually collapsed and Member States had to step in (Hancher, Ottervanger and Slot 2016, p. 546).

231 Among the first cases in which the Commission applied Article 87(3)(b) EC Treaty were an aid scheme adopted by the UK (EC, 13 October 2008, C(2008)6058 (N 507/2008 – UK) and an aid scheme adopted by Ireland (EC, 13 October 2008, C(2008)6059 (NN 48/2008 – Ireland).

232 See e.g. GC, 6 April 2017, T-219/14, ECLI:EU:T:2017:266 (*Regione autonoma della Sardegna v Commission*), par. 113; GC, 1 March 2017, T-454/13, ECLI:EU:T:2017:134 (*SNCM v Commission*), par. 98-99. GC, 3 March 2010, T-102 and 120/07, ECLI:EU:T:2010:62 (*Freistaat Sachsen v Commission*), par. 134. Bacon 2017, p. 99.

The Commission decisions mentioned in this dissertation therefore serve an illustrative purpose.

3.5.2.1 The balancing test under Article 107(3)(b) TFEU

Article 107(3) TFEU gives the Commission the sole competence to determine whether the conditions for compatibility of State aid with the internal market are fulfilled. In exercising its wide discretionary powers, the Commission has to balance the necessity and the proportionality of the aid measure in achieving an EU objective versus the distortion of competition brought about by it (the 'balancing test'). State aid in the EU should only be granted, if it can reach objectives of common interest which cannot be achieved by the free market only.[233]

Over time, there has been a growing willingness at the level of the EU and the Member States to consider the effectiveness of State subsidies in pursuing public policy objectives, and to look more closely at the costs and benefits of State aid. The stated aim was to strive for 'less and better targeted State aid'. This objective was pursued by the Commission through its State Aid Action Plan published in June 2005,[234] and more specifically through the introduction of the refined economic approach, consisting of an effects analysis of State aid awards in the application of Article 107(3) TFEU. The main thrust behind the introduction of a more refined economic approach in the State Aid Action Plan has been to make the positive and negative implications of the State aid measure at issue more explicit and to ensure a more systematic assessment of the positive and negative effects.[235] The refined economic approach is embodied in the balancing test under Article 107(3) TFEU.[236]

In essence, the balancing test assesses (i) whether the State aid addresses a market failure or other objective of common interest; (ii) whether there is an incentive effect (i.e. whether the aid affects the behaviour of the recipient in a way which meets the objective); (iii) whether the aid leads to distortions of competition and trade and; (iv) whether given the magnitude of

233 Nicolaides 2010, p. 366-367.
234 Neven and Verouden 2008, par. 1.18.
235 Hancher, Ottervanger and Slot 2012, p. 150.
236 Hildebrand and Schweinsberg *W.Com.* 2007, p. 451-453. Hancher, Ottervanger and Slot 2012, p. 47.

the positive and negative effects, the overall balance is positive.[237] In most cases this balancing is not carried out explicitly, but rather by reference to predetermined criteria based on certain principles.[238]

The balancing test originates from Article 107(3)(c) TFEU.[239] The GC however confirmed in its judgment of 17 July 2014 in the case *Westfälisch-Lippischer Sparkassen- und Giroverband v European Commission* that the balancing test also applies under Article 107(3)(b) TFEU.

> In this case, a shareholder in WestLB, a commercial bank in Germany that had received State aid, put forward that the objective of remedying a disturbance in the economy of an EU Member State is always in the common interest, as a result of which authorisation of aid under Article 107(3)(b) TFEU cannot be made subject to conditions seeking to protect competition. The GC considered it clear from the actual wording of Article 107(3)(b) TFEU (at that time, Article 87(3)(b) EC Treaty) that the Commission, when it finds that State aid is intended to remedy a serious disturbance in the economy of a Member State, is not, by the fact alone, obliged to consider that aid to be compatible with the common market. Moreover, according to settled case-law, Article 107(3) TFEU confers on the Commission a discretion the exercise of which involves economic and social assessments which must be made in a Community context. Accordingly, the difference in wording between Article 107(3)(c) TFEU, which allows the authorisation of some aid provided that it 'does not adversely affect trading conditions to an extent contrary to the common interest' and Article 107(3)(b) TFEU, which lays down no such condition, cannot lead to the conclusion that the Commission cannot assess the impact of aid authorised under the latter provision on the relevant market or markets in the EU as a whole.[240]

237 Neven and Verouden 2008, par. 1.3.
238 Neven and Verouden 2008, par.1.17.
239 Quigley 2009, p. 138-139; Szyszczak 2011, p. 74.
240 GC, 17 July 2014, T-457/09, ECLI:EU:T:2014:683 (*Westfälisch-Lippischer Sparkassen- und Giroverband v Commission*), par. 178-184. See also EC State aid Manual of Procedures, section 1-5. Hancher, Ottervanger and Slot 2012, p. 600.

3.5.3 The principles governing the State aid assessment

Following the 2005 State Aid Action Plan, the Commission published a State Aid Modernization Communication in 2012. The aim was to focus State aid control on measures which genuinely affect competition in the internal market while at the same time simplifying and streamlining rules and procedures. One of the actions taken in that respect was the identification and definition of 'common assessment principles' applicable to the assessment of compatibility of all the aid measures carried out by the Commission.[241] The common assessment principles maintain the criteria developed in the balancing test introduced in the State Aid Action Plan.[242]

The common assessment principles include the following:

1. contribution to a well-defined objective of common interest: a State aid measure must have an objective of common interest in accordance with Article 107(3) TFEU;
2. need for State intervention: a State aid measure must be targeted towards a situation where aid can bring about a material improvement that the market cannot deliver itself, for example by remedying a market failure or addressing an equity or cohesion concern;
3. appropriateness of the aid measure: the aid measure must be an appropriate policy instrument to address the objective of common interest;
4. incentive effect: the aid must change the behaviour of the undertakings concerned in such a way that they engage in additional activity which they would not carry out without the aid or they would carry out in a restricted or different manner or location;
5. proportionality of the aid (aid limited to the minimum): the aid amount must be limited to the minimum needed to induce the additional investment or activity in the area concerned;
6. avoidance of undue negative effects on competition and trade between Member States: the negative effects of the aid must be sufficiently limited, so that the overall balance of the measure is positive;

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241 EC, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: EU State Aid Modernisation (SAM), COM(2012) 209 final, p. 6.

242 Nicolaides *ECJ* 2014, p. 155. Bacon 2017, p. 7. Hancher, Ottervanger and Slot 2016, p. 43.

7. transparency of aid: Member States, the Commission, economic operators, and the interested public, must have easy access to all relevant acts and to pertinent information about the aid awarded thereunder.

The common assessment principles were introduced in revised versions of various guidelines, including the 2014 R&R Guidelines; these, however do not apply to banks. The common assessment principles were not included in the 2013 Banking Communication. It can be derived from a Discussion Paper published by the Commission in relation to the common assessment principles that if a given aid measure, by nature of its objective, falls within the scope of existing guidelines and therefore has to be notified under these guidelines, only the principles as formulated in those guidelines apply.[243] It is therefore the author's understanding that the common assessment principles do not apply to the State aid regime for the banking sector, but, instead, the principles set out in the 2013 Banking Communication apply.[244] These are the principles of appropriateness, necessity and proportionality.

> The observance of these principles in compliance with the State aid rules and the fundamental freedoms enshrined in the TFEU, including the principle of non-discrimination,[245] is deemed necessary by the Commission for the preservation of the proper functioning of the internal market.[246]

3.5.3.1 Appropriateness

State aid should be appropriate to effectively achieve the objectives set out in the TFEU. Taking into account that the legal basis for the assessment of rescue and restructuring aid was Article 107(3)(c) TFEU under the 2004 R&R Guidelines, these guidelines provided that rescue and restructuring

243 EC, Staff Working Paper – Common Principles for an Economic Assessment of the Compatibility of State aid under Article 87.3, 2009, par. 6.

244 Bacon 2017, p. 100. See also GC, 9 June 2016, Y-162/13, ECLI:EU:T:2016:341 (*Magic Mountain Kletterhallen v Commission*), par. 56-58. Taking into account that the common assessment principles maintain and refine the criteria of the balancing test, the author does not expect that – possible – future application of such common assessment principles on the State aid regime for the banking sector will have a material impact on the way in which the Commission conducts its assessments of State aid awards under the State aid regime for the banking sector.

245 See also Laprévote and Frisch 2017, p. 197-198.

246 2008 Banking Communication, point 16.

aid must be warranted on the grounds of serious social difficulties and have no unduly adverse spillover effects on other Member States.[247] The shift to Article 107(3)(b) TFEU in the 2008 Banking Communication meant State aid in the banking sector should be well-targeted in order to be able to effectively achieve the objective of remedying a serious disturbance in the economy.[248]

> The importance of the appropriateness principle for State aid awards in the banking sector has been stressed by the ECJ in the *Kotnik* case. According to the ECJ, within the discretion conferred on it by Article 107(3)(b) TFEU, the Commission is entitled to refuse the grant of aid where that aid does not induce the recipient undertakings to adopt conduct likely to assist attainment of one of the objectives referred to in that provision. This aid must be necessary for the attainment of the objectives specified in that provision, in the sense that, without it, market forces alone would not succeed in getting the recipient undertakings to adopt conduct likely to assist attainment of those objectives. Aid which improves the financial situation of the recipient undertaking but is not necessary for the attainment of the objectives specified in Article 107(3) TFEU cannot be considered to be compatible with the internal market.[249]

In order to be able to assess the appropriateness of aid, it is therefore essential to understand what is meant by 'to remedy a serious disturbance in the economy of a Member State'. There is however no legal definition thereof and, moreover, this term has not been further explained by the Commission in its communications. In the absence of this definition and explanation, the following guidance can be derived from the case-law of the EU Courts and literature.

Serious disturbance in the economy of a Member State
First, the EU Courts interpret 'serious disturbance' as being a disturbance that *affects the whole economy*, not just a region or sector.[250] According to Olivares-Caminal and Russo, a serious disturbance in the economy is an

247 2004 R&R Guidelines, point 25(b).
248 2008 Banking Communication, point 15.
249 ECJ, 19 July 2016, C-526/14, ECLI:EU:C:2016:570 (*Kotnik v Slovenia*), par. 49.
250 GC, 15 December 1999, T-132/96 and T-143/96, EU:T:1999:326 (*Freistaat Sachsen and Others v Commission*), par. 167. The Commission however seems to taka a different approach. See section 6.6.2.4.

exogenous event beyond the banks' control.[251] In addition they mention that the existence of a serious disturbance in the economy of a Member States *does not necessarily mean that there is a systemic crisis*. However, this might hint at the fragility of the sector as a whole which makes a systemic crisis more likely to occur.[252]

> This can also be derived from the 2013 Banking Communication which states that the Commission shall conduct its assessment taking account of the evolution of the crisis from one of acute and system-wide distress towards a situation of more fundamental economic difficulties in parts of the Union, with a correspondingly higher risk of fragmentation of the single market.[253]

Systemic relevance of the bank

According to Hancher, Ottervanger and Slot, aid can only effectively achieve the objective of remedying a serious disturbance in the economy, if the beneficiary bank is of relevance for the financial system, i.e. it must be of *systemic relevance*.[254] It can be derived from the Commission's decisions in relation to State aid awards in the banking sector that in several cases[255] the Commission has requested the national central bank involved to confirm the systemic importance of the beneficiary bank.[256]

> The Commission, for example, considered in its decision in relation to the Austrian bank Hypo Group Alpe Adria (HGAA) that the Austrian Central Bank had confirmed that HGAA was a bank with systemic importance for the financial market in Austria. Without the measure, HGAA risked closure by the supervisory authorities. For those reasons the Commission accepted that the State aid to HGAA could be assessed under Article 107(3)(b) TFEU.[257]

251 Olivares-Caminal and Russo 2017, p. 10.
252 Olivares-Caminal and Russo 2017, p. 10.
253 2013 Banking Communication, point 7.
254 Hancher, Ottervanger and Slot 2016, p. 554. Van Lambalgen 2018, p. 214-215.
255 See also Van Lambalgen 2018, p. 214. He mentions that the fact that some decisions mention the systemic importance of the bank while other decisions do not creates a somewhat chaotic impression.
256 Hancher, Ottervanger and Slot 2016, p. 554.
257 EC, 19 July 2011, C(2011) 5229 final (SA.32172 and SA.32554 – HGAA), par. 28. Other examples include EC, 9 April 2015, C(2015) 2353 final (SA.33442 – Irish Life and Permanent Group Holdings), par. 63; EC, 21 January 2013, C(2013) 333 final (SA.34662 – Banif), par. 54; EC, 12 May 2009, C(2009) 3828 final (N241/2009 – Allied Irish Bank), par. 60-61.

The Commission has been criticized by some authors because it seemed to consider every bank as being of 'systemic importance' during the GFC, and accordingly, to approve high amounts of aid on the basis of Article 107(3)(b) TFEU.[258] It should however be acknowledged that the GFC created exceptional circumstances in which the bankruptcy of one bank, even a bank of small size, could undermine trust in the financial system at large, both at national and international level.[259] The assessment whether a bank has systemic importance is therefore not static in the author's view, but can depend on the prevailing market conditions.

Financial stability

During the GFC, the Commission continuously stressed that financial stability is the overriding goal of State aid policy, whilst ensuring that State aid and distortions of competition between banks and across Member States are kept to the minimum.[260]

> According to Koopman, no structural trade-off between financial stability and competition can be identified. However, the design of both policies needs to be sensitive to spillover effects and should, especially, in a crisis environment, be taken forward in an integrated manner to allow interactions to be internalized as best as possible. [261]

Persuant to point 7 of the 2013 Banking Communication, financial stability implies the need to prevent major negative spillover effects for the rest of the banking system which could flow from the failure of a bank, as well as the need to ensure that the banking system as a whole continues to provide adequate lending to the real economy. Protecting financial stability can thus be separated into preventing two spillover effects: i) on other banks, and ii) on the real economy via the lending channel.[262]

> It can be derived from the Commission's decisions that it asked the ECB to make an assessment of aid measures from a financial stability perspective where the aid measure relates to rules applicable

258 Bacon 2017, p. 11. Lyons and Zhu *J.I.C.T.* 2013, p., p. 61-62.
259 EC, 29 June 2012, C(2012) 4427 final (SA.34445 – FIH), par. 49.
260 2013 Banking Communication, point 7.
261 Koopman *CPI* 2011, p. 10. There also authors that argue that greater competition improves bank stability or that greater competition leads to greater bank fragility (Goetz *JFI* 2018, p. 67).
262 De Groen 2017, p. 5.

to financial institutions.[263] The ECB defines financial stability as a state whereby the build-up of systemic risk is prevented. Systemic risk is described as the risk that the provision of necessary financial products and services by the financial system will be impaired to a point where economic growth and welfare may be materially affected.[264]

The 2013 Banking Communication does not elaborate on how the goal of financial stability should be seen in relation to the assessment on the basis of Article 107(3)(b) TFEU whether the aid is appropriate to effectively achieve the objective of remedying a serious disturbance. The relationship between the two has however been discussed by the Commission in its State aid decisions, although it is hard to distract any clear guidance. For example:

– in the case of Cooperative Central Bank (CCB), the Commission considered that aid was necessary to avoid a serious disturbance in the economy of a Member State; the failure of a bank would have threatened financial stability.[265]
– in the case of the Irish Credit Union Resolution Scheme, it considered aid to be appropriate as it ensured that financial stability was maintained by resolving credit unions that failed or were likely to fail;[266]
– in relation to the Greek State Guarantee Scheme, it considered that this scheme aims at ensuring financial stability and, thus, remedying a serious disturbance in the Greek economy.[267]

It seems therefore that the Commission assumes a certain interlinkage between both objectives. The objective of ensuring financial stability seems to be implied in the objective of remedying a serious disturbance in the economy of a Member State, although the latter may be broader.[268]

263 EC, 12 December 2012, C(2012) 9410 final (SA.35744 – Ireland), par. 32-38.
264 ECB, Financial stability and macroprudential policy, available on the website of the ECB: www.ecb.europa.eu. See also Grünewald 2014, p. 11-14.
265 EC, 18 December 2015, C(2015) 9681 final (SA.43367 – Cooperative Central Bank), par. 79.
266 EC, 25 May 2018, C(2018) 3216 final (SA.50953 – Ireland), par. 29.
267 EC, 7 June 2018, C(2018) 3546 final (SA.51087 – Greece), par. 20.
268 See also sections 3.5.4.2 and 2.5.4.3 on rescue recapitalisation and rescue asset relief measures that can only be authorised by the Commission, if this is required to preserve financial stability.

3.5.3.2 Necessity

State aid must, in its amount and form, be necessary to achieve the objective. As a result, State aid should be limited in time and scope.

3.5.3.3 Proportionality

The positive effects of State aid should be properly balanced against the distortions of competition, in order for those to be limited to a minimum. Undue distortions of competition should be avoided by applying certain safeguards. These may include: (i) a significant contribution from the beneficiaries and/or the sector to the cost of the State aid has to be ensured, (ii) the State aid is adequately remunerated, (iii) behavioural constraints are imposed that ensure that beneficiary banks do not engage in aggressive expansion against the background of the State aid to the detriment of competitors not covered by this protection and, (iv) the Member State concerned can enforce these behavioural constraints, including the sanction of withdrawing the State aid in case of non-compliance.[269]

3.5.4 Assessment criteria for rescue aid

The 2013 Banking Communication lists the assessment criteria which reflect the general principles set out in the previous section in light of the specific policy context. Due to the fact that the 2013 Banking Communication should be read in conjunction with the (amended) Crisis Communications, other than the 2008 Banking Communication (repealed by the 2013 Banking Communication), it is sometimes difficult to establish which criteria exactly apply. Against this background, this section attempts to provide a complete overview of the assessment criteria for each type of aid measure that can be granted to banks, as set out in section 3.4.3.2.

> It can be deducted from the Commission's decisions that it is not always necessary to meet all assessment criteria, as long as the principles are complied with.[270] For example, in the case of State aid to QIL, the Commission considered that the objectives pursued by the requirement for appropriate remuneration, namely burden-sharing and minimising competition distortion, had been attained by other

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269 2008 Banking Communication, point 27.

270 See also EC Staff Working Paper 2011, p. 32. The Commission here mentions the 'communicating vessels principle' according to which some degree of compensation among the compatibility conditions is allowed.

means. It therefore concluded that, despite non-compliance with the criteria of valuation and remuneration, in view of the far-reaching restructuring, and taking into account that the competition distortion had been limited by the scaling-down and sale of parts of QIL in an open, transparent and unconditional tender, the asset relief in favour of the Irish general insurance activities of QIL sold to the joint venture set up by Liberty Mutual and Anglo was in conformity with the Impaired Assets Communication.[271]

3.5.4.1 Funding guarantees and liquidity support

In order to be temporarily approved by the Commission, rescue aid in the form of funding guarantees and liquidity support must meet the following criteria:

<u>Criterion 1: Eligible debt instruments</u>
Funding guarantees may only be granted for new issues of banks' senior debt (subordinated debt is excluded) with maturities from three months to five years, or a maximum of seven years in the case of covered bonds. Guarantees with a maturity of more than three years must, except in duly justified cases, be limited to one-third of the outstanding guarantees granted to the individual bank.[272]

In exceptional cases, guarantees may also be approved covering exposures of the European Investment Bank (EIB) towards banks for the purpose of restoring lending to the real economy in countries with severely distressed borrowing conditions compared to the EU average. When assessing these measures, the Commission will examine in particular whether they do not confer an undue benefit that could, for example, serve to develop other business activities of those banks. The guarantees may cover a period of up to seven years. If approved by the Commission, they do not trigger an obligation for the bank to present a restructuring plan.[273] An example of a guarantee scheme covering exposures of the EIB is the Portuguese Guarantee Scheme on EIB lending.[274]

271 EC, 12 October 2011, C(2011) 7266 final, (SA.33023 – Quinn Insurance Ltd), par.117 and 118.
272 2013 Banking Communication, point 59(a) and (b).
273 2013 Banking Communication, point 61.
274 EC, 17 February 2017, C(2017) 1142 final (SA.47164 – Portugal).

Criterion 2: Remuneration
Liquidity support and funding guarantees should be adequately remunerated. The minimum remuneration level of funding guarantees must be in line with the formula set out in the 2011 Prolongation Communication. This pricing formula establishes the minimum guarantee fees that should apply where funding guarantees are granted on a national basis, without any pooling of guarantees among Member States. The guarantee fee is set as a sum of a basic fee of 40 basis points (or 50 for debt with a maturity of less than one year) and a risk-based fee which takes into account the CDS spreads of the beneficiary bank and the Member State granting the guarantee.[275]

> The 2011 Prolongation Communication recognised that the creditworthiness of the Member State providing the funding guarantee should be reflected in the pricing of the funding guarantee.[276] Until that time, in many instances 'weak' banks located in 'strong' Member States had access to cheaper funding than 'strong' banks located in 'weak' Member States.[277]

In relation to liquidity support, the 2013 Banking Communication does not specify what an adequate remuneration is. However, the Commission has, in the past, applied the rules applicable to funding guarantees by analogy when appraising liquidity facilities.[278] In respect of subordinated loans, it has applied the recommendations of the ECB on the pricing of recapitalisations.[279]

Criterion 3: Behavioural safeguards
The recipients of guarantees and liquidity support must refrain from advertising referring to State support and from employing any aggressive commercial strategies which would not take place without the support of the Member State.[280]

275 2013 Banking Communication, point 59(c). 2011 Prolongation Communication, point 18 and the Annex.
276 Annex to the 2011 Prolongation Communication.
277 Gray and De Cecco 2017, p. 43-44. Levy and Zaghini *Banks and Banks Systems* 2011, p. 16, 22-23.
278 Bacon 2017, p. 378. See, for example, EC, 15 September 2010, C(2010)6202 final (C 26/2009 – AS Parex Banka), par. 56; EC, 6 June 2011, C(2011) 3912 final (SA.32634 – Amagerbanken), par. 65.
279 See e.g. EC, 6 June 2011, C(2011) 3912 final (SA.32634 – Amagerbanken), par. 65.
280 2013 Banking Communication, point 59(f).

Criterion 4: Restructuring or liquidation plan
Unlike recapitalisation or asset relief measures which in principle must be preceded by the notification of a restructuring plan by the Member State concerned and approval by the Commission before they can be granted, the Commission can accept that Member States notify funding guarantees and liquidity support to be granted after approval on a temporary basis as rescue aid before a restructuring or liquidation plan is approved.[281]

A restructuring or liquidation plan must, however, be submitted to the Commission within two months for any bank granted guarantees on new liabilities or on renewed liabilities for which, at the time of the granting of the new guarantee, the total outstanding guaranteed liabilities (including guarantees accorded before the date of that decision) exceed both a ratio of 5% of total liabilities and a total sum of EUR 500 million. In addition, for any bank which causes the guarantee to be called on, an individual restructuring or liquidation plan must be submitted within two months after the guarantee has been activated.[282]

In relation to liquidity support, the 2013 Banking Communication does not specify when and in which circumstances liquidity support requires the submission of a restructuring or liquidation plan. Taking into account that the Commission has, in the past, applied the rules applicable to funding guarantees by analogy when appraising liquidity support, it is likely that banks that receive liquidity support in excess of both a ratio of 5% of total liabilities and EUR 500 million or default on their payment obligations, must submit a restructuring or liquidation plan.[283]

3.5.4.2 Rescue recapitalisations

The Recapitalisation Communication, in combination with the 2013 Banking Communication, sets out the following specific assessment criteria for rescue recapitalisations as defined in section 3.4.3.2.

> If the recapitalisation takes place in the form of restructuring aid, the criteria for restructuring aid set out in section 3.5.6.1 must be met.[284]

281 2013 Banking Communication, point 56.
282 2013 Banking Communication, point 59(d) and (e).
283 Bacon 2017, p. 378. See, for example, EC, 6 June 2011, C(2011) 3912 final (SA.32634 – Amagerbanken), par. 53.
284 The position of existing shareholders in rescue recapitalisations is discussed in paragraph 8.

Criterion 1: Financial stability exception

Recapitalisation can only be authorised by the Commission to be granted by a Member State on a temporary basis as rescue aid before a restructuring plan is approved, if this measure is required to preserve financial stability.[285]

> If a Member State invokes the financial stability clause in order to grant rescue aid in the form of recapitalisation, the Commission will request an *ex ante* analysis from the competent authority confirming that a current (not prospective) capital shortfall exists, which would force the supervisor to withdraw the institution's banking license immediately if no such measures were taken. Moreover, any such analysis will have to demonstrate that the exceptional risk to financial stability cannot be averted with private capital within a sufficiently short period of time or by any other less distorting temporary measure, such as a State guarantee.[286] An example of a case in which this financial stability clause was invoked is the case of Abanka.[287] This Slovenian bank was in financial trouble due to insufficient subscription to capital issues and a constant growth of its non-performing loans. The Slovenian State therefore decided to recapitalise Abanka. The Bank of Slovenia informed the Commission about its findings that the situation of Abanka threatened financial stability and that, given the systemic importance of the bank and potential disruptions in the market in case of initiation of bankruptcy proceedings, an urgent State aid intervention was necessary to ensure financial stability in Slovenia. It also confirmed that it would have to withdraw Abanka's banking license in absence of the recapitalisation. The Commission took into account the findings of the Bank of Slovenia and also noted that the calculation of the capital shortfall had been based on the asset quality review/stress test, a credible exercise carried out by several external experts. Lastly, it assessed that the recapitalisation would enable Abanka to maintain its access to funding from the ECB, in the absence whereof the bankruptcy of Abanka would be triggered. Against that background,

285 2013 Banking Communication, point 50. This requirement was introduced by the 2013 Banking Communication.

286 2013 Banking Communication, point 50.

287 EC, 18 December 2013, C(2013) 9633 final (SA.37690 – Abanka).

the Commission deemed that the recapitalisation was appropriate because it maintained financial stability – besides achieving the objective of remedying a serious disturbance in the economy.[288]

Criterion 2: Remuneration

The remuneration for rescue recapitalisations should lead to a certain rate of return for the Member State involved in the recapitalisation. This remuneration can be fixed or variable (e.g. when a Member State subscribes to shares in the capital of the beneficiary bank). The starting point is that closeness of pricing to market prices is the best guarantee to limit competition distortions. The exact level of remuneration in relation to the recapitalisation of an individual bank is set taking into account different paraments, such as the type of capital chosen, the appropriate benchmark risk-free interest rate, and the individual risk profile of the beneficiary and, at national level, that of all eligible banks. Additionally, Member States may choose a pricing formula that includes step-up or payback clauses.[289] The remuneration should in principle reflect the risk profile of the beneficiary.[290]

Criterion 3: Incentives for exit

Rescue recapitalisations must contain appropriate incentives for banks to exit from State support as quickly as possible. In relation to shares with variable remuneration, exit incentives could, for example, be designed in a way that limits the upside potential for the Member State, for example by issuing warrants to the incumbent shareholders to allow them to buy back the newly issued shares from the State.[291] In addition, pricing conditions should provide an incentive for the bank to redeem the State as soon as the crisis is over. The simplest way to provide an incentive for banks to look for alternative capital is for Member States to require an adequately high remuneration for the State recapitalisation. Member States may also consider using a restrictive dividend policy to ensure the temporary character of State intervention. In general, the higher the size of the recapitalisation and the higher the risk profile of the beneficiary bank, the more necessary it becomes to set out a clear exit mechanism.

288 EC, 18 December 2013, C(2013) 9633 final (SA.37690 – Abanka), par. 36-46.
289 Recapitalisation Communication, points 23, 28 and 29.
290 Recapitalisation Communication, point 44.
291 2011 Prolongation Communication, point 11.

For example, in the case of ING, the Dutch State provided a capital injection of EUR 10 billion. ING repaid the principal amount and an amount of EUR 3.5 billion in interest and premiums, six months ahead of the agreed repayment schedule. In addition, the Dutch State took over the risk on 80% of a portfolio of high-risk mortgages of EUR 27.7 billion and made a profit of EUR 1.4 billion when it sold this portfolio in February 2014. The total return for the Dutch State on the State aid that it had provided to ING was therefore EUR 4.9 billion.[292] Another example is the repayment of State aid, including a penalty of 50%, by KBC to the Belgian State. KBC had received capital injections for a sum of EUR 7 billion, as well as a guarantee to cover its exposure to collateralized debt obligations. In exchange for this aid, KBC paid the Belgian State a total of EUR 13.09 billion at the end of 2015, 5 years ahead of the scheduled repayment date.[293] One could wonder whether the incentives for exiting from State support were set at the right level in these cases, or whether they provided for economic coercion against the cost of further development of the bank involved. Both ING and KBC paid a high fee for their State aid, in addition to burdensome behavioural and divestiture measures.

Criterion 4: Compliance with burden-sharing principle for restructuring aid

Rescue aid in the form of recapitalisation must not prevent compliance with the burden-sharing principle set out for restructuring aid in the 2013 Banking Communication. These requirements are discussed in more detail in section 3.5.6.1. Consequently, either the required burden-sharing measures must be implemented as part of the rescue aid, or the recapitalisation must be arranged in a manner that allows for the implementation of the burden-sharing measures *ex post*. This may be achieved by, for example, equity recapitalisation in a form that is senior to existing capital and subordinated debt instruments, whilst being compliant with the applicable regulatory and supervisory framework.[294]

292 ING, State aid for ING: the facts and figures, available on the website of ING: www.ing.com.

293 KBC, Press release - KBC repays all outstanding debt to government 5 years ahead of schedule, 11 December 2015.

294 2013 Banking Communication, point 52. See paragraph 8 for third party treatment in respect of the application of the burden-sharing principle.

Criterion 5: Behavioural safeguards

Until redemption of the State aid, behavioural safeguards for banks subject to recapitalisation should, in principle, include a restrictive policy on dividends, including a ban on dividends at least during the restructuring period, limitation of executive remuneration, or the distribution of bonuses, an obligation to restore and maintain an increased level of the solvency ratio compatible with the objective of financial stability, and a timetable for redemption of State participation.[295] In addition, banks subject to recapitalisation should avoid advertising this for commercial purposes or engaging in aggressive commercial strategies.[296]

The extent of behavioural safeguards will be based on a proportionality assessment, taking into account all relevant factors and, in particular, the risk profile of the beneficiary bank. While banks with a very low risk profile may only require limited behavioural safeguards, the need for these increases with a higher risk profile, according to the Commission. The proportionality assessment is further influenced by the relative size of the capital injection by the State and the level of capital endowment reached.[297]

Criterion 6: Restructuring plan

Following the authorisation of rescue aid in the form of recapitalisation, the Member State must submit a restructuring plan in line with the Restructuring Communication within two months of the date of the decision temporarily approving the aid.[298]

3.5.4.3 Rescue asset relief measures

Asset relief measures can be temporarily approved by the Commission as rescue aid. In that case the criteria of the Impaired Assets Communication, as discussed in section 3.5.5, should be met, in combination with the criteria set out below.[299] It may be that in such a case, not all criteria of the Impaired Assets Communication can be fulfilled at the time of the temporary approval and that the Commission will complete the assessment when it reaches its decision on the restructuring plan.[300]

295 Recapitalisation Communication, point 45.
296 Given the objectives of ensuring lending to the real economy, balance sheet growth restrictions are not necessary in recapitalisation schemes of fundamentally sound banks (Recapitalisation Communication, footnote 4).
297 Recapitalisation Communication, point 38.
298 2013 Banking Communication, point 53.
299 2013 Banking Communication, point 51.
300 See e.g. EC, 30 June 2009, C(2009) 5268 final (C 18/2009 – KBC), par. 96-97.

> Impaired asset measures normally qualify as restructuring aid, in which case the criteria set out in the Restructuring Communication should be met in addition to the criteria in the Impaired Assets Communication. The criteria set out in the Restructuring Communication are discussed in section 3.5.6.1.

<u>Criterion 1: Financial stability exception</u>
Asset relief measures can only be authorised by the Commission on a temporary basis as rescue aid before a restructuring plan is approved, if this measure is required to preserve financial stability.[301] This is the same requirement as discussed for rescue recapitalisations.

> An example of an asset relief measure that was temporarily approved by the Commission as a rescue asset relief measure for reasons of financial stability was the impaired asset measure by which problematic assets were transferred from FIH Group to a separate bad bank.[302]

<u>Criterion 2: Compliance with burden-sharing principle for restructuring aid</u>
Either the required burden-sharing measures as requested in relation to restructuring aid must be implemented as part of the rescue aid, or the impaired asset measure must be arranged in a manner that allows for the implementation of the burden-sharing measures *ex post*.[303]

<u>Criterion 3: Restructuring plan</u>
Following the authorisation of rescue aid in the form of asset relief measures, the Member State must submit a restructuring plan in line with the Restructuring Communication within two months of the date of the decision temporarily approving the aid.[304]

3.5.5 The assessment criteria for asset relief measures

The Impaired Assets Communication sets out the following specific assessment criteria for impaired assets measures. If asset relief measures are granted in the form of restructuring aid, these criteria must be met in addition to the criteria for restructuring aid, set out in section 3.5.6.1. Impaired

301 2013 Banking Communication, point 50.
302 EC, 29 June 2012, C(2012) 4427 final (SA.34445 – FIH), par. 79.
303 2013 Banking Communication, point 52.
304 2013 Banking Communication, point 53.

assets measures can also exceptionally be awarded in the form of rescue aid, under the additional conditions discussed in section 3.5.4.3.

Criterion 1: Eligible assets
When determining the range of eligible assets for relief, a balance needs to be found between meeting the objective of immediate financial stability and the need to ensure the return to normal market functioning over the medium turn.[305] To ensure consistency in the identification of eligible assets across Member States, categories of assets ('baskets') reflecting the extent of existing impairment have been developed by the Commission. The Member States have to decide which category of assets could be covered and to what extent, subject to the Commission's review of the degree of impairment of the assets chosen.[306]

> Assets commonly referred to as 'toxic assets' e.g. US mortgage-backed securities and associated hedges and derivatives which triggered the financial crisis and largely became illiquid or subject to severe downward value adjustments, are considered eligible for impaired asset measures. Member States may however extend eligibility to well-defined categories of assets corresponding to this systemic threat on due justification without quantitative restrictions.[307]

Criterion 2: Transparency and disclosure
Applications for asset relief aid should be subject to full *ex ante* transparency and disclosure of impairments by eligible banks on the assets to be covered by the relief measures, based on adequate valuation, certified by recognised independent experts, and validated by the relevant supervisory authority.[308]

Criterion 3: Valuation
A correct and consistent approach to valuation is deemed of key importance to prevent undue distortions of competition. The main aim of the valuation exercise is to establish the real economic value (REV) of the assets. The REV constitutes the benchmark level in so far as a transfer of impaired assets at that value indicates the compatibility of aid. In other words, transfer at REV creates a relief effect because it is in excess of the

305 Impaired Assets Communication, point 32.
306 Impaired Assets Communication, point 33.
307 Impaired Assets Communication, points 32-34.
308 Impaired Assets Communication, point 20(a).

current market value (MV), but keeps the aid amount to the minimum necessary.

> It was recognised by the Commission that the value attributed to impaired assets in the context of an asset relief program (the 'transfer value') will inevitably be above current market prices (which may effectively be as low as zero) in order to achieve the relief effect. To ensure consistency in the assessment of the compatibility of aid, the Commission considers a transfer value reflecting the underlying long-term economic value (the 'real economic value') of the assets, on the basis of underlying cash flows and broader time horizons, an acceptable benchmark indicating the compatibility of the aid amount as the minimum necessary.[309]
>
> Where the valuation of assets appears particularly complex, alternative approaches could be considered, such as the creation of a 'good bank' whereby the State would purchase the good rather than the impaired assets. Public ownership of a bank (including nationalisation) could be an alternative option, with a view to carrying out the valuation over time in a restructuring or winding up in an orderly manner context, thus eliminating any uncertainty about the proper value of the assets concerned.[310]

An application for aid by an individual bank should be followed by a full review of that bank's activities and balance sheet, with a view to assessing the bank's capital adequacy and its prospects for future viability (viability review). This review must occur in parallel with the certification of the impaired assets covered by the asset relief programme but, given its scale, could be finalised after the bank enters into the asset relief programme. The results of the viability review must be notified to the Commission and will be taken into account in the assessment of necessary follow-up measures.[311]

309 Impaired Assets Communication, point 40.
310 Impaired Assets Communication, point 38.
311 Impaired Assets Communication, point 20(b).

Criterion 4: Management of assets subject to relief measures
It is for Member States to choose the most appropriate model for relieving banks from assets. Whatever the model, in order to facilitate the bank's focus on the restoration of viability and to prevent possible conflicts of interest, it is necessary to ensure clear functional and organisational separation between the beneficiary bank and its impaired assets, notably regarding their management, staff, and clientele.[312]

Criterion 5: Remuneration (own contribution) and burden-sharing
As a general principle, banks ought to bear the losses associated with impaired assets to the maximum extent. This requires, firstly, full *ex ante* transparency and disclosure, followed by the correct valuation of assets prior to government intervention. The bank should bear the difference between the nominal value and the REV of the assets. As a general rule, an asset relief measure can only be declared compatible, if the transfer value is equal or below the REV. Where this is not possible, the bank should be requested to contribute to the loss or risk coverage at a later stage, for example in the form of claw-back clauses or far-reaching restructuring.

In addition, a correct remuneration of the State for the asset relief measure is required.

> In any event, any pricing of asset relief must include remuneration for the State that adequately takes account of the risks of future losses exceeding those that are projected in the determination of the REV and any additional risk stemming from a transfer value above the REV. This remuneration may be provided by setting the transfer price of assets at below the REV to a sufficient extent so as to provide for adequate compensation for the risk in the form of a commensurate upside, or by adapting the guarantee fee accordingly.[313]

Criterion 6: Behavioural constraints (prevention of undue distortion of competition)
Access to asset relief should always be conditional on a number of appropriate behavioural constraints. In particular, beneficiary banks should be subject to safeguards which ensure that the capital effects of relief are used for providing credit to appropriately meet demand according to commercial criteria and without discrimination, and not for financing a growth

312 Impaired Assets Communication, point 44-46.
313 Impaired Assets Communication, p. 26.

strategy (in particular acquisitions of sound banks) to the detriment of competitors. Restrictions on dividend policy and caps on executive remuneration should also be considered. The specific design of behavioural constraints should be determined on the basis of a proportionality assessment taking account of the various factors that may imply the necessity of restructuring.[314]

> An interesting case in which the scope of the behavioural constraints was highly debated, is the aid package granted to ING by the Netherlands. This aid package consisted of an increase in capital, a cash flow swap relating to the impaired assets of a portfolio of securities backed by residential mortgages granted in the United States, and guarantees given on ING liabilities amounting to USD 9 billion and to EUR 5 billion. The Commission first authorised the capital injection and impaired asset measure as rescue recapitalisation and asset relief measure for a period of six months. On 12 May 2009, the Netherlands sent the Commission a restructuring plan for ING covering the capital injection and the impaired asset measure. On 14 July 2009, a meeting was held between the Commission, the Netherlands, ING and the Dutch Central Bank to discuss the restructuring plan. In this meeting, the Commission called for additional compensatory measures, including a complete prohibition on acquisitions, a price leadership prohibition in the retail banking sector in the Netherlands, and significant divestments of assets in the Netherlands, Belgium and within ING. On 5 August 2009, a second meeting took place in which ING explained why the original restructuring plan proposed on 12 May 2009 should be accepted by the Commission. The Commission, however, reiterated that it considered the plan insufficient. On 13 August 2009, ING, through the Netherlands, submitted a new restructuring plan to the Commission based on the restructuring requirements laid down by the Commission. It was not until 18 November 2009 and several versions of the restructuring plan later, that the Commission authorised the capital injection and the impaired asset measure as restructuring aid.[315]

314 Impaired Assets Communication, points 30-31.

315 See GC, 2 March 2012, T-29/10 and T-33/10, ECLI:EU:T:2012:98 (*Netherlands and ING v Commission*), par. 9-38. EC, 18 November 2009. (2010/608/EC), (C10/09 (ex N138/09) – ING). See also Shamsi, Solomon and Robins 2017, p. 163-165, 177-179.

3.5.6 The assessment criteria for restructuring and liquidation aid

3.5.6.1 Restructuring aid

As set out in section 3.4.3.2, once a restructuring plan has been established and is being implemented, all further aid will be considered as restructuring aid. This includes aid already temporarily authorised by the Commission as rescue aid. Taking into account the more structural nature of restructuring aid, this will normally have the form of recapitalisation and/or asset relief measures. Liquidity support or funding guarantees can however also be granted in the form of restructuring aid. For restructuring aid to be approved by the Commission, certain specific assessment criteria have been set in the 2013 Banking Communication; these are discussed below.

Criterion 1: Restoring long-term viability
The Member State involved should submit a restructuring plan to the Commission in order to demonstrate how the bank will restore its long-term viability.[316] The aim of restructuring aid should always be restoring the long-term viability of the bank. In the event that the bank cannot be restored to viability, it should be wound up in an orderly fashion. In that case, the bank has no access to restructuring aid, but it may have access to liquidation aid.[317] Long-term viability is achieved when a bank is able to cover all its costs including depreciation and financial charges and provide an appropriate return on equity, taking into account the risk profile of the bank.[318] Long-term viability therefore requires that any State aid received is either redeemed over time, as anticipated at the time the aid is granted, or is remunerated according to normal market conditions, thereby ensuring that any form of additional State aid is terminated.[319]

Restructuring should be implemented as soon as possible and should not last more than five years to be effective and allow for a credible return to viability of the restructured bank.[320] Provision of additional aid during the restructuring period is an option if justified by reasons of financial

316 The restructuring plan is discussed in more detail in section 3.7.1.1.
317 Restructuring Communication, point 9.
318 Restructuring Communication, point 13.
319 Restructuring Communication, point 14.
320 Restructuring Communication, point 15.

stability.[321] This will however be subject to individual *ex ante* notification and any such further aid will be taken into account in the Commission's final decision.[322]

Criterion 2: Own contribution and burden-sharing

In order to limit distortions of competition and address moral hazard, aid should be limited to the minimum necessary, and an appropriate own contribution to restructuring costs should be provided by the aid beneficiary. The bank and its capital holders should contribute to the restructuring as much as possible with their own resources. This is necessary to ensure that rescued banks bear adequate responsibility for the consequences of their past behaviour and to create appropriate incentives for their future behaviour.[323] In order to meet the burden-sharing principle, (a) capital raising measures should be taken, (b) shareholders and subordinated debt holders should contribute to a maximum to the cost of intervention, and (c) the beneficiary bank should pay an adequate remuneration.[324] These measures are included in the capital raising plan which has to be submitted before or as part of the submission of a restructuring plan. The capital raising plan should achieve that the restructuring aid only solves the capital shortfall that remains after the implementation of this plan.[325]

Criterion 3: Measures to limit the distortion of competition

Whilst State aid can support financial stability in times of systemic crisis, with wider positive spillovers, it can nevertheless create distortions of competition in various ways. The Commission therefore, in its assessment of restructuring aid, includes the need to implement measures to limit the distortion of competition. Possible measures to limit the distortion of competition should be included in the restructuring plan.

321 Restructuring Communication, point 7, last indent.
322 Restructuring Communication, point 16.
323 Restructuring Communication, point 22.
324 Sections 3.5.4.2 and 3.5.4.3 contain a description of the guidance that the Commission has provided in relation to the pricing of rescue recapitalisations and asset relief measures. This guidance also applies in relation to the remuneration of recapitalisation and asset relief measures in the restructuring phase. Restructuring Communication, point 24, footnote 4.
325 Hancher, Ottervanger and Slot 2016, p. 569. The capital raising plan is discussed in more detail in section 3.7.1.2.

3.5.6.2 Liquidation aid

In the event that a bank cannot be credibly restored to viability, it should be wound up in an orderly fashion. In that case, the bank may have access to liquidation aid.[326]

> In the 2013 Banking Communication, the Commission recognises that due to the specificities of credit institutions and in the absence of mechanisms allowing for the resolution of credit institutions without threatening financial stability, it might not be feasible to liquidate a credit institution under ordinary insolvency proceedings. For that reason, State measures to support the liquidation of failing credit institutions may be considered as compatible aid.[327] As will be seen in section 6.5.2, the Commission may still consider liquidation aid to be compatible with the internal market after the introduction of the resolution framework.

Aid to assist in the winding up of a bank in an orderly manner
The bank that is to be wound up will normally continue to carry out some economic activities, also when limited to those necessary for winding up the bank in an orderly manner within a limited period of time. In that case it can be considered an aid beneficiary. For liquidation aid that assists in the winding up of the bank to be approved by the Commission, certain specific assessment criteria have been set in Section 6 of the 2013 Banking Communication; these are discussed below.

Criterion 1: Winding up of a bank in an orderly manner
The Member State should provide a comprehensive and detailed winding up plan that indicates how the bank can be wound up in an orderly fashion.[328] The goal of the orderly liquidation must be the cessation of the ailing bank's activity over a limited period of time. That goal implies that no new third party business may be undertaken. However, it does not prevent existing business from being executed if doing so reduces the liquidation costs. Moreover, liquidation must, as much as possible, aim at selling

326 Restructuring Communication, point 9.
327 2013 Banking Communication, point 66.
328 See for example EC, 25 January 2012, C(2012) 148 final (SA.33485 – Amagerbanken), par. 113-118.

off parts of the business or assets by means of a competitive process. The orderly liquidation procedure requires that the proceedings of any sale of assets contribute to the liquidation costs.[329]

Criterion 2: Limitation of liquidation cost to the minimum necessary
Member States should demonstrate that the aid enables the bank to be effectively wound up in an orderly fashion, while limiting the amount of aid to the minimum necessary to keep it afloat during the liquidation in view of the objective pursued.[330] In other words, it should be demonstrated that the chosen winding up scenario is the least costly option, in particular that an immediate liquidation or bankruptcy would be more costly and would present more systemic risk.[331] This should be set out in the plan for the orderly liquidation of a bank. This does not have to prove the viability of the bank.[332]

Criterion 3: Burden-sharing
In the context of liquidation, particular care has to be taken to minimise moral hazard, notably by excluding shareholders and possibly certain types of creditors from receiving the benefit of any aid in the context of the controlled winding up procedure.[333] Therefore, the claims of shareholders and subordinated debt holders must not be transferred to any continuing economic activity. The same capital raising and burden-sharing measures should be complied with as for restructuring aid.[334]

Criterion 4: Measures to limit the distortion of competition
To avoid undue distortions of competition, the winding up phase should be limited to the period strictly necessary for the orderly liquidation.[335] As long as the beneficiary bank continues to operate, it must not actively compete on the market or pursue any new activities. Its operations must in principle be limited to continuing and completing activities pending for existing customers. Any new activity with existing customers must be limited to changing the terms of existing contracts and restructuring existing loans, provided that this improves the respective asset's net present

329 2013 Banking Communication, point 67.
330 2013 Banking Communication, point 72.
331 Hancher, Ottervanger and Slot 2016, p. 634.
332 Hancher, Ottervanger and Slot 2016, p. 634.
333 2008 Banking Communication, point 46.
334 2013 Banking Communication, point 77. See section 3.7.1.2.
335 This timeframe can however be very long. For example, the Dutch DSB Bank has been unwinding for more than 10 years (Volkskrant, 10 jaar na faillissement draait DSB Bank als een tierelier, 22 October 2019).

value.[336] In addition, the pricing policy of the bank to be wound up must be designed to encourage customers to find more attractive alternatives. Where a banking license is necessary, for example for a rump bank or a temporary institution created for the sole purpose of orderly liquidation of a bank ('bridge bank'), it should be limited to the activities strictly necessary for the winding up. The banking license should be withdrawn as soon as possible by the competent authority.[337]

Aid to the sold economic activity

The liquidation of the bank may involve the sale of (parts of) that bank. In that case, the economic activity to be sold can be the beneficiary of the State aid if the functional identity of the activity continues to exist and is considered as an entity that perpetuates the commercial activity of the bank.[338] The compatibility of this aid is subject to an individual examination on the basis of the 2013 Banking Communication. The 2013 Banking Communication does not further specify which assessment criteria are used, except for criterion 1 below. In addition, criteria 2, 3 and 4 below can be derived from the Commission's decision practice.

Criterion 1: Viability of the integrated entity

The Commission verifies the viability of the entity resulting from the sale. In its viability assessment, the Commission takes into due consideration the size and strength of the buyer relative to the size and strength of the business acquired.[339]

Criterion 2: Limitation of aid to the minimum necessary

The aid is limited to the minimum necessary providing the sales process is carried out in a transparent, objective and non-discriminatory manner and the activities sold are sold at the highest price possible, while preserving the long-term viability of the purchaser.[340]

336 2013 Banking Communication, point 73-74.
337 2013 Banking Communication, point 75-76.
338 See for example EC, 25 January 2012, C(2012) 148 final (SA.33485 – Amagerbanken), par. 88-91.
339 2013 Banking Communication, points 65-82.
340 See for example EC, 25 January 2012, C(2012) 148 final (SA.33485 – Amagerbanken), par. 107.

Criterion 3: Burden-sharing
Burden-sharing is considered to be sufficient when the shareholders have lost control of the bank and all financial stakes therein without any compensation. The wipe-out of the shareholders and subordinated debt holders constitutes the maximum possible own contribution in the restructuring of the bank.[341]

Criterion 4: Measures to limit the distortion of competition
The Commission takes into account whether the sale of activities of the bank is undertaken in an open, transparent and non-discriminatory manner. In addition, it assesses the amount of aid, the period of time during which the economic activity benefitted from the aid, and the scope of activities to be transferred.[342]

Aid to the buyer
If the liquidation entails the sale of the bank or parts of it to a buyer, it should be assessed whether any aid granted in that respect benefits the buyer. The sale of a bank during an orderly liquidation procedure may entail State aid to the buyer, unless the sale is organised via an open and unconditional competitive tender and the assets are sold to the highest bidder.[343] The competitive tender should, where appropriate, allow for sale of parts of the bank to different bidders. In particular, when determining if there is aid to the bank's buyer or parts of it, the Commission examines whether:
(a) the sales process is open, unconditional and non-discriminatory;
(b) the sale takes place on market terms;
(c) the bank or the government, depending on the structure chosen, maximises the sales price for the assets and liabilities involved.

3.5.7 *Ad hoc cases, individual cases and schemes*

The previous sections set out the assessment criteria for rescue, restructuring and liquidation aid to individual banks on an *ad hoc* basis. This aid can, however, also be granted on the basis of general schemes adopted by

341 See for example EC, 25 January 2012, C(2012) 148 final (SA.33485 – Amagerbanken), par. 106, 108.
342 See for example EC, 25 January 2012, C(2012) 148 final (SA.33485 – Amagerbanken), par. 110-112.
343 2013 Banking Communication, points 79-81.

the Member States.[344] When aid is granted to a bank on the basis of a general scheme, this is called an individual case instead of an *ad hoc* case. The difference between an individual case and an *ad hoc* case is that awards of aid under general schemes are exempt from individual notification to the Commission. Since the Commission has already assessed – and approved – the compatibility with the internal market of the general scheme, it is not necessary to establish this compatibility for each individual case of application of the scheme, as long as the conditions of the general scheme are complied with in the individual case.

Twenty-one Member States adopted general schemes during and after the GFC, most of which have been extended multiple times; a number are still active even today.

Table 4: General schemes adopted by Member States during and after GFC[345]

Member State	**General scheme**
Austria	Bank support scheme
Bulgaria	Liquidity scheme
Croatia	Resolution scheme for small credit institutions
Cyprus	Special government bond scheme
	State guarantee scheme
Denmark	Compensation scheme
	Liquidity support scheme
	Recapitalisation scheme and guarantee scheme on new debt
	Guarantees for merging banks
	Winding-up scheme
Finland	Guarantee scheme
	Recapitalisation scheme
France	Bank guarantee scheme
	Bank recapitalisation scheme
	Régime de renforcement des fonds propres

344 A general scheme should be viewed as an aid scheme in accordance with Article 1(d) Procedural Regulation, that is "*any act on the basis of which, without further implementing measures being required, individual aid awards may be made to undertakings defined within the act in a general and abstract manner and any act on the basis of which aid which is not linked to a specific project may be awarded to one or several undertakings for an indefinite period of time and/or for an indefinite amount*."

345 This overview has been prepared by the author on the basis of the State aid decisions available on the Commission website: https://ec.europa.eu/competition/state_aid/register/.

Germany	Deposit guarantee scheme for private banks
	Asset relief scheme
	Refinancing scheme for export loans
	Bank rescue scheme
Greece	Bank guarantee scheme
	Hellenic Asset Protection Scheme (Hercules)
	Recapitalisation of credit institutions in Greece under the Financial Stability Fund
	Bond loan scheme for credit institutions
Hungary	Recapitalisation and guarantee scheme
	Liquidity scheme
Ireland	Eligible liabilities guarantee scheme
	Credit union resolution scheme
	Credit union restructuring and stabilisation scheme
	Asset relief scheme (NAMA)
Italy	Bank guarantee scheme
	Securitisation scheme
	Bank recapitalisation scheme
	Liquidation scheme for small banks
Latvia	Bank support scheme
Lithuania	Bank guarantee scheme
	Bank recapitalisation and asset relief scheme
Poland	Credit Unions Orderly Liquidation Scheme
	Bank guarantee scheme
	Resolution scheme for cooperative banks and small commercial banks
	Bank recapitalisation scheme
Portugal	Guarantee scheme
	Recapitalisation scheme
	Guarantee scheme on EIB lending
Slovakia	Bank support scheme
	Bank liquidity scheme
	Bank guarantee scheme
Spain	Recapitalisation scheme
	Guarantee scheme
	Fund for the acquisition of financial assets in Spain
Sweden	Bank guarantee scheme
	Bank recapitalisation scheme
The Netherlands	Guarantee scheme
United Kingdom	Credit easing scheme (NLGS)
	Working capital guarantee scheme
	Bank support scheme
	Assets backed securities scheme

It may be that aid, in the first instance, is granted to a bank on the basis of a general scheme, but is continued to be granted on an *ad hoc* basis. This can be the case when the conditions for granting aid on the basis of a general scheme are no longer met or when the general scheme provides for a notification obligation in case a second grant of State aid is considered.

> An example of a case in which State aid was first granted on the basis of a general scheme, followed by an *ad hoc* grant is the case of the Austrian bank HGAA. HGAA received a EUR 0.9 billion capital injection from Austria on the basis of the Austrian banking emergency rescue scheme. This scheme was approved by the Commission in December 2008. On 14 December 2009, an agreement was reached between the owners of HGAA and the Austrian State that Austria would acquire all the shares of HGAA for a symbolic price of EUR 1 and a capital injection of EUR 450 million. This aid was assessed on an *ad hoc* basis and temporarily approved by the Commission. Following the nationalisation, additional aid measures were notified and approved by the Commission, again on an *ad hoc* basis, after which liquidation of HGAA followed.[346]

3.5.7.1 Additional assessment criteria for aid schemes

The 2004 R&R Guidelines only provided for the possibility to adopt an aid scheme for granting rescue and restructuring aid to SMEs for a maximum sum of EUR 10 million per firm. The 2008 Banking Communication broadened the scope to guarantee and recapitalisation schemes for all financial institutions, no matter their size or the amount of the aid that was intended to be granted.[347] The options for these schemes were tightened up in the 2013 Banking Communication.

Under the 2013 Banking Communication, the assessment by the Commission of the compatibility with the internal market of aid schemes takes place on the basis of the same criteria used by the Commission for *ad hoc* cases, supplemented by the following criteria:

346 EC, 3 September 2013, C(2013) 5648 final, (SA.32554 – HGAA), points 1-13.
347 2004 R&R Guidelines, point 79. 2008 Banking Communication, point 13.

Additional criterion 1: Time limit

A scheme may be authorised by the Commission for a period of six months only.[348] After this, the scheme can be prolonged, but this requires a new assessment by the Commission. This criterion does not apply in relation to liquidation aid schemes.

Additional criterion 2: Reporting to the Commission

Member States must report to the Commission, so that the Commission can evaluate whether the relevant scheme achieves its objective and is implemented correctly. The periodicity of these reports depends on the type of aid scheme:

- Liquidity and guarantee schemes: Member States must report to the Commission on a three-monthly basis on the operation of the scheme, the guaranteed debt issues, and the actual fees charged. In addition, they must supplement their reports on the operation of the scheme with available updated information on the cost of comparable non-guaranteed debt issuances (nature, volume, rating, currency).[349]
- Recapitalisation and restructuring schemes: Member States must provide a report on the use of the scheme on a six-monthly basis after the scheme's authorisation.[350]
- Liquidation schemes: Member States must provide regular reports, at least on an annual basis, on the operation of any liquidation scheme. In addition, Member States must submit regular reports (on at least a yearly basis) on the development of the liquidation process of each bank in liquidation, and a final report at the end of the winding up procedure.[351]

Additional criterion 3: No capital shortfall (only for liquidity and guarantee schemes)

Liquidity support schemes and funding guarantee schemes must be restricted to banks which have no capital shortfall. In addition, they may only cover guarantees with a maturity of more than three years, if these guarantees are limited to one-third of the total guarantees granted to the individual bank.[352]

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348 See for liquidity and guarantee schemes: 2013 Banking Communication, point 57. See for impaired assets schemes: Impaired Assets Communication, point 26.

349 2013 Banking Communication, point 60.

350 2013 Banking Communication, point 54-55.

351 2013 Banking Communication points 87-88.

352 2013 Banking Communication, point 60(b).

Additional criterion 4: Maximum balance-sheet (only for recapitalisation and restructuring schemes)
The application of any recapitalisation and restructuring scheme must be restricted to banks with a balance-sheet total of not more than EUR 100 million. The sum of the balance-sheets of the banks that receive aid under the scheme must not exceed 1.5% of the total assets held by banks in the domestic market of the Member State concerned.[353]

Additional criterion 5: Limited size (only for liquidation schemes)
Liquidation aid schemes can only be approved for banks of limited size. Aid measures under an approved scheme in favour of banks with total assets of more than EUR 3,000 million must be individually notified for approval.[354]

3.6 Granting State aid to a group

In most instances, banks that are beneficiaries of State aid are not standalone entities, but form part of a group, including entities in multiple Member States. Questions may arise as to the appropriate level on which to award State aid (e.g. at the holding level or at the level of bank subsidiaries) and cooperation between Member States (e.g. in relation to the respective shares in the support or the impact of restructuring measures). The State aid regime for the banking sector does not contain specific provisions in relation to the assessment of State aid awards to groups. The EU Courts, however, dealt with some questions in this respect. In addition, the Commission decisions contain some guidance as to how the Commission deals with the assessment of State aid awards to groups.

3.6.1 Determination of the aid beneficiary within a group

In order for a group entity to qualify as aid beneficiary, it is not necessary that the aid measure was granted to the entity. The measure can also be granted to one group entity, while another group entity benefits from this aid, and therefore (also) qualifies as aid beneficiary. This is especially important, if the first entity does not qualify as an 'undertaking', as only aid granted to an undertaking can qualify as State aid.

353 2013 Banking Communication, point 54.
354 2013 Banking Communication, point2 83-86.

> A holding company of a bank does not qualify as an 'undertaking', if it does nothing more than holding shares in companies, even controlling shareholdings, where its function gives rise only to the exercise of the rights attached to the status of shareholder or member, as well as, if appropriate, the receipt of dividends, which are merely the fruits of the ownership of an asset. This is different, if the holding company actually exercises control by involving itself directly or indirectly in the management of the bank. [355]

Which entity is the aid beneficiary is also important when the 'one time, last time' principle applies. Although this principle does not apply under the 2013 Banking Communication, it is included in the 2014 R&R Guidelines.

> The 2014 R&R Guidelines set out that where a business group has received rescue aid or restructuring aid, the Commission will normally not allow further rescue or restructuring aid to the group itself or any of the entities belonging to the group unless 10 years have elapsed. This should be seen against the background that rescue and restructuring aid is considered among the most distortive types of State aid.[356] If the aid was granted to a single entity belonging to a business group, the group as a whole as well as the other entities of the group remain eligible for rescue or restructuring aid, with the exception of the earlier beneficiary of the aid. In that case, Member States have to demonstrate that no aid will be passed on from the group or other group entities to the earlier beneficiary of the aid.[357]

There may be multiple aid beneficiaries in one banking group. If State aid is granted to a banking group, it may, for example, be that the aid awarded to the bank also benefits the shareholder of the bank (which may be a bank in its turn).

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355 Quigley 2015, p. 57. Sánchez Rydelski 2006, p. 83-84. ECJ, 10 January 2006, C-222/04, ECLI:EU:C:2006:8 (*Cassa di Risparmio di Firenze and Others*), par. 111-112.

356 2014 R&R Guidelines, point 6, 70.

357 2014 R&R Guidelines, point 74. To determine whether a company is independent or forms part of a group, the criteria laid down in Annex I to Recommendation 2003/361/EC are taken into account under the 2014 R&R Guidelines (2014 R&R Guidelines, footnote 28).

> In the case of the Austrian bank HGAA, the Commission considered that the aid for HGAA also seemed to benefit its shareholder BayernLB. Without the aid, HGAA would have become insolvent and BayernLB would have lost not only its capital in that bank but also (part or all of) liquidity provided to HGAA. In addition, the rescue of HGAA might have prevented a possible negative reputational effect for BayernLB which could have followed, if it had let its main subsidiary go bankrupt. Therefore, the Commission considered that BayernLB benefited from the aid granted to its subsidiary HGAA.[358]

If State aid is granted to a shareholder of a bank, after which the shareholder uses part of the State aid to assist its bank subsidiary, this should not be double counted as State aid.

> BayernLB was itself recapitalised by the Free State of Bavaria in 2008 and used part of the funds to recapitalise its subsidiary HGAA. The full amount of the recapitalisation granted by the Free State of Bavaria constituted aid to BayernLB. As the amount of aid in one measure cannot be double-counted, the Commission concluded that the recapitalisation of HGAA by BayernLB did not constitute State aid to the benefit of HGAA.[359]

3.6.2 Cost allocation within a group

Under the 2004 R&R Guidelines, if a firm in difficulty formed part of a larger business group, it was only eligible for rescue and restructuring aid where it could be demonstrated that the firm's difficulties were intrinsic and were not the result of an arbitrary allocation of costs within the group, and that the difficulties were too serious to be dealt with by the group itself.

> In the case of SachsenLB, for example, the Commission considered that the eligibility seemed not to be hampered by the fact that SachsenLB belonged to a group in the sense of point 13 of the 2004 R&R Guidelines, given that the difficulties were intrinsic and too serious to be dealt with by the group itself.[360]

358 EC, 23 December 2009, C(2009) 10672 final (C16/2009 and N698/2009 – BayernLB and HGAA), par. 52.
359 EC, 3 September 2013, C(2013) 5468 final (SA.32554 – HGAA), par. 96.
360 EC, 27 February 2008, C(2008)/ 711 def. (C9/2008 – SachsenLB), par. 64. Another example can be found in EC, 22 November 2006, C(2006)5427 final (C50/2006 – BAWAG-PSK), footnote 15.

The 2013 Banking Communication contains no similar condition.

3.6.3 Cooperation between Member States

It is the prerogative of the Member States to decide whether or not to grant State aid to undertakings established in their territory, to decide on the amount of the aid, and to decide on the eligibility of beneficiaries. This can lead to coordination issues, especially when a Member State is led by protectionist motives.

> A remarkable example of (the lack of) cooperation between Member States, is the case of Cyprus Popular Bank Public Co Ltd (Laiki). This Cypriot bank had to seek government assistance due to severe losses and deposit outflows. Cyprus was, however, cut off from international capital markets at that time, as a result of which Laiki could not be bailed out by Cyprus. It therefore tried to get assistance from Greece. Laiki had a Greek subsidiary which it had converted into a branch of the Cypriot parent bank. Due to this status as branch, Laiki was however denied access to the ELA of the Greek central bank and recapitalisation mechanisms made available to banks located in Greece. The assistance that Cyprus eventually provided came too late and Laiki had to sell its Greek operations to Piraeus Bank. This formed the reason for Laiki to start arbitral proceedings against Greece under the 1992 bilateral investment treaty between Greece and Cyprus, reportedly alleging unequal treatment in relation to other banks operating in Greece.[361] At the time of writing this dissertation, the arbitral proceedings are still pending.
>
> Another case concerns the aid scheme adopted in Ireland at the beginning of the GFC. This aid scheme only guaranteed the debts and deposits of the six largest Irish banks and their subsidiaries abroad; it was not available for banking subsidiaries or branches of foreign banks active in Ireland. This created a cross-border flow of cash from British businesses to the Irish banks covered by the aid scheme which made the British banks active in Ireland more fragile. Following discussions with the Commission, the scope of the aid scheme was broadened to include five foreign banking subsidiaries in Ireland with a significant and broad-based footprint in the

361 Laprévote and Frisch 2017, p. 213. Cyprus Popular Bank Public Co. Ltd. v. Hellenic Republic, ICSID Case No. ARB/14/16.

domestic economy and foreign branches having a systemic significance. The Commission subsequently accepted that the rules of the aid scheme were not discriminatory in themselves.[362]

Sometimes, the award of State aid is a joint action by several Member States.

Kaupthing Bank Luxembourg provided private banking services in Luxembourg and through its two branches in Belgium and Switzerland. Luxembourg provided a loan of EUR 320 million to Kaupthing Bank Luxembourg when it became impossible for the bank to refinance itself. Belgium financed half of the loan through an interstate loan to Luxembourg of EUR 160 million. Both Belgium and Luxembourg notified the Commission of the measures taken. Belgium stated that it supported the notification from the Luxembourg authorities. The Commission therefore assumed that the Belgian authorities endorsed all facts and circumstances cited by the Luxembourg authorities in support of their notification and henceforth only referred to Luxembourg. The Commission considered the loan from the Belgian State to the Luxembourg State not to constitute State aid because it was simply a transfer of funds between States. The loan from Luxembourg to Kaupthing Bank Luxembourg was considered State aid.[363]

In the case of Fortis, the Belgian, Luxembourg and Dutch authorities notified the Commission of the application of three measures to assist Fortis Banque, Fortis Banque Luxembourg and Fortis Bank Nederland: Belgium nationalised Fortis Banque, provided liquidity assistance and financed an investment vehicle to buy impaired assets from Fortis Banque; Luxembourg provided a convertible loan to Fortis Banque Luxembourg; the Netherlands repurchased Fortis Bank Nederland, provided the necessary funding for the repayment of loans granted to Fortis Bank Nederland by Fortis Banque and acquired Fortis Insurance Nederland. Subsequently, 76% of the shares in Fortis Banque and 16% of those in Fortis Banque Luxembourg

362 EC, 13 October 2008, C(2008)6059 (NN 48/2008 – Ireland), par. 47.
363 EC, 9 July 2009, C(2009) 5640 final (N 344/2009 and N 380/2009 – Kaupthing Bank Luxembourg), par. 23, 31-34.

were sold to BNP Paribas.[364] The aid measures were separately assessed by the Commission, but addressed in combined decisions.[365]

In the case of Dexia, the authorities of Belgium, France and Luxembourg notified the Commission of the aid measures taken in relation to Dexia. These measures consisted of a capital injection by both Belgium and France in Dexia, the parent company of the Dexia group. Luxembourg invested EUR 376 million in Dexia Banque Internationale Luxembourg SA in the form of convertible bonds. In addition, Belgium, France and Luxembourg extended a joint and non-several guarantee to Dexia covering all financing obtained by Dexia and its subsidiaries Dexia Banque Belgique, Dexia Banque Internationale à Luxembourg, and Dexia Crédit Local from credit institutions and institutional depositors, and the bonds and debt instruments issued by Dexia to institutional investors.[366]

The Member State that awards the State aid has to submit a restructuring plan. The restructuring may imply the divesture of branches and/or subsidiaries, not only in the territory of the Member State that awards the State aid, but also in other Member States. This may have (far-reaching) consequences for the competition in the territory of this other Member State, but it may also have a social impact, e.g. in the form of reduction of employment. The question may therefore arise as to how the distortion-correction in one Member State should be weighed against the distortion-correction in another.[367]

In taking restructuring decisions, the Commission explicitly weighs the risk that divestments of foreign subsidiaries would fragment the internal market. In a number of cases, the Commission requested that banks divested assets in domestic markets instead, with a view toward ensuring competitive market conditions therein.[368]

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364 EC, 12 May 2009, C(2009) 3907 final (N 255/2009 and N 274/2009 – Fortis), par. 1.

365 EC, 12 May 2009, C(2009) 3907 final (N 255/2009 and N 274/2009 – Fortis), par. 40. EC, 3 December 2008, C(2008) 8085 (NN 42/2008, NN 46/2008 and NN 53/A/2008) – Fortis).

366 EC, 19 November 2008, C(2008) 7388 final (NN 49/2008, NN 50/2008 and NN 45/2008 – Dexia), par. 2-8, 10, 17, 18.

367 Hancher, Ottervanger and Slot 2016, p. 36. See also De Serière *Ondernemingsrecht* 2009, par. 7.

368 Koopman *CPI* 2011, p. 14. See, e.g., EC, 18 November 2009, C(2009) 9087 final (N 428/2009 – Lloyds Banking Group), par. 99; EC, 18 November 2009 C(2009) 8980 final (C 18/2009 – KBC), par. 52, 173-176.

In practice, the number of cases in which the Commission obtained from banks the commitment that they divest standalone units on their home markets remained quite limited. The divestitures often concerned foreign subsidiaries or 'non-core activities'.[369] Laprévote and Frisch describe that in the case of Dexia, the restructuring led to discussions between France and Belgium. The two countries were unable to agree on the right formula for splitting the group into a bad bank and a good bank. This reflected the two Member States' diverging incentives, as Belgium sought to preserve the soundness of one of its largest retail banks and to secure financial stability, while France, where Dexia's retail banking activities were much more limited, aimed to preserve a key actor in local authority and hospital funding. As a result, the restructuring package eventually approved by the Commission on 26 February 2010 did not foresee the creation of a bad bank.[370]

3.6.4 *Cooperation with third country authorities*

A final attention point relates to the coordination between the Commission and third country authorities in case a banking group has a third country presence in the form of branches or subsidiaries. In such a case, coordination with third country authorities may be necessary, e.g. because the third country authority approves State aid granted to the third country presence, or in relation to the implementation of restructuring measures in respect of the third country presence. Although many banks granted State aid during the GFC were active outside the EU, e.g. in the US, to the best of the author's knowledge, none of the decisions from the Commission discussed cooperation with third country authorities.

The Commission supports both multilateral and bilateral cooperation. On 2 June 2017, the Commission signed a Memorandum of Understanding (the MoU) with China on a dialogue in the area of State aid control in order to exchange on how to optimise and steer the use of State resources to promote the efficient and sustainable economic developments of both economies. The MoU does not contain any provisions in relation to the cooperation in actual cases.

369 Laprévote and Frisch 2017, p. 200.
370 Laprévote and Frisch 2017, p. 206-207.

> The Commission cannot exercise powers conferred on it by Article 108 TFEU in respect of aid measures granted by third countries.[371] The Commission can therefore not interfere when a third country subsidiary of a European banking group receives aid from a third country. It may however be argued that the Commission can take this third country aid into consideration when exercising its discretion with regard to State aid granted to an EU entity within that banking group.[372] In the situation where an EU subsidiary of a third country banking group receives State aid, the third country is regarded – in legal proceedings before the EU Courts against the Commission decision in respect of this aid – like any person, distinct from the Member States, who must establish an interest in the result of the case.[373]

3.7 Treatment of the beneficiary bank

The 2013 Banking Communication provides that a bank that receives State aid of a structural nature or, in certain circumstances, of a non-structural nature needs to restructure. If it is clear that restructuring will not lead to a restoration of the long-term viability of the beneficiary bank, the bank will need to be liquidated. This section discusses which requirements are imposed when a bank is restructured or wound up in normal insolvency proceedings.

> Since the start of the GFC in 2008 until December 2014, the Commission has approved restructuring plans for 56 banks, agreed on plans for orderly wind up for 33 banks, and reviewed the viability of 14 others without further need for a restructuring plan.[374]

371 See e.g. GC, 18 June 2019, T-624/15, T-694/15 and T-704/15, ECLI:EU:T:2019:423 (*European Food and Others v Commission*), par. 79.
372 See also Sánchez Rydelski 2006, p. 426.
373 See e.g. Order of the Vice-President of the Court, 17 May 2018, C-12/18 P, ECLI:EU:C:2018:330 (*USA v Apple Sales International and Others*), par. 9. See further on judicial protection against State aid decisions section 3.9.
374 EC State aid brief 2015, p. 1.

3.7.1 Restructuring

This section describes the content of the restructuring and capital raising plan. A restructuring plan is normally accompanied or preceded by a capital raising plan.

> In the phase of rescue aid, the Commission already takes commitments by Member States to impose certain behavioural constraints into account, such as a ban on advertising State support, a ban on aggressive commercial strategies, dividend restrictions, or a cap on executive remuneration. [375]

The exact nature and scope of the required restructuring is discussed between the Commission, the Member State involved and (unofficially) the beneficiary bank, its shareholders and its competitors.[376] This is a political game that is not transparent for outsiders.[377] The starting point is the restructuring plan submitted by the Member State. It is therefore the Member State that decides on the scope and nature of the measures, in concert with the beneficiary bank. The Commission has, however, to agree with the restructuring plan. If it does not agree, the Member State has to submit a revised restructuring plan.[378] This revision often takes the form of commitments regarding how the Member State or the beneficiary will act in the future.[379] If the Commission is still not satisfied after the submission of the revised restructuring plan, it can issue a negative decision. It can attach

375 See section 3.5.4.

376 Gray and De Cecco 2017, p. 39.

377 The EU Courts have acknowledged the existence of a general presumption that disclosure of documents in the administrative file relating to a procedure for reviewing State aid in principle undermines the protection of the objectives of investigation (ECJ, 29 June 2010, C-139/07 P, ECLI:EU:C:2010:376 (*Commission v Technische Glaswerke Ilmenau*), par. 60-63). In June 2016, a report was prepared on request of the Commission on the perception and awareness about transparency of State aid. The key findings were harsh: European citizens are insufficiently aware about State aid and, most Europeans think information about State aid is difficult to find. Most think there should be full access to information about the State aid given to companies, but few think sufficient information is actually available. A majority of respondents agree that transparency about State aid is beneficial, but relatively few think it has recently improved. Of the respondents, 43% think there is a need for more transparency about State aid in financial services (Special Eurobarometer Report 2016, p. 4, 44). See in reaction to these findings: EC, State aid transparency: Why? What? When? Where? How?, Competition policy brief, 2016(4), p. 3.

378 See for example EC, 19 July 2011, C(2011) 5229 final (SA.32172 and SA.32554 – HGAA), par. 38-39. See also Botta *JEI* 2016, p. 274.

379 Hancher, Ottervanger and Slot 2016,, p. 613.

certain conditions to its approval of the State aid award, but, only, if this approval follows the formal investigation procedure.[380] As a result, the design of State aid is the result of complex interactions between the parties involved. The Commission has, however, a decisive influence on the nature and scope of restructuring requested from the bank, taking into account that the Commission has the exclusive power to authorise the State aid measure. If a beneficiary bank is unhappy with the restructuring obligations as part of the State aid approval, it can challenge the decision from the Commission in the EU Courts, as further discussed in section 3.9.2.

> Under the application of the proportionality principle, the 2008 Banking Communication, Recapitalisation Communication and Impaired Assets Communication made a difference in treatment between illiquid but otherwise fundamentally sound banks and banks characterized by endogenous problems. Fundamentally sound banks were banks whose problems merely and largely had to do with the extreme situation in the GFC, rather than with the soundness of their business model.[381] Under the Recapitalisation Communication, recapitalisation of banks that were not fundamentally sound could only be accepted on the condition of either the bank's winding up[382] or a thorough and far-reaching restructuring, including a change in management and corporate governance where appropriate.[383] In addition, the price charged for recapitalisation should be set higher for banks that were characterised by endogenous problems than for banks that were fundamentally sound.[384] Pursuant to the Restructuring Communication, distortions of competition resulting from aid measures supporting fundamentally sound banks were

380 During the period 2008 to 2016, the Commission adopted 10 conditional decisions (EC Memo 2016). See for the difference between commitments and conditions Hancher, Ottervanger and Slot 2016, p. 613-615.

381 2010 Prolongation Communication, point 12. The Recapitalisation Communication set a number of indicators to further define the distinction between fundamentally sound banks and banks characterized by endogenous problems: capital adequacy, current credit default swap spreads, current rating of the bank and its outlook as well as, *inter alia*, the relative size of recapitalisation.

382 Recapitalisation of a bank that is subsequently wound up seems to be economically illogical, taken into account that recapitalisation normally is a 'going concern' solution. The Recapitalisation Communication however considers that a capital injection from public sources providing emergency support to an individual bank may help to avoid short term systemic effects of its possible insolvency (Recapitalisation Communication, point 6).

383 Recapitalisation Communication, point 44.

384 Recapitalisation Communication, point 44.

deemed to be more limited.[385] If the beneficiary was fundamentally sound, the Member State was required to submit a viability review to the Commission instead of a restructuring or liquidation plan. In that case, the Commission requested less detailed information, albeit that the principles underlying the restructuring plan applied by analogy to viability reviews.[386]

Under the 2010 Prolongation Communication, which applied to State aid measures as of 1 January 2011, the distinction between sound and distressed banks was deemed to be no longer relevant in order to determine which banks should restructure and which banks should not. This was a result of the renewed access to capital markets.[387] A restructuring plan was again required from every beneficiary of State aid, independent of the cause of its failure.[388] In the 2011 Prolongation Communication, the Commission explains that it makes a proportionate assessment of the long term viability of banks, taking full account of elements indicating that banks could be viable in the long term without the need for significant restructuring.[389] This means that banks can benefit from a complete or partial exemption from restructuring. It can be derived from the 2011 Prolongation Communication that the proportionate assessment was particularly introduced while having in mind the situation in which the capital shortage of a bank is essentially linked to a confidence crisis on sovereign debt and the sovereign debt portfolio had not been acquired by the bank as a result of excessive risk-taking.[390]

3.7.1.1 The restructuring plan

A restructuring plan should include:

1. Information on the bank, including in particular its organisational structure, funding (demonstrating viability of the short and long term funding structure), corporate governance (demonstrating prevention of conflicts of interest as well as necessary management changes), risk management (including disclosure of impaired assets

385 2008 Banking Communication, point 14.
386 Restructuring Communication, point 8, footnote 2 and 4. 2010 Prolongation Communication, point 12.
387 2010 Prolongation Communication, points 13-14.
388 2010 Prolongation Communication, point 14.
389 2011 Prolongation Communication, point 14.
390 See Gray and de Cecco 2017, p. 34-35.

and prudent provisioning for expected non-performing assets), and asset-liability management, cash-flow generation (which should reach sufficient levels without State support), off-balance sheet commitments (demonstrating their sustainability and consolidation when the bank bears a significant exposure), leveraging, current and prospective capital adequacy in line with applicable supervisory regulation (based on prudent valuation and adequate provisioning), and the remuneration incentive structure (demonstrating how it promotes the beneficiary's long-term profitability);

2. A market description and calculations of market shares;
3. An analysis of the reasons why the bank ran into difficulty;
4. A comparison with alternative options, including a break-up or absorption by another bank, in order to allow the Commission to assess whether more market oriented, less costly or less distortive solutions are available consistent with maintaining financial stability.[391]
5. A description of the State intervention (that is, information on whether the bank or its subsidiaries have already received rescue or restructuring aid in the past, information on the form and amount of the State support) and assessment of the State aid;
6. A presentation of the measures that will be taken to restore the long-term viability of the bank, including a presentation of the different market assumptions and a description of the repayment plan of the State aid;
7. A presentation of the measures that will limit the distortion of competition; and
8. Monitoring arrangements.[392]

Ad 6: Measures to restore the long-term viability of the bank

The restructuring plan needs to include measures to restore the long-term viability of the bank, because zombie banks artificially kept alive distort competition and market prices, do not provide for financial stability and cannot lend to the real economy.[393] The restructured bank should be able to compete in the marketplace for capital on its own merits in compliance with relevant regulatory requirements.[394]

391 Restructuring Communication, point 9.
392 Restructuring Communication, point 46. Restructuring Communication, Annex.
393 Laitenberger 2016, p. 4.
394 See also section 3.5.6.1.

> In a speech of 28 June 2017, Ms Vestager, in her role as DG Competition Commissioner, stated that the overwhelming majority of banks that had restructured under the State aid rules were returning to viability. On average, three years after the start of that restructuring, they perform just as well as banks that didn't need aid.[395]

The expected results of the planned restructuring need to be demonstrated in the restructuring plan under a base case scenario as well as under 'stress' scenarios. For this, restructuring plans need to take account, *inter alia*, of the current state and future prospects of the financial markets, reflecting base-case and worst-case assumptions.[396] On the basis of the outcome of this 'stress testing', certain measures should be proposed in the restructuring plan to restore the long-term viability of the bank. These measures should be mainly internal measures, such as a withdrawal from activities which would remain structurally loss making in the medium term.[397] The solutions can however range from limited restructuring with no divestments to winding up the bank in an orderly manner. An adjustment in the bank's business model can also be necessary, *inter alia*, to reduce systemic risks.[398] This can consist of an investment restriction in the form of an acquisition ban (if the bank has insufficient capital buffers), constraints in respect of the investment portfolio, price leadership bans and restrictions on profitability (when aggressive pricing and commercial practices have contributed to the structural difficulties of the beneficiary).[399] In addition to divestments and business constraints measures, corporate governance measures have been central for promoting the return to viability. These can include changes in the management of the bank or reinforcement of the role of the risk control committee.[400]

> In the case of the restructuring of the German bank WestLB, the Commission had demanded a change in the ownership structure, because it was the finding of the Commission that the problems of WestLB were caused by the pursuit of the wrong business model which it needed to change in order to achieve long-term viability. The shares of WestLB were hold by the German State and other State-controlled entities. A shareholder in WestLB brought

395 Vestager 2017-1. See also Athanasaki *EPL* 2017, p. 622.
396 Restructuring Communication, point 13.
397 Restructuring Communication, point 12.
398 Bomhoff, Jarosz-Friss and Pesaresi *CPN* 2009, p. 3.
399 Iftinchi 2017, p. 64-65.
400 EC Staff Working Paper 2011, p. 59-60.

an action for annulment of the decision from the Commission before the GC, *inter alia*, because it did not agree on the requirement set by the Commission. The GC considered that the Commission is not required to explain the need for each measure provided for by the restructuring plan or to seek to impose only the least restrictive measures, unless the Member State has not committed itself to the restructuring plan or committed itself only to a restructuring plan because the Commission had definitively informed it that the aid would not be authorised in the absence of those measures.[401] The shareholder in WestLB had not submitted a plea for annulment of the contested decision alleging that the Commission used coercion or placed undue pressure on Germany so that it would commit itself to the final restructuring plan.[402] In addition, in principle, the fact that authorisation of restructuring aid is made subject to compliance with the measures provided for by the restructuring plan to which the Member State concerned has committed itself cannot result in an infringement of the principle of equal treatment .[403]

Ad 7: Measures to limit the distortion of competition

Whilst State aid can support financial stability in times of systemic crisis, with wider positive spillovers, it can nevertheless create distortions of competition in various ways. State aid prolongs past distortions of competition created by excessive risk-taking and unsustainable business models by artificially supporting the market power of beneficiaries. In this way it may create a moral hazard for the beneficiaries, while weakening the incentives for non-beneficiaries to compete, invest and innovate. Finally, State aid may undermine the single market by shifting an unfair share of the burden of structural adjustment and the attendant social and economic problems to other Member States, whilst at the same time creating entry barriers and undermining incentives for cross-border activities.[404]

401 GC, 17 July 2014, T-457/09, ECLI:EU:T:2014:683 (*Westfälisch-Lippischer Sparkassen- und Giroverband v Commission*), par. 297.
402 GC, 17 July 2014, T-457/09, ECLI:EU:T:2014:683 (*Westfälisch-Lippischer Sparkassen- und Giroverband v Commission*), par. 378.
403 GC, 17 July 2014, T-457/09, ECLI:EU:T:2014:683 (*Westfälisch-Lippischer Sparkassen- und Giroverband v Commission*), par. 370.
404 Restructuring Communication, point 28.

The restructuring plan should therefore also include measures to limit the distortion of competition as a result of the State aid award. These should not compromise the prospects of the bank's return to viability.[405]

> Despite the fact that the distinction between measures limiting distortions and measures to restore the long-term viability of the bank can be useful to better understand the restructuring process, some measures can address two objectives at the same time – for instance, a divestment could be instrumental in restoring the viability of the beneficiary and in mitigating distortions of competition.[406] In practice, the distinction could therefore be less clear than presented here.

The Commission takes as a starting point for its assessment of the need for measures limiting distortions of competition the size, scale and scope of the activities that the bank in question would have upon implementation of a credible restructuring plan. Depending on the nature of the distortion of competition, it may be addressed through measures in respect of liabilities and/or in respect of assets. The nature and form of these measures depend on two criteria:

1. The amount of the aid and the conditions and circumstances under which it was granted; and
2. The characteristics of the market or markets on which the beneficiary bank will operate.[407]

As regards the first criterion, measures limiting distortions will vary significantly according to the amount of the aid as well as the degree of burden-sharing and the level of pricing. Generally speaking, where there is greater burden-sharing and the own contribution is higher, there are fewer negative consequences resulting from moral hazard. Therefore, the need for further measures is reduced.[408]

As regards the second criterion, the Commission analyses the likely effects of the aid on the markets where the beneficiary bank operates after the restructuring. Firstly, the size and the relative importance of the bank on its market or markets, once it is made viable, are examined. If the restructured bank has limited remaining market presence, additional constraints,

405 Restructuring Communication, point 32.
406 EC Staff Working Paper 2011, p. 59.
407 Restructuring Communication, point 30.
408 Restructuring Communication, point 31.

in the form of divestments or behavioural commitments, are less likely to be needed.[409] In addition, the Commission pays attention to the risk that restructuring measures may undermine the internal market and positively views measures that help to ensure that national markets remain open and contestable.[410]

The measures to limit the distortion of competition can be divided in structural measures, corporate governance measures and behavioural measures.[411]

Structural measures

The structural measures that can be included in the restructuring plan to limit the distortion of competition may differ. Their purpose is to incentivise the entry of competitors as well as cross-border activity.[412] Examples thereof are:

– The sale of the entire bank to another bank via a transparent, objective, unconditional and non-discriminatory competitive sale process to offer equal opportunities to all potential bidders.[413]
– Divestment of subsidiaries or branches, portfolios of customers or business units.[414]
– The creation of an autonomous 'bad bank'. The 'bad' assets and liabilities of a bank in difficulty are in this solution transferred to another entity or put in run-off.[415]
– The creation of an autonomous 'good bank'. This solution entails that the 'good' assets and liabilities are transferred to another entity.[416]

409 Restructuring Communication, point 32.
410 Restructuring Communication, point 33. For some banks divestment was a condition for receiving State aid. For other banks, the lack of refinancing capacity forced them to divest or withdraw from foreign markets. Liikanen Report 2012, p. 9, 16.
411 In addition to these measures, the restructuring can also include government measures (see Restructuring Communication, point 45). Such measures have to be executed by the Member States and consist of promoting more sound and competitive markets, for instance by favoring entry and exit. The author does not further discuss such measures, since these are not directly directed at restructuring individual banks.
412 Shamsi, Solomon and Robins 2017, p. 151.
413 Restructuring Communication, point 18.
414 Restructuring Communication, point 35.
415 Restructuring Communication, point 21.
416 Restructuring Communication, point 21.

– The obligation to provide access to infrastructure by the beneficiary to its competitors.[417]
– Commitments to pre-announced paths that alter the bank balance sheet (that is, the improvement of indicators, such as short-term funding compared as a percentage of total funding, the average maturity of long term funding, and the proportion of 'stable funding').[418]

Where the imposition of structural measures is not appropriate, the Commission may accept the imposition by the Member State of a clawback mechanism, for example in the form of a levy on the aid recipients.[419]

Corporate governance measures
In addition to the structural measures set out above, banks can also be required to take certain internal governance measures. If recourse to State aid could have reasonably been averted through appropriate and timely management action, any entity relying on State aid for its restructuring or winding up in an orderly manner should normally replace the CEO, as well as other board members, if appropriate.[420] Some Member States imposed the appointment of new board members or their direct participation in the board, sometimes with veto power on key decisions (such as acquisition, compensation or dividend payments).[421]

In addition, entities in need of recapitalisation or asset relief measures should apply strict executive remuneration policies. This requires a cap on remuneration of executive pay combined with incentives ensuring that the bank is implementing its restructuring plan towards sustainable, long-term company objectives. Thus, any bank in receipt of State aid in the form of recapitalisation or asset relief measures should restrict the total remuneration to staff, including board members and senior management, to an appropriate level. The total remuneration of any such individual may not exceed 15 times the national average salary in the Member State where the beneficiary is incorporated or 10 times the average salary of employees in the beneficiary bank. Restrictions on remuneration must apply until the end of the restructuring period or until the bank has repaid the State aid, whichever occurs earlier.[422]

417 EC Staff Working Paper 2011, p. 62.
418 EC Staff Working Paper 2011, p. 62. Restructuring Communication, point 36.
419 Restructuring Communication, point 42.
420 2013 Banking Communication, point 37.
421 EC Staff Working Paper 2011, p. 54.
422 2013 Banking Communication, point 38.

Lastly, any bank in receipt of State aid in the form of recapitalisation or asset relief measures should not in principle make severance payments in excess of what is required by law or contract.[423]

Behavioural measures

State aid should not be used to the detriment of competitors which do not enjoy similar public support. It can therefore be necessary to include certain behavioural measures in the restructuring plan. The 2013 Banking Communication, in combination with the relevant Crisis Communications, remains open as to the specificities of these commitments. Member States consequently adopted a wide set of measures to foster appropriate behaviour from beneficiaries:

– A ban on using State aid for the acquisition of competing businesses. In exceptional circumstances and on notification, acquisitions may be authorised by the Commission where they are part of a consolidation process necessary to restore financial stability or to ensure effective competition.[424]
– A ban on dividend or limitations on the payment of dividends for the duration of the State aid.
– A ban on advertising the State support when marketing financial offers.
– A ban on aggressive commercial strategy.
– A ban on price leadership. State aid should not be used to offer terms (for example as regards rates or collateral) which cannot be matched by competitors which are not in receipt of State aid.
– Formal commitments by the beneficiary to ensure lending to SMEs and households with sometimes quantified targets for those subcategories.[425]

The behavioural measures should remain in place, depending on the scope, size and duration of the aid, for a period ranging between three years and the entire duration of the restructuring period (normally, five years). They would then also serve as a clear incentive to repay the State as soon as possible.[426]

423 2013 Banking Communication, point 39.
424 Restructuring Communication, point 41.
425 Restructuring Communication, point 44. EC Staff Working Paper 2011, p. 53-54, 62-64.
426 Restructuring Communication, point 44.

According to Shamsi, Solomon and Robins there is a general scepticism among commentators about whether compensatory measures introduced during the financial crisis were effective at achieving their stated objectives. Commentators noted that instead of aiming to remedy distortions to competition, many of the structural measures appear to have been imposed so as to restructure the market and to sanction excessive risk taking and mismanagement.[427] According to some, structural measures may even have reduced competition, undermined the competitive process and damaged the economy by reducing lending.[428] According to Heimler and Jenny, the introduction of broad and discretionary behavioural remedies cannot eliminate moral hazard. This should be left to the 'one time last time principle'.[429] It is however this principle that had been let go by the Commission in the State aid regime for the banking sector. Heimler and Jenny suggest that, instead of approving the aid in almost all circumstances, while imposing all sort of behavioural remedies on the aided company, the Commission should only approve the aid when it does not restrict competition, and should otherwise prohibit it.[430] In the author's view, this approach would not work in the financial sector due to the overriding goal of financial stability.

Government measures

For exceptional cases involving closed off vulnerable banking markets, the Restructuring Communication also foresaw the possibility of going beyond structural and behavioural measures and directly requiring Member States 'to promote more sound and competitive markets'.[431]

In the restructuring of Bank of Ireland, Ireland for example committed to enact reforms to ease customer switching and increase consumer protection, to lift restrictions on online banking and to improve corporate governance in the financial sector.[432]

427 Shamsi, Solomon and Robins 2017, p. 176-177.
428 Lyons and Zhu *J.I.C.T.* 2013, p. 64.
429 Heimler and Jenny *Oxford Review of Economic Policy* 2012, p. 360, 364.
430 Heimler and Jenny *Oxford Review of Economic Policy* 2012, p. 362.
431 Laprévote and Frisch 2017, p. 204.
432 Laprévote and Frisch 2017, p. 204.

Ad 8: The monitoring arrangements

The restructuring plan should also describe the monitoring arrangements. The Commission requires appropriate monitoring to be in place to ensure that aid beneficiaries comply with either general conditions of schemes or the more specific conditions included in individual restructuring plans.[433]

In relation to individual restructuring plans, the Commission requires the appointment of a monitoring trustee. The monitoring trustee is normally appointed after the approval of the restructuring plan. The beneficiary bank normally provides the Commission with the name of one or more persons whom it proposes to appoint as trustee. Such a person must be independent of the bank, possess the necessary qualifications to carry out the mandate (e.g. as an investment bank, consultant or auditor) and should not be exposed to a conflict of interest.[434] The monitoring trustee must also be agreed by the Member State. It may be that a divestiture trustee is appointed in addition to the monitoring trustee. This can be the case if the beneficiary bank fails to comply with certain divesture requirements. The divestiture trustee may be the same person as the monitoring trustee.[435]

> According to the Commission, the monitoring trustee has proved a useful tool in the implementation of the complicated restructuring decisions. Although trust has to be built between the trustee and both the Commission and the aid recipient, that structure allows for original commitments to include fall-back options and claw-back mechanisms, which eventually help the decisions to be adapted to the actual circumstances of each bank and better reach their objectives.[436]

In relation to aid schemes and *ad hoc* rescue aid measures the Commission is usually satisfied with monitoring by, and regular reports from, the Member State granting the aid.[437]

433 Bacon 2017, p. 395.
434 Hancher, Ottervanger and Slot 2016, p. 632.
435 Bacon 2017, p. 396.
436 EC Staff Working Paper 2011, p. 32.
437 Bacon 2017, p. 395. See also section 3.5.7.1 in relation to monitoring arrangements for aid schemes.

3.7.1.2 The capital raising plan

Pursuant to the 2013 Banking Communication, a capital raising plan, before or as part of the submission of a restructuring plan, has to be submitted in case of restructuring aid. A capital raising plan, in conjunction with a thorough asset quality review of the bank and a forward looking capital adequacy assessment, should enable the Member State, jointly with the Commission and the competent authority, to determine precisely the (residual) capital shortfall of a bank that needs to be covered with State aid.

The capital raising plan should a) list the capital raising measures, b) list the (potential) burden-sharing measures for shareholders and subordinated creditors, and c) contain safeguards preventing the outflows of funds from the bank. If after the implementation of these measures a capital shortfall remains, it can in principle be covered by public recapitalisation, asset relief measures or a combination of the two.[438] Any such residual capital shortfall which needs to be covered by State aid requires the submission of a restructuring plan.[439]

> The capital raising plan is in practice used as a way to enter into pre-notification contact with the Commission in order to ensure that the capital shortfall that needs to be covered by State aid will be limited to the minimum. According to Laprévote and Coupé, a key question is whether preventative measures that result from this pre-notification contact can credibly be imposed under the sole remit of State aid rules. The Commission's powers under Article 107 and 108 TFEU are limited to assessing (and authorising) State aid granted by States and not to prevent this aid being granted in the first place.[440] See further section 7.2.1.3.

<u>Ad a: Capital raising measures</u>
Capital raising measures aim to increase the regulatory capital, improve the funding structure or shorten the balance sheet of a bank in order to reduce the need for State aid to a minimum. Capital raising measures could consist of rights issues, voluntary conversion of subordinated debt instruments into equity on the basis of a risk-related incentive, liability

438 2013 Banking Communication, point 49.
439 2013 Banking Communication, point 29-30.
440 Laprévote and Coupé 2017, p. 140.

management exercises, capital-generating sales of assets and portfolios, securitisation of portfolios in order to generate capital from non-core activities, earnings retention or other measures reducing capital needs.[441]

> Liability management exercises are in practice commercially negotiated consensual bail-in arrangements. For example, a consensual bail-in led to the recapitalisation of the UK Co-op Bank.[442]

<u>Ad b: Burden-sharing measures</u>

Adequate burden-sharing normally entails that losses are first absorbed by equity, after which contributions are made by hybrid capital holders and subordinated debt holders (the burden-sharing principle). Hybrid capital and subordinated debt holders must contribute to reducing the capital shortfall to the maximum extent. This can take the form of either a conversion into CET 1 instruments or a write-down of the principal of the instruments. The Commission does not require a contribution from senior debt holders (in particular from insured deposits, uninsured deposits, bonds and all other senior debt) as a mandatory component of burden-sharing whether by conversion into capital or by write-down of the instruments. State aid must not be granted before equity, hybrid capital and subordinated debt have fully contributed to offset any losses.[443]

> Where the capital ratio of the bank that has the identified capital shortfall remains above the EU regulatory minimum, the bank should normally be able to restore the capital position on its own, in particular through capital raising measures as set out above. If there are no other possibilities, including any other supervisory action, such as early intervention measures or other remedial actions to overcome the shortfall as confirmed by the competent or resolution authority, then burden-sharing measures must be taken.
>
> In cases where the bank no longer meets the minimum regulatory capital requirements, subordinated debt must always be converted or written down, in principle before State aid is granted.

441 2013 Banking Communication, point 35.
442 World Bank Report 2016, p. 73-75. See also section 2.6.1.1 in relation to the case of the Co-op bank.
443 2013 Banking Communication, point 41-44.

An exception to the burden-sharing principle can be made where implementing burden-sharing measures would endanger financial stability or lead to disproportionate results. This exception could cover cases where the aid amount to be received is small in comparison to the bank's risk weighted assets and the capital shortfall has been reduced significantly in particular through capital raising measures. Disproportionate results or a risk to financial stability could also be addressed by reconsidering the sequencing of measures to address the capital shortfall.[444]

> The Commission has decided in several cases that no remuneration had to be paid by the bank for State aid measures *in the form of rescue aid*, because the financial stability in a Member State could be endangered without the State intervention.[445] In the case of Banca Tercas, it was argued by the parties involved that not requesting the conversion or write-down of subordinated creditors was in line with this exception in this case.[446] The Commission however assessed that burden-sharing by subordinated creditors was also applied to a large proportion of the banking sector in Slovenia and Spain and the third-largest bank of Portugal without putting in danger the financial stability or leading to disproportionate results. Therefore the Commission could not accept this risk to be present in view of the small scale of Banca Tercas.[447]
>
> The exception on the basis of disproportionate results has been applied several times. Examples are the State aid decisions in relation to the Greek banks Eurobank[448] and Alpha Bank[449] and the Spanish bank CEISS-Unicaja.[450]

444 2013 Banking Communication, point 45.

445 EC, 30 March 2010, C(2010) 2111 final (NN 11/2010 – INBS), par. 70; EC, 26 June 2009, (N 356/2009 – Anglo Irish Bank), par. 64; EC, 2 June 2010, C(2010) 3541 final (N 160/2010 – EBS), par. 72.

446 EC, 23 December 2015, C(2015) 9526 final (SA.39451 – Banca Tercas), par. 105.

447 EC, 23 December 2015, C(2015) 9526 final (SA.39451 – Banca Tercas), par. 206.

448 EC, 29 April 2014, C(2014) 2933 final (SA.36006 – Eurobank Group), par. 400. EC, 26 November 2015, C(2015) 8486 final (SA.43363 – Eurobank), par. 97.

449 EC, 26 November 2015, C(2015) 8488 final (SA.43366 – Alpha Bank), par. 96.

450 EC, 12 April 2014, C(2014) 1658 final (SA.36249 – CEISS-Unicaja), par. 102-104. See also Iftinchi 2017, p. 74.

Ad c: Safeguards preventing the outflow of funds

Outflows of funds from the bank could, for example, occur by the bank acquiring stakes in other undertakings or paying dividends or coupon. From the time capital needs are known or should have been known to the bank, the Commission considers that the bank should take all measures necessary to retain its funds. In particular, from that moment on, banks which have identified or should have identified capital needs, must not:

a) pay dividends on shares or coupons on hybrid capital instruments (or any other instruments for which the coupon payment is discretionary);
b) repurchase any of their own shares or call hybrid capital instruments for the duration of the restructuring period without prior approval by the Commission;
c) buy back hybrid capital instruments, unless such a measure, possibly in combination with others, allows the bank to fully absorb its capital shortfall, and occurs sufficiently close to current market levels and at not more than 10% above the market price. Any buy back is subject to prior approval by the Commission;
d) perform any capital management transaction without prior approval by the Commission;
e) engage in aggressive commercial practices;
f) acquire a stake in any undertaking, be it an asset or share transfer. That requirement does not cover: (i) acquisitions that take place in the ordinary course of the banking business in the management of existing claims towards ailing firms; and (ii) the acquisition of stakes in undertakings provided that the purchase price paid is less than 0.01% of the last available balance sheet size of the bank at that moment and that the cumulative purchase prices paid for all acquisitions from that moment until the end of the restructuring period is less than 0.025 % of its last available balance sheet size at that moment; (iii) the acquisition of a business, after obtaining the Commission's approval, if it is, in exceptional circumstances, necessary to restore financial stability or to ensure effective competition; and
g) advertise referring to State support and from employing any aggressive commercial strategies which would not take place without the support of the Member State.[451]

451 2013 Banking Communication, point 47.

3.7.2 Liquidation

When a bank cannot be restored to viability, it should be wound up in an orderly fashion. Depending on the circumstances, a winding up plan or integration plan can be required.

> Examples of cases in which liquidation aid was provided are the case of Bradford & Bingley[452], ATE Bank[453], Factor Banka[454], Amagerbanken[455] and Roskilde Bank.[456]

3.7.2.1 The winding up plan

When aid is provided to the bank to assist in winding up the bank in an orderly manner, a winding up plan will have to be submitted by the Member State to the Commission. This plan should indicate how the bank can be wound up in an orderly fashion. The plan should furthermore identify the causes of the difficulties faced by the bank. Also, a monitoring trustee, a divestment trustee or both may be appointed in certain cases to ensure compliance with any conditions and obligations underpinning the authorisation of the liquidation aid.[457]

3.7.2.2 The integration plan

When liquidation involves the sale of (parts of) the bank to a third party, and aid is provided to the economic activity to be sold, an integration plan needs to be provided by the Member State for the combined entity after the purchase. This plan needs to set out how the economic activity is to be integrated in the own organisation of the buyer and how this combined entity returns to long-term viability. The plan needs to be implemented by the buyer, while the Member State submits a commitment to ensure that the buyer implements the plan.

452 EC, 25 January 2010, C(2010) 350 final (N 194/2009 – Bradford and Bingley).
453 EC, 3 May 2013, C(2013) 2655 final (SA.35460 – ATE).
454 EC, 18 December 2013, C(2013) 9640 final (SA.37643 – Factor Banka).
455 EC, 25 January 2012, C(2012) 148 final (SA.33485 – Amagerbanken).
456 EC, 24 May 2011, C(2011) 3639 final (NN 52/2010 – Roskilde Bank).
457 2013 Banking Communication, points 87-88.

3.8 Third party treatment

The State aid regime for the banking sector does not address the treatment of third parties, such as shareholders and creditors of banks, affected by State aid awards to these banks. As stated by Kassim and Lyons, State aid control remains in large part a privileged dialogue between the Commission, national governments and favoured firms, in which political pressures have not evaporated and third parties have still a relatively weak position.[458] The decision by a bank to request a Member State for State aid can nonetheless have far-reaching consequences for the position of these third parties. For example, in order for restructuring aid to be found compatible with the internal market by the Commission, banks and their stakeholders need to contribute to the restructuring as much as possible in order to ensure that aid is limited to the minimum necessary. In its assessment, the Commission checks whether this requirement has been met, taking into account the commitments proposed by the Member State in relation to the State aid that is intended to be awarded. In addition, the Commission can attach conditions to its approval of the State aid award that have an impact on third parties.

The Commission has however no power to impose any measures on third parties or banks. It can only disapprove of the State aid award by the Member State or attach certain conditions to its decision. As a result, any measures taken in relation to third parties need either (i) to be implemented in cooperation between the bank and its stakeholders, or (ii) to be imposed by the Member State through national legislation.[459] This section discusses examples of cases of State aid awards in which these measures were taken.

> If, following a formal investigation procedure, the Commission considers the State aid measure incompatible with the internal market (unlawful aid), it will require the Member State to recover the aid from the beneficiary (recovery decision). The Member State has to implement the decision in accordance with national law, but leave national provisions unapplied if they stand in the way of effective and immediate implementation of the Commission decision.

458 Kassim and Lyons *J.I.C.T.* 2013, p. 11; Bacon 2017, p. 16. See section 3.9 on the judicial protection of third parties against State aid decisions of the Commission.

459 EC, State aid: Commission adapts crisis rules for banks - frequently asked questions, 15.10.2013, MEMO/13/886, p. 4.

3.8.1 Measures implemented in cooperation between the bank and its stakeholders

Examples of measures that can be deducted from the Commission's decisions[460] and that were implemented or taken by shareholders and other creditors to contribute in the losses of a bank are: transfer of shares against a symbolic price, renouncement of shareholder's rights, relief from the obligation to repay credit lines and subscription to capital instruments of which the nominal amount is subsequently reduced following loss allocation and conversion of Tier-2 capital into Tier-1 capital. In addition, shareholders and other creditors cooperated in the repurchase by banks of capital instruments significantly below par or even cancellation.

For the implementation of some measures the approval of the shareholders or creditors was necessary.

> In the case of Kaupthing Bank Luxembourg the restructuring plan was approved by a double majority vote of the inter-bank creditors on 5 June 2009. That approval was a legal requirement for implementation of the restructuring plan. The other stakeholders, including the Luxembourg Deposit Guarantee Association (AGDL), also agreed to the plan.[461]
>
> On 12 December 2008, the Brussels Court of Appeal suspended the sale of Fortis Banque to BNP Paribas and requested a consultation of the bank's shareholders.[462] Following the lodging of an interlocutory suspension order by Fortis Holding shareholders, the Brussels Court of Appeal ruled that the sale of Fortis Banque by Fortis Holding required the approval of the latter's shareholders, and suspended the transfer by the Federal Participation and Investment Company (SFPI) of control of Fortis Banque to BNP Paribas. This created huge uncertainty as to the validity and future of the contract for the sale of 75% of Fortis Banque to BNP Paribas. At an extraordinary general meeting on 11 February 2009, Fortis Holding's shareholders rejected the conditions of the transaction. Subsequently, Fortis Holding, BNP Paribas and Belgium renegotiated the initial agreement of

460 For example, EC, 3 September 2013, C(2013) 5648 final (SA.32554 – HGAA), par. 34 - 44. EC, 19 September 2012, C(2012) 6307 final (SA.31883 – ÖVAG), par. 118.
461 EC, 9 July 2009, C(2009) 5640 final (N 344/2009 and N 380/2009 – Kaupthing Bank Luxembourg), par. 15.
462 Laprévote and Frisch 2017, p. 210.

> 10 October 2008. The new operating terms were approved by the general meeting of Fortis Holding's shareholders on 28 and 29 April 2009 with a majority of more than 70%.[463]

For the implementation of other measures, contracts were signed in order to ensure that parties committed themselves to the measures imposed.

> In the case of restructuring of Fortis, Fortis Holding and BNP Paribas formally committed themselves to financing of an investment vehicle to buy impaired assets from Fortis Banque in contracts signed on 10 October 2008.[464]

Also where burden-sharing was introduced *ex post*, i.e. after State aid had been approved by the Commission, private law contractual arrangements were used.[465]

3.8.2 Measures imposed by Member States through national legislation

When contracts do not foresee any conversion clauses and measures cannot be imposed in cooperation with shareholders or creditors, Member States can adopt specific legislation.

> In the case of Banca Tercas, it was, for example, considered that no additional sacrifice of subordinated debt-holders was legally feasible, since under the current law the latter could be forced to share losses only in the event of compulsory administrative liquidation.[466]

There are examples of Member States that have adopted specific legislation to impose e.g. mandatory conversion or write down as a pre-condition for granting State aid or to take over a bank without the consent of the general meeting.[467] There are a number of safeguards in that respect.

463 EC, 12 May 2009, C(2009) 3907 final (N 255/2009 and N 274/2009 – Fortis), par. 3-4.
464 EC, 12 May 2009, C(2009) 3907 final (N 255/2009 and N 274/2009 – Fortis), par. 2.
465 Iftinchi 2017, p. 72.
466 EC, 23 December 2015, C(2015) 9526 final (SA.39451 – Banca Tercas), par. 104.
467 Iftinchi 2017, p. 73. See e.g. ECJ, 19 July 2016, C-526/14, ECLI:EU:C:2016:570 (*Kotnik v Slovenia*).

Below, the 'no creditor worse off' principle and the Second Company Law Directive[468] are discussed.[469]

3.8.2.1 Compatibility with the 'no creditor worse off' principle

In the context of implementing the burden-sharing principle, the 'no creditor worse off' principle should be adhered to. This entails that subordinated creditors should not receive less in economic terms than what their instruments would have been worth, if no State aid were to be granted.[470] Respecting the principle predominantly depends on the conversion rate applied.[471]

3.8.2.2 Compatibility with the Second Company Law Directive

The interests of shareholders and other members of public limited liability companies are protected within the EU by the Second Company Law Directive.[472] While the ECJ held that the Second Company Law Directive continues to apply in the case of 'ordinary reorganisation measures',[473] the Second Company Law Directive must be interpreted as not precluding a measure adopted in a situation where there is a serious disturbance of the economy and the financial system of a Member State threatening the financial stability of the EU.[474]

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468 Directive 2012/30/EU (the Second Company Law Directive). This directive recast the Second Council Directive 77/91/EEC.

469 Other safeguards can for example be formed by the principle of the protection of legitimate expectations or the right to property (2013 Banking Communication, point 19). Discussion of such other safeguards it outside the scope of this dissertation.

470 2013 Banking Communication, point 46.

471 Hancher, Ottervanger and Slot 2016, p. 577.

472 Pursuant to Article 8 Second Company Law Directive, shares may not be issued at a price lower than their nominal value, or, where there is no nominal value, their accountable par. Under Article 25 of the Second Company Law Directive, any increase in capital must be decided on by the general meeting, save where previously authorised by the statutes or instrument of incorporation or by the general meeting under the conditions set out in that provision. Article 29(1) of the Second Company Law Directive provides that whenever the capital is increased by consideration in cash, the shares must be offered on a pre-emptive basis to shareholders in proportion to the capital represented by their shares. Moreover, pursuant to Article 29(4), the right of pre-emption cannot be restricted or withdrawn by the statutes or instrument of incorporation, but only by decision of the general meeting under the conditions specified in that paragraph.

473 ECJ, 12 March 1996, C-441/93, EU:C:1996:92 (*Pafitis and Others*), par. 57.

474 ECJ, 8 November 2016, C-41/15, ECLI:EU:C:2016:836 (*Dowling c.s. v Minister for Finance*), par. 26-28, 41-55.

In the case of Permanent TSB, formerly known as Irish Life and Permanent Group, the Irish Minister for Finance submitted to the shareholders of the holding company of Permanent TSB (ILPGH) a proposal designed to facilitate the recapitalisation of Permanent TSB by means of, *inter alia*, a capital injection of EUR 2.7 billion. That proposal was rejected by the extraordinary general meeting of ILPGH held on 20 July 2011, which meeting mandated the directors of that company to examine other recapitalisation options. The Minister subsequently prepared a Proposed Direction Order, which he submitted to the High Court. The Direction Order was adopted by the High Court in the terms sought, directing ILPGH to issue, in return for the capital injection of EUR 2.7 billion, new shares to the Minister at a share price dictated by him, that is at a price 10% below the quoted share price of 23 June 2011. Consequently, the Minister obtained, without any decision having been made by the general meeting of shareholders of ILPGH 99.2% of the shares of that company. In addition, the delisting of the company on the Irish and London Stock Exchanges was ordered.

Members and shareholders of ILPGH started proceedings before the High Court of Ireland. They claimed that the increase in share capital resulting from the Direction Order was incompatible with Articles 8, 25 and 29 of the Second Company Law Directive, since it was effected without the approval of the general meeting of ILPGH. As regards the Direction Order, it was clear that the effect of that order was that shares in ILPGH were issued at a price lower than their nominal value and that the share capital of that company was increased, while the pre-emptive right to subscribe was denied, without the agreement of the general meeting of that company. In a judgment of 8 November 2016, following a request for a preliminary ruling, the ECJ assessed that the protection conferred by the Second Company Law Directive on the shareholders and creditors of a public limited liability company, with respect to its share capital, does not extend to a national measure of that kind that is adopted in a situation where there is a serious disturbance of the economy and financial system of a Member State and that is designed to overcome a systemic threat to the financial stability of the European Union, due to a capital shortfall in the company concerned. Although the ECJ recognised that there is a clear public interest in ensuring, throughout the European Union, a strong and consistent protection of shareholders and creditors, it assessed that such an interest cannot be held to prevail in all circumstances over the public interest in ensuring the stability of the financial system established by those amendments. The Second Company Law Directive must therefore be interpreted as not precluding a measure, such as the Direction Order, adopted in a situation where there is a serious disturbance of the economy and the financial system of a Member State threatening the financial stability of the European Union.[475]

Also, in the case of the restructuring of a number of Slovenian banks, the applicability of the Second Company Law Directive was discussed by the ECJ in a reference for a preliminary ruling. More particular, it concerned the provisions of the Second Company Law Directive that provide that any increase or reduction in the capital of a public limited liability company must be subject to a decision by the general meeting of the company. The ECJ considered that the Second Company Law Directive does not preclude measures relating to share capital being adopted, in certain specific circumstances, such as those mentioned in the 2013 Banking Communication, without the approval of the company general meeting. It also considered that the 2013 Banking Communication contains no specific provision on the legal procedures whereby the burden-sharing measures set out in points 40 to 46 of that communication are to be implemented. It is therefore up to the Member States whether they find it necessary, in a particular situation, to adopt burden-sharing measures without the agreement of the general meeting of the company.[476]

3.9 Judicial protection

As can be read in the previous sections, the award of State aid does not only have a major impact on the bank, being the aid beneficiary, but potentially also on its shareholders, creditors, counterparties and/or competitors. Effective judicial protection is therefore an important tool to safeguard the interests of the parties involved. This section discusses the possibilities that these parties have to challenge a decision from the Commission.

475 ECJ, 8 November 2016, C-41/15, ECLI:EU:C:2016:836 (*Dowling c.s. v Minister for Finance*), par. 26-28, 41-55.

476 ECJ, 19 July 2016, C-526,14, EU:C:2016:570 (*Kotnik v Slovenia*), par. 84-85, 89.

3.9.1 Actions of an interested party

As said, the State aid procedure is seen as an exclusive dialogue between the Member State that grants the aid and the Commission.[477] The addressee of the decisions from the Commission is the Member State concerned and not the beneficiary of the State aid measure.[478] In the two-stage procedure of preliminary examination and formal investigation by the Commission, aid beneficiaries, just like their shareholders, creditors, counterparties and competitors are considered 'interested parties', within the meaning of the Procedural Regulation and Article 108(2) TFEU.[479]

Interested parties cannot access the Commission's file, including the letters and other information that has passed between the Member State and the Commission, and have no right to be heard before the Commission.[480] Interested parties are only entitled to submit comments on the Commission's decision to open a formal investigation, normally within one month from its publication in the Official Journal.[481] Interested parties which have submitted comments and any aid beneficiary will receive a copy of the decision taken by the Commission to close the formal investigation procedure.[482] They can also, on their request, obtain a copy of a decision not to raise objections or to initiate the formal investigation procedure following the preliminary examination, a positive, conditional or negative decision to close the formal investigation procedure, a decision to require the provision of information by a Member State, or a decision to require a Member State to suspend or recover any unlawful aid until the Commission has taken a decision on the compatibility of the aid with the internal market.[483]

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477 Gjevori *Juridical Tribune* 2015, p. 46.

478 Article 31(2) of the Procedural Regulation.

479 Article 1(h) Procedural Regulation defines "*interested party*" as "*any Member State and any person, undertaking or association of undertakings whose interest might be affected by the granting of aid, in particular the beneficiary of the aid, competing undertakings and trade associations*."

480 Gambaro and Mazzochi *IAR* 2016, p. 62-63. Hancher, Ottervanger and Slot 2016, p. 23, 1083.

481 Article 108(2) TFEU. Article 24(1) Procedural Regulation.

482 Article 24(1), second sentence Procedural Regulation.

483 Article 24(3) Procedural Regulation.

Besides submitting comments, any interested party may submit a complaint to inform the Commission of any alleged unlawful aid or any alleged misuse of aid.[484]

3.9.2 Legal proceedings before the EU Courts

The EU Courts have jurisdiction to review the decisions adopted by the Commission. More specifically, they have jurisdiction to:

(i) review the legality of and annul decisions adopted by the Commission in accordance with Article 263 and 264 TFEU in actions brought by Member States, EU institutions, as well as any natural or legal person;

(ii) review an action brought against the Commission for failure to act, in accordance with Article 265 TFEU by Member States, EU institutions, as well as any natural or legal person;

(iii) give preliminary rulings on request of national judicial authorities on the validity and interpretation of acts of the Commission in accordance with Article 267 TFEU; and

(iv) determine the non-contractual liability of the Commission in accordance with Article 268 TFEU.

The following sections further discuss the actions of annulment and preliminary rulings, as these are the most common form of judicial protection against Commission's decisions in State aid cases in the banking sector.

3.9.2.1 Ad (i): Actions of annulment

Under Article 263 TFEU, there are four requirements for actions of annulment:

1. The act must be reviewable.
2. The challenge must be made within the specified time limit.
3. The individual must have an interest in seeing the contested measure annulled.
4. The individual must have *locus standi*.

<u>Ad 1: Reviewable act</u>

The EU Courts can, *inter alia*, review the legality of acts of the Commission.[485] The decisions of the Commission that can be challenged by third parties

484 Article 24(2) Procedural Regulation.

485 Article 263, first paragraph TFEU.

are not restricted to decisions opening the formal investigation procedure. Also decisions declaring that a measure does not constitute State aid or that it is compatible with the internal market can be challenged by third parties. These are regarded as implicit rejections to open the formal investigation procedure, thus as depriving third parties to make full use of the procedural guarantees provided to them during the formal investigation procedure.[486]

It can be derived from case-law that, having regard to the nature of the compatibility investigation by the Commission of State aid, the Commission enjoys a wide discretion in respect of its assessment and consequently review by the EU Courts in that regard is necessarily limited.[487] This is different in relation to the assessment as to whether a measure falls within the scope of Article 107(1) TFEU (that is, whether or not this measure qualifies as State aid), since State aid is a legal concept which must be interpreted on the basis of objective factors. As a result, the EU Courts must, in principle, carry out a comprehensive review as to whether a measure falls within the scope of Article 107(1) TFEU.[488]

Ad 2: Time limit

The proceedings have to be instituted within two months of the publication of the measure, or of its notification to the plaintiff, or, in the absence thereof, of the day on which it came to the knowledge of the latter, as the case may be.[489]

Ad 3: Legal interest

An action for annulment brought by a natural or legal person is not admissible unless the applicant itself has an interest in seeing the contested measure annulled. The applicant's interest must continue until the Court's final decision on the application. A shareholder of a bank that is the aid beneficiary must demonstrate that its interest is separate from that of the bank that it (partly) controls, if it is to have a separate right of action.[490]

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486 Gjevori *Juridical Tribune* 2015, p. 47. See also ECJ, 19 May 1993, C-198/91, ECLI:EU:C:1993:197 (*Cook v Commission*), par. 22-23 and ECJ, 15 June 1993, C-225/91, ECLI:EU:C:1993:239 (*Matra v Commission*), par. 16-17.

487 GC, 8 April 2014, T-319/11, ECLI:EU:T:2014:186 (*ABN AMRO v Commission*), par. 31, 81.

488 GC, 12 December 2014, T-487/11, ECLI:EU:T:2014:1077 (*Banco Privado Português v Commission*), par. 45. Hancher, Ottervanger and Slot 2016, p. 16-17.

489 Article 263, sixth paragraph TFEU.

490 Bacon 2017, p. 510-511.

Ad 4: Locus standi

Any natural or legal person may institute proceedings against an act addressed to that person or which is of 'direct and individual concern' to them, and against a regulatory act which is of direct concern to them and does not entail implementing measures. They can institute proceedings on grounds of lack of competence, infringement of an essential procedural requirement, infringement of the Treaties or of any rule of law relating to their application, or misuse of powers.[491]

In terms of judicial protection, aid beneficiaries, just like their shareholders, creditors, counterparties and competitors should be considered 'third parties', since the State aid decision is addressed to the Member State awarding the State aid. This means that they only have the possibility to challenge decisions addressed to the Member State, if the decision is of direct and individual concern to them. In order for such a concern to be direct, the measure at issue must directly affect the legal situation of the individual and leave no discretion to its addressees who are entrusted with the task of implementing it, the implementation being purely automatic and resulting from Union rules without the application of other intermediate rules.[492] The decision is of individual concern, if the very strict conditions established by the ECJ in the *Plaumann* case are met. These conditions entail that persons other than those to whom a decision is addressed may only claim to be individually concerned, if that decision affects them by reason of certain attributes which are peculiar to them or by reason of circumstances in which they are differentiated from all other persons, and by virtue of these factors distinguishes them individually just as in the case of the person addressed.[493]

> Actions for annulment brought by banks, being aid beneficiaries
>
> Only a small number of banks have contested decisions from the Commission. In all these cases, the admissibility of the banks as claimants was not discussed.

491 Article 263, fourth paragraph TFEU. The *locus standi* requirements under Articles 265 and 268 TFEU are different.

492 ECJ, 5 May 1998, C-386/96 P, ECLI:EU:C:1998:193 (*Dreyfus v Commission*), par. 43.

493 ECJ, 15 July 1963, C-25/62, ECLI:EU:C:1963:17 (*Plaumann v. Commission*). Pursuant to Article 263(4) TFEU, a party is entitled to take action for annulment without having to prove that the decision is of indivdiual concern to them, provided that the decision concerns a regulatory act that is of direct concern and does not entail implementing measures. Decisions on aid schemes could qualify as such. Gambaro and Mazzochi *IAR* 2016, p. 72-73.

ABN AMRO – unsuccessfully – challenged the scope and duration of the acquisition ban imposed on it by the Commission in its decision of 5 April 2011.[494]

ING had more success in challenging the decision from the Commission that an amendment to the repayment terms of the capital injection granted by the Netherlands constituted additional State aid. The decision was partly annulled (in so far as it found this amendment to constitute additional State aid) by the GC and this judgment was upheld by the ECJ.[495]

The Banco Privado Português (BPP) also contested a decision from the Commission in which the Commission declared aid that was granted to BPP to be incompatible with the internal market and ordered Portugal to proceed with its immediate and effective recovery. The GC upheld the decision from the Commission.[496] An appeal against this judgment was found by the ECJ to be manifestly inadmissible and manifestly unfounded.[497]

BES started an action for a partial annulment of a Commission decision, in so far as this decision imposed on BES the responsibility for ensuring the remuneration or payment of any other costs of the monitoring trustee with respect to the commitments made by Portugal. The Commission argued that BES was not entitled to seek partial annulment, since the commitments made by a Member State in the context of the preliminary examination of a notified measure are an integral part of the approved measure. The GC followed the Commission by assessing that the commitments were inextricably linked to the notified aid measures, as a result of which BES could not seek the annulment of only the commitments.[498]

494 GC, 8 April 2014, T-319/11, ECLI:EU:T:2014:186 (*ABN AMRO v Commission*).
495 ECJ, 3 April 2014, C-224/12, ECLI:EU:C:2014:213 (*Commission v The Netherlands and ING*). See also section 3.3.2.1.
496 GC, 12 December 2014, T-487/11, ECLI:EU:T:2014:1077 (*Banco Privado Português v Commission*).
497 ECJ, 15 October 2015, C-93/15 P, ECLI:EU:C:2015:703 (*Banco Privado Português v Commission*).
498 GC, 1 December 2015, T-814/14, ECLI:EU:T:2015:936 (*Banco Espírito Santo v Commission*), par. 24-34, 40.

FIH Holding and FIH successfully brought an action before the GC to annul the decision from the Commission in which it assessed that the asset transfer from FIH Group to the Danish Financial Stability Company constituted State aid. [499] However, in the appeal the ECJ set aside the judgment of the GC. This case has been extensively discussed in section 3.3.2.2.

Actions for annulment brought by shareholders, other creditors and competitors

An example of a case that was brought by a shareholder of a bank, is the case of Westfälisch-Lippischer Sparkassen- und Giroverband, one of the owners of WestLB, against the Commission. This case has been discussed in sections 3.5.2.1 and 3.7.1.1. In relation to the admissibility of the shareholder as claimant, the GC noted that it had an interest in bringing proceedings separate from that of WestLB, but only in so far as authorisation of the guarantee at issue was made subject to compliance with the obligation to sell.[500]

Another example forms the action that was brought by two minority shareholders in HSH Nordbank. In 2009, the Commission was notified by Germany of two aid measures to rescue HSH Nordbank (a EUR 3 billion recapitalisation and a EUR 10 billion guarantee). The Commission authorised the aid, first as rescue aid (in 2009) and thereinafter as restructuring aid (in 2011). The minority shareholders contested the 2011 decision of the Commission. In so far the applicants sought the annulment of the Commission decision in its entirety, the GC held that the applicants had not shown that they had an individual interest separate from HSH Nordbank in bringing proceedings. The action of the minority shareholders was however admissible in so far it concerned the option provided by the Commission to increase HSH Nordbank's capital for the sole benefit of HSH Finanzfonds (thereby diluting the minority shareholders without having the possibility to acquire new shares).[501]

499 GC, 15 September 2016, T-386/14, ECLI:EU:T:2016:474 (*FIH Holding v Commission*).
500 GC, 17 July 2014, T-457/09, ECLI:EU:T:2014:683 (*Westfälisch-Lippischer Sparkassen- und Giroverband v Commission*), par. 114-120.
501 GC, 12 November 2015, T-499/12, ECLI:EU:T:2015:840 (*HSH Investment Holdings v Commission*), par. 57-60.

In the case of BPP as already mentioned above, Massa Insolvente do Banco Privado Português, the general body of creditors of BPP, was also an applicant besides BPP. The admissibility of the claim of this body was however not discussed by the GC.

In the case of the resolution of BES[502], subordinated creditors holding Lower Tier 2 Bonds started legal proceedings in order to annul the decision from the Commission and more specifically the commitment by Portugal that no claim of a shareholder or holder of subordinated debt or any hybrid instrument may be transferred to the bridge bank that was set up. The creditors argued that they have an interest in bringing proceedings before the GC, because they have brought an action before the national court of Portugal against the decision of the Portuguese resolution authority to put BES in resolution in the context of which the possible annulment of the contested decision before the EU Courts is capable of benefiting the creditors. The GC dismissed the action as being inadmissible. It considered that the annulment of the decision from the Commission does not lead to the obligation for the Portuguese resolution authority to alter the decision to put BES in resolution. In addition, it assessed that the fact that the Portuguese Republic gave commitments relating to certain arrangements of the resolution procedure, which the applicants maintained were prejudicial to their interests, does not mean that those arrangements were imposed by the Commission as a condition to ensure that the aid at issue was compatible with the internal market or that the annulment of the contested decision would have any effect on the applicants. By the contested decision, the Commission merely took account of the commitments voluntarily given by the State at the stage at which it was given notification of the contested measure, in order to clarify certain points. Lastly, the GC considered that the subject matter of the national proceedings differs from the subject matter of the proceedings before it, since the former concerned violation of the Portuguese constitutional law, while the latter concerned violation of European law. The GC therefore concluded that the applications did not have any legal interest in bringing proceedings for annulment of the Commission's decision.[503] The ECJ however set aside the judgment of the GC. It held that the GC erred in law in holding that, given that the proceedings

502 This resolution case is discussed in more detail in section 4.4.2.2.
503 GC, 19 July 2017, T-812/14, ECLI:EU:T:2017:560 (*BPC Lux 2 Sarl c.s. v Commission*), par. 27-37.

before it and the national proceedings did not have the same subject matter, the possible annulment of the contested decision would have no effect on those latter proceedings and would therefore not benefit the appellants, within the meaning of the relevant case-law.[504]

In the case of the nationalisation of SNS Reaal, 366 (Italian) subordinated bond holders started legal proceedings to annul the decision from the Commission in which it approved on the State aid that was granted to SNS Reaal by the Dutch State. Four of the applicants were also competitors of SNS Reaal. The applicants' subordinated bonds were expropriated in the context of the nationalization. The GC considered that the decision to expropriate the bonds was taken by the Kingdom of the Netherlands and that the annulment of the Commission's decision would not result in the Kingdom of the Netherlands reversing its expropriation decision. In addition, although the annulment of the Commission's decision could perhaps lead to the insolvency of SNS Reaal and SNS Bank, as claimed by the applicants, they failed to establish that this would procure an advantage for them. The GC therefore assessed that the applicants, being subordinated bondholders only, did not have a legal interest in bringing proceedings.[505] The GC also assessed that the applicants, being competitors, had no standing to bring proceedings, because they failed to prove that they were indeed in competition with the beneficiaries of the disputed aid.[506]

A last example, is the case of Bank Burgenland, in which the owner of the aid beneficiary, Bank Burgenland, and the buyer of Bank Burgenland, GRAWE, started legal proceedings to annul the decision from the Commission in which it ordered the privatisation of Bank Burgenland. The GC dismissed the actions for annulment and the ECJ dismissed the appeals.[507] The admissibility of the applicants was not discussed by the GC or the ECJ. This case has been discussed in more detail in section 3.3.2.3.

504 ECJ, 7 November 2018, C-544/17 P, ECLI:EU:C:2018:880 (*BPC Lux 2 Sarl c.s. v Commission*), par. 57. Louisse *JOR* 2019.
505 GC, 26 March 2014, ECLI:EU:T:2014:175 (*Adorisio c.s. v Commission*), par. 25-35.
506 GC, 26 March 2014, ECLI:EU:T:2014:175 (*Adorisio c.s. v Commission*), par. 47.
507 GC, 28 February 2012, T-268/08 and T-281/08, ECLI:EU:T:2012:90 (*Land Burgenland and Austria v Commission*); GC, 28 February 2012, T-282/08, ECLI:EU:T:2012:91 (*GRAWE v Commission*); ECJ, 24 October 2013, C-214/12 P, C-215/12 P and C/223/12 P, ECLI:EU:C:2013:682 (*Land Burgenland, Austria and GRAWE v European Commission*).

Actions for annulment brought by Member States

In a number of cases, Member States started legal proceedings besides the aid beneficiaries (e.g. the Netherlands in the case of ING and Italy in the case of Banca Tercas) or the owner of the aid beneficiary (e.g. Austria in the case of Land Burgenland). Austria also brought an action for annulment before the GC in relation to a Commission decision on State aid granted by Germany and Austria to Bayerische Landesbank. This action was dismissed by the GC.[508]

Actions for annulment brought by other parties

One of the Italian deposit guarantee schemes, Interbank Deposit Protection Fund (IDFF), brought an action before the EU Courts against the decision from the Commission concluding that the contributions by the IDFF for the benefit of Banca Tercas qualified as State aid. On 15 February 2017, the GC assessed that an intervention by another Italian deposit guarantee scheme, Fondo di Garanzia dei Depositanti del credito cooperative (FGDCC), in the case of IDFF was inadmissible. The FGDCC argued that the qualification of the contributions from IDFF as State aid would have a negative impact on FGDCC, because this would prevent it from intervening early in order to avoid bank resolution under the resolution regime.[509] The GC assessed that FGDCC did not have a direct and present interest in the resolution of the dispute.[510] It did however consider that IDFF has a direct and individual interest. IDFF has a direct interest, since the decision from the Commission requires Italy to reimburse the aid that is granted by IDFF immediately and effectively from Banca Tercas without leaving any discretion to Italy. In addition, IDFF has an individual interest, since it has adopted and implemented the measures that are qualified as State aid. Moreover, the decision from the Commission makes it impossible for IDFF to grant aid, not only in the case of Banca Tercas, but also in the future. Hence, IDFF is restricted in the autonomous exercise of its powers other than its payout function.[511]

508 GC, 28 January 2016, T-427/12, ECLI:EU:T:2016:41 (*Austria v Commission*).

509 The access to State aid for banks in resolution is further discussed in Chapter 5.

510 GC, 15 February 2017, T-198/16, ECLI:EU:T:2017:114 (*Fondo interbancario di tutela dei depositi v Commission*), par. 14-20.

511 GC, 19 March 2019, T-98/16, T-196/16 and T-198/16, ECLI:EU:T:2019:167 (*Italy, Banca Popolare di Bari and Fondo interbancario di tutela dei depositi v Commission*), par. 48-56.

> The action of the consumer association Codacons in relation to the State aid granted to the Italian bank MPS was dismissed as being inadmissible, because the action was brought too late.[512]

3.9.2.2 Ad (iii): Preliminary rulings

National courts may make a reference for a preliminary ruling to the ECJ on the basis of Article 267 TFEU, if questions arise about the interpretation of the EU Treaties or on the validity and interpretation of a Commission decision.

> In the *Kotnik* case the Constitutional Court of Slovenia requested for a preliminary ruling following applications for review of constitutionality of the law on the banking sector brought by private individuals, the National Council of Slovenia and the Slovenian Ombudsman.[513]

> Another request for a preliminary ruling came from the Tribunal do Comércio de Lisboa in relation to the attempt by the Portuguese State to recover the unlawful aid from BPP. BPP and Massa Insolvente do Banco Privado Português held that Portugal's claim had no legal basis, because the Commission's decision in which it ordered the repayment of the unlawful aid was unlawful. On 5 March 2015, the ECJ concluded that there were no reasons to doubt the validity of the Commission's decision in relation to the aid granted to BPP.[514]

> The High Court of Ireland requested a preliminary ruling in legal proceedings between Mr Dowling c.s. and the Minister for Finance in relation to State aid granted to Permanent TSB, formerly known as Irish Life and Permanent Group, a bank operating in Ireland. The applicants in the main proceedings were members and shareholders of the holding company of Permanent TSB. The details of the case have been discussed in section 3.8.2.2.

512 GC, 3 July 2013, T-313/13, ECLI:EU:T:2013:355 (*Codacons v Commission*).
513 ECJ, 19 July 2016, C-526/14, ECLI:EU:C:2016:570 (*Kotnik v Slovenia*).
514 ECJ, 5 March 2015, C-667/13, ECLI:EU:C:2015:151 (*Estado português v Banco Privado Português and Massa Insolvente do Banco Privado Português*).

3.9.3 Legal proceedings before national courts

The national courts have no jurisdiction to declare State measures compatible with Article 107(2) or (3) TFEU.[515] In addition, decisions from the Commission cannot be challenged before the national courts.[516] The national courts do however play a role in interpreting the notion of State aid, in cases where a Member State has granted State aid without respecting the standstill obligation (unlawful aid) and in the enforcement of recovery decisions. The involvement of national courts in such cases usually arises from actions brought by competitors of the beneficiary.[517] The national courts may ask the Commission to transmit to them information in its possession or its opinion on questions concerning the application of State aid rules.[518] Where the coherent application of Article 107(1) or Article 108 TFEU so requires, the Commission, acting on its own initiative, may submit written observations to the national courts. It may, with the permission of the court in question, also make oral observations.[519]

Remedies available before national courts include preventing the payment of unlawful aid, recovery of unlawful aid (regardless of compatibility) and interest, damages for competitors and other third parties, and interim measures against unlawful aid.[520]

> National courts have to preserve, until the final decision by the Commission, the rights of private parties against any violation by the State in question of the prohibition that Article 108(3) TFEU imposes (the standstill obligation).

3.10 Conclusion

The EU is unique in having a State aid regime under which Member States give up part of their sovereignty by requiring the approval by the Commission of State aid awards. Not all public funding qualifies as State

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515 ECJ, 18 July 2007, C-119/05, ECLI:EU:C:2007:434 (*Lucchini*), par. 50-51.
516 Quigley 2015, p. 637. If a national court has reason to doubt the validity of a decision from the Commission it may make a reference to the ECJ pursuant to Article 267 TFEU for a ruling on that issue.
517 Enforcement Notice, p. 2-6. See also D'Sa, 1998, p. 7-24; Barents 2008, p. 34-35.
518 Article 29(1) Procedural Regulation.
519 Article 29(2) Procedural Regulation.
520 Enforcement Notice, points 21-69.

aid. Public funding only comes within the remit of State aid control, if it is assessed to be an intervention by a Member State or through Member State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods and that affects trade between Member States.

The State aid assessment by the Commission normally starts with the request of a Member State for approval to award State aid. It remains for each Member State to determine the circumstances in which it wishes to grant State aid and the beneficiaries to whom this aid is to be granted. The Member States design the aid measure in liaison with the bank. At the end, it is however the Commission that has to approve the aid as being compatible with the internal market, which makes the process of designing the aid measure more of a trialogue. Third parties, such as the shareholders and creditors of a bank, also play their part when State aid is awarded. Sometimes far-reaching restructuring of the bank is necessary, which may include dilution, cancellation or conversion of capital instruments, write-off of debts, replacement of management, divestment etc. Especially in respect of burden-sharing, cooperation by third parties is very important, although in certain cases this was bypassed by the adoption of specific laws by Member States.

The Commission makes use of soft law instruments to inform Member States how it assesses State aid awards. The urgency, the inter-dependence of financial markets and the extraordinary size of the subsidies committed by Member States to save national banks during the GFC led the Commission to modify its ordinary decision-making practices and adopt a new set of soft laws, consisting of the Crisis Communications.[521] As a result of the GFC, the Commission started to assess State aid awards in the banking sector on the basis of Article 107(3)(b) TFEU. State aid awards therefore need to be appropriate to remedy a serious disturbance in the economy of a Member State.

At the time of writing this dissertation, the Commission still assesses State aid awards on the basis of the State aid regime for the banking sector that it developed during the GFC. The temporality thereof, although still advocated by the Commission, therefore seems to be no longer reality. The idiosyncrasies of the banking sector may be a reason to create a permanent State aid regime for the banking sector, also taking into account the resolution regime that has been developed and that will be discussed in the next chapter.

521 Botta *JEI* 2016, p. 275.

CHAPTER 4

THE RESOLUTION FRAMEWORK FOR THE BANKING SECTOR

> *"[t]here is wide recognition that the EU needs to build a resolution regime that would ensure that all competent authorities effectively coordinate their actions and have the appropriate tools for intervening quickly to manage the failure of a bank, with the objective of minimising the need for States to resort to the kind of exceptional measures that have been necessary in this crisis."*
>
> *Commission, Communication of 20 October 2009, p. 2*

4.1 Introduction

The term 'resolution' has a new meaning as of 1 January 2015, when the BRRD entered into force. From that date on, it is commonly used to explain the situation that a bank is failing or likely to fail, but, instead of being wound up in normal insolvency proceedings, it is 'resolved' through administrative, non-judicial procedures and tools for the restructuring or managed dissolution of failing banks while preserving insured deposits and other services essential for maintaining financial stability, such as payment services.[1] The primary objective of resolution is to maintain financial stability and minimize losses for the society, in particular taxpayers. For this reason, certain critical stakeholders and functions (such as depositors and payment systems) need to be protected and maintained as operational, while other parts, which are not considered key to financial stability, may be allowed to fail in the normal way. Resolution is not available for each and every bank. Only, if the resolution authority decides that there is a 'public interest' to put a bank in resolution this can take place.

At the time of writing this dissertation, the resolution regime is still in its infancy. The different authorities involved in resolution scan the boundaries of their mandates and powers, the Member States try to find loopholes to comply with the resolution regime, while keeping their electors

1 Impact Assessment BRRD, p. 8.

satisfied, and the resolution regime faces an upgrade (through BRRD II, BRRD II bis and SRMR II). Against that background, this chapter describes the resolution framework for banks and banking groups. Section 4.2 starts with a description of the development of the resolution framework. Section 4.3 subsequently discusses the legal outline and scope of the resolution framework. It also analyzes the relationship between the two main legislative instruments of this framework: the BRRD and SRMR. Section 4.4 subsequently sets out the concept of resolution. Section 4.5 describes the process of resolution, while also paying attention to the complex relationship between the SRB and the national resolution authorities as the competent resolution authorities. Section 4.6 discusses the provisions of the resolution framework in relation to group resolution. Sections 4.7 and 4.8 describe the treatment of the bank in resolution and third parties (such as shareholders and creditors of a bank) involved therein. Section 4.9 swiftly discusses the judicial protection available for banks and third parties against decisions of the SRB and national resolution authorities. Section 4.10 concludes this chapter.

This chapter does not discuss the provisions of the resolution regime that deal with the award and assessment of public funding. These provisions are discussed in Chapters 5 to 7.

4.2 The development of a resolution framework for the banking sector

4.2.1 Member States develop own resolution regimes

Prior to the BRRD and the SRMR, a number of Member States[2] already adopted a national resolution regime in order to cope with the consequences of bank failure as a result of the GFC.[3] Sharing common understandings on the ways in which resolution objectives can be pursued, the national resolution regimes displayed many technical similarities. Many technical aspects of the national resolution regimes, with the exception of the financing aspects and the bail-in technique, had their origins in earlier

2 Including the UK, Germany, Sweden, Denmark, the Netherlands, Belgium, Ireland, Greece and Portugal.

3 Impact Assessment BRRD, p. 15, 61, 79. See Bierens *TvFR* 2013 in respect of the resolution regime that had been developed in the Netherlands and the application thereof to SNS Reaal.

American resolution policy.[4] To a large extent, the national resolution regimes built on global standards, developed by the Basel Committee on Banking Supervision (Basel Committee) and, primarily, by the Financial Stability Board (FSB).[5]

> The FSB, established by the Group of Twenty (G20) in April 2009, and the Basel Committee, established by the Group of Ten (G10) at the end of 1974, took a leading role in the necessary reform of the banking landscape. On 20 October 2010, the FSB published its recommendations concerning the reduction of the moral hazard posed by systemically important financial institutions.[6] The Basel Committee issued its Recommendations on cross-border bank resolution[7] in March 2010 and the Basel III rules text, which presents the details of global regulatory standards on bank capital adequacy and liquidity, in December 2010.
>
> In July 2011 the Basel Committee published a report on the status of national resolution regimes.[8] The Basel Committee distinguished three types of resolution regimes in its report: (i) special resolution regimes that enable authorities to take control of banks and other financial group companies before or on insolvency and that provide a wider range of resolution or stabilisation powers thereafter (these were adopted in the UK, Germany, Spain and the Netherlands), (ii) special administration or management regimes which are hybrid administrative/judicial regimes in which the banking supervisors or resolution authorities appoint special officials (variously referred to as special administrators, provisional administrators, special managers or statutory managers) to implement resolutions (these were adopted in Belgium, France and Italy) and (iii) mixed regimes without the full range of powers exhibited by the first two groups, in some cases because the powers can only be exercised with the consent or on a majority vote of shareholders and/or creditors, and in some cases because the regime strongly relies on court-administered proceedings, in particular in the insolvency liquidation phase (this regime was adopted in Luxembourg).[9]

4 See the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), PL 102-242, 105 Stat 2236.
5 Hadjiemmanuil, 2015, p. 226-227.
6 FSB Report 2010.
7 Basel Committee, Report and Recommendations of the Cross-border Bank Resolution Group, March 2010.
8 Basel Committee Report 2011.
9 Basel Committee Report 2011, p. 8. Grünewald 2014, p. 82-83.

4.2.2 Need for harmonization

As the GFC evolved into a sovereign crisis, the financial position of certain Member States deteriorated significantly. As a result, certain Member States introduced (by means of public law) bail-in requirements that went beyond the bail-in requirements set by the Commission in the State aid regime for the banking sector. Examples are the Netherlands and Denmark. In addition, other Member States had to apply for EFSF/ESM support as a result of which stricter burden-sharing requirements applied as a program conditionality.[10] Although the 2013 Banking Communication strengthened the burden-sharing requirements, it did not lead to the desired harmonization of the approach by Member States of failing banks. In addition, there was a lack of a cross-border cooperation framework for the resolution of banks, as a result of which national resolution tools were applied at the level of each entity rather than at the level of the cross-border group.[11] This raised the risks of reduced confidence, competitive distortions, high bail-out costs carried by taxpayers and legal uncertainty.[12]

The Larosière report of 25 February 2009 planted the seed for a harmonized resolution regime by concluding that "*[t]he lack of consistent crisis management and resolution tools across the Single Market places Europe at a disadvantage vis-à-vis the US and these issues should be addressed by the adoption at EU level of adequate measures*".[13] This report was followed by a Communication of 20 October 2009 from the Commission in which it confirmed that Europe needs a strong regulatory framework that covers prevention, early intervention, bank resolution and winding up.[14] The Communication of 20 October 2009 eventually led to the publication of the proposal for the BRRD on 6 June 2012.

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10 Iftinchi 2017, p. 72-73.

11 The Reorganisation and Winding Up Directive addresses only supervisory intervention and the mutual recognition of insolvency proceedings for cross-border bank *branches*. It requires that any reorganisation or winding up of a credit institution with branches in another Member State is initiated and carried out under a single procedure by the relevant authorities, and in accordance with the national insolvency law, of the home Member State of the bank. Cross-border banking groups, composed of a parent company with *subsidiaries* in other Member States are not covered by the Reorganisation and Winding Up Directive (EC Cross-Border Crisis Management Communication, 2009, p. 7).

12 EC Cross-Border Crisis Management Communication, 2009, p. 2.

13 See Larosière Report, 2009, p. 34.

14 EC Cross-Border Crisis Management Communication, 2009, p. 2.

> In the Impact Assessment that accompanied the proposal of the BRRD, the Commission assessed national resolution regimes previously adopted by Member States to be largely compatible with the proposal, although the proposal included more tools and powers (especially the bail-in tool) than existing national systems and also introduced the cross-border cooperation framework, which national legislations did not address at all.[15]

Less than two years after the publication of the proposal, on 15 May 2014, the adoption of the BRRD formed the first significant step towards harmonisation of the rules relating to the resolution of banks across the EU. The SRMR was adopted two months after the BRRD on 15 July 2014. The adoption of the SRMR was motivated by the fact that the BRRD had only established minimum harmonisation rules and had not led to centralization of decision-making in the field of resolution. The BRRD essentially provided for common resolution tools and resolution powers available for the national authorities of every Member State, but left discretion to national authorities in the application of these tools and in the use of national resolution funds in support of resolution procedures.[16] According to the recitals of the SRMR, the BRRD does therefore not completely avoid the taking of separate and potentially inconsistent decisions by the Member States regarding the resolution of cross-border groups which may affect the overall cost of resolution. Moreover, as it provides for national resolution funds, it does not sufficiently reduce the dependence of banks on the support from national budgets and does not completely prevent different approaches by Member States to the use thereof.[17] The purpose of the SRMR therefore is to provide a common framework on bank recovery and resolution for banks and bank groups that are established in the participating Member States of the SSM.[18] The SRMR accompanies the SSMR under which the application of the prudential supervision rules is entrusted

15 Impact Assessment BRRD, p. 61.

16 Such discretion is however not unlimited. The BRRD lays down a bail-in waterfall, as further discussed in section 4.5.3.4, and Article 101 BRRD provides for certain constraints on the interventions by national resolution funds.

17 Recital (10) SRMR. Section 5.5.2 further discusses whether the SRM does 'sufficiently' reduce the dependence of banks on the support from national budgets.

18 It will be seen in section 4.5.1.2, that the BRRD still plays a role within the SRM, since the implementation of resolution schemes adopted by the SRB still takes place by the national resolution authorities on the basis of the national implementation of the BRRD.

to the ECB, thereby addressing the misalignment between the central supervision by the ECB of banks in participating Member States and the national treatment of these banks in the resolution proceedings.[19]

The SRMR establishes a centralised power of resolution, in the form of the SRB working together with the national resolution authorities of the participating Member States of the SSM in order to enhance the uniform application of the resolution framework in these Member States. In addition, the SRMR also provides that the SRF is built up over a period of 8 years as a funding resource for banks that are established in the participating Member States.

> Before the introduction of the resolution framework, a failing bank could either be liquidated in insolvency proceedings or artificially be kept alive by means of State aid. With the introduction of the resolution framework, a special framework was designed to deal with failing banks. The resolution framework equips the national resolution authorities and the SRB with tools and powers to address banking crises pre-emptively, safeguarding financial stability and minimising taxpayers' exposure to losses. This was necessary, because insolvency proceedings do not cater for the special needs of a bank failure. The very short timelines to take decisions when a bank is failing are not catered for within existing insolvency frameworks. In addition, insolvency regimes insufficiently reflect the importance of the need for financial stability and the continuance of essential functions. The purpose of insolvency law is the orderly liquidation of the insufficient estate of a failing debtor and the equal distribution of the respective proceeds, if any, among all creditors. Insolvency proceedings aim to maximize creditors' payoff, while respecting creditors' hierarchy. Insolvency proceedings typically involve the creditors or administrators in the decision how to reallocate the debtors' assets, while there is no time for such involvement when a bank fails.[20]

19 Recitals (10), (11) and (14) SRMR.
20 Haentjens and Wessels 2014, ch. 3, par. 2.1.2. Janssen 2019.

4.3 The resolution framework for the banking sector

This section describes the legal outline and scope of the current resolution framework for the banking sector. It also analyzes the relationship between the BRRD and the SRMR.

4.3.1 The legal outline of the resolution framework

The legal outline of the resolution framework is described in this section along the lines of the primary and secondary law sources of EU law.[21]

4.3.1.1 The primary law sources

The legal basis for the SRMR and the BRRD is Article 114 TFEU. In accordance with Article 114 TFEU, the European Parliament and the Council may, acting in accordance with the ordinary legislative procedure and after consulting the Economic and Social Committee, adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market.[22] With regard to the scope of Article 114 TFEU, the ECJ has recalled that a legislative act adopted on that legal basis must, first, comprise measures for the approximation of the provisions laid down by law, regulation or administrative action in the Member States and, second, have as its object the establishment and functioning of the internal market.[23] While a mere finding of disparities between national rules is not sufficient to justify having recourse to Article 114 TFEU, it is otherwise where there are differences between the laws, regulations or administrative provisions of the Member States which are such as to obstruct the fundamental freedoms and thus have a direct effect on the functioning of the internal market. As discussed in section 4.2.2, this was considered to be the case as a result of the development of the national resolution regimes.

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21 The main sources of primary law are the treaties establishing the EU (the TFEU, TEU and Treaty establishing the European Atomic Energy Community), the protocols and annexes to the treaties, the treaties on accession of Member States to the EU and other treaties. Secondary law sources are legal instruments based on the treaties and include regulations, directives, decisions, recommendations and opinions.

22 Dejmek *CJoEL* 2009, p. 458.

23 ECJ, 22 January 2014, C-270/12, ECLI:EU:C:2014:18 (*United Kingdom v European Parliament and Council*), par. 100, 102.

> Tuominen takes a critical stance towards the use of Article 114 TFEU as the basis for the European Banking Union, which includes the resolution framework, taking into account that the European Banking Union stands at the crossroads between the Economic Monetary Union (EMU)[24] and the internal market, containing the four fundamental elements of free movement. The European Banking Union can be critized for mixing the internal market and economy policy objectives, which makes reliance on Article 114 TFEU insecure.[25]

In addition, an intergovernmental agreement was entered into by the participating Member States of the SSM on transferring the funds raised at national level towards the SRF as well as on a progressive merger of the different funds raised at national level to be allocated to national compartments of the SRF (the SRF Agreement). The obligation to transfer the contributions raised at national level towards the SRF does not derive from EU law. This had therefore to be established by the SRF Agreement.[26] The SRF supports the SRM.[27] It is only available to support the resolution of banks and banking groups in scope of the SRM.

The home state principle

Since the legal basis of the SRMR and the BRRD is formed by Article 114 TFEU, the 'home state principle' should be mentioned, being the underlying principle of the internal market for financial services. In the absence of harmonization measures, each Member State is considered competent to conceive rules that are valid in its own territory. However, the TFEU provisions on the free movement of goods, services, persons and capital prohibit all national measures that might render less attractive or hinder free movement. These provisions therefore require Member States to take into account regulations and measures which have already been fulfilled in the state of origin (the home state). This is also referred to as the home state principle.[28]

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24 Whilst all 28 Member States take part in the economic union, only 19 countries have taken integration further and adopted the euro. These are the Eurozone Member States. Within the Eurozone the monetary policy is centralized to the ECB. Economic policy competences are retained by the Member States, also within the Eurozone. See also section 1.4.4.

25 Tuominen *CML Rev.* 2017, p. 1374.

26 Recital (7) SRF Agreement.

27 Article 1 SRMR.

28 Janssens 2013, p. 39.

The home state principle applies in relation to the Reorganisation and Winding up Directive and CRD IV/CRR.

> The Reorganisation and Winding up Directive provides that the administrative or judicial authorities of the home Member State which are responsible for winding up shall alone be empowered to decide on the opening of winding up proceedings concerning a bank, including branches established in other Member States. This decision has to be recognised within the territory of all other Member States and is effective there when the decision is effective in the Member State in which the proceedings are opened.[29] The home state principle also applies in relation to reorganization measures, including the application of resolution tools and the exercise of resolution powers provided for in the BRRD.[30]
>
> The application of the home state principle in relation to CRD IV/CRR entails that the Member State licensing a bank is also responsible for supervising its activities throughout the EU. The home state principle forms the basis of the single license and the European passport that were introduced with the adoption of the First Banking Directive[31] in 1977 and the Second Banking Directive[32] in 1989, respectively.[33] On the basis of the European passport, banks established in Member States may offer services, either through the cross-border provision of services or through the establishment of branches, in any other Member State without seeking authorisation from the host Member State.[34]

The home state principle also applies in relation to the BRRD, as a result of which the BRRD's tools and procedures are applied in a decentralized manner, with individual Member States retaining responsibility for the

29 Article 9 Reorganisation and Winding Up Directive.
30 Articles 2 and 3 Reorganisation and Winding Up Directive.
31 Directive 77/780/EEC (First Banking Directive).
32 Directive 89/646/EEC (Second Banking Directive).
33 Dejmek *CJoEL* 2009, p. 460-461. EC, Communication of 11 May 1999 entitled "Implementing the framework for financial markets: action plan", COM(1999) 232 final (Financial Services Action Plan), p. 15. The Second Banking Directive has been replaced by Directive 2000/12/EC. Directive 2000/12/EC has been recast by Directive 2006/48/EC. Directive 2006/48/EC, as amended, has been merged in CRD IV and CRR. See also EC, Completing the Internal Market: White Paper from the Commission to the European Council, COM(85) 310, June 1985, p. 28.
34 Dombret 2013, p. 29.

resolution of their domestic banks.[35] The BRRD ensures that all assets and liabilities of a bank regardless of the country in which they are situated, are dealt with in a single process in the home Member State and that creditors in the host Member States are treated in the same way as creditors in the home Member State.[36]

Although the BRRD is based on the home state principle, the development of the SSM and the SRM led to the introduction of a centralized supervisory and resolution power in the form of the ECB and the SRB, respectively, for significant banks and (certain) banking groups within the Eurozone.[37] Although the ECB and SRB seem to consider themselves as absorbing the roles of the home and host state supervisor and replacing the resolution authorities, respectively,[38] it is the author's view that the centralization of power at the level of the ECB and the SRB in the Eurozone is incompatible with the home state principle. One could even say that the concept of home state and host state are actually no longer relevant within the SSM (and therefore SRM). The only fact of relevancy is whether the bank is established within a participating Member State of the SSM or not. It is no longer relevant which participating Member State that is.[39]

In the author's view, abandoning the home state principle within the SSM and SRM does not impair and can even contribute to the internal market for financial services. A few observations should however be made. First, it should be recognised that there may be a certain tension, if the home state principle still applies to other parts of the internal market. One could for example think of the winding up of banks through normal insolvency proceedings or the public funding of failing banks.

> In respect of the latter, it is stated that during the GFC most Member States applied a 'home taxpayer principle'; that is, the money had to come from the taxpayer of the country where the (cross-border) bank had its headquarter, e.g. Belgium for KBC, the Netherlands for ING, the UK for Barclays. Exceptions have been Fortis, where Belgium, Luxembourg and the Netherlands have contributed, Kaupthing

35 Hadjiemmanuil, 2015, p. 228. Articles 2 and 3 Reorganisation and Winding Up Directive.
36 Recital (119) BRRD.
37 It will be seen in section 4.3.4.2 that the groups in relation to which the ECB and the SRB can exercise their powers are not completely overlapping.
38 ECB, Guide to Banking Supervision, November 2014, p. 11-12. Recital (42) SRMR.
39 See also Teixeira *EBOLR* 2017, p. 557.

Bank Luxembourg, where Belgium and Luxembourg have contributed, and Dexia, where Belgium, France and Luxembourg have contributed. In the BRRD it was acknowledged that effective resolution regimes in all Member States are necessary to ensure that banks cannot be restricted in the exercise of the internal market rights of establishment by the financial capacity of their home Member State to manage their failure.[40] Within the SRM, the SRF was created, which has to become a mutual fund accessible for all banks within the Eurozone. Leaving the whole tab to national taxpayers, while introducing centralized supervision in the Eurozone, was politically impossible.[41] That is why the SRF will have to provide for centralized funding. At the time of writing this dissertation, the SRF however still lacks a common backstop.[42]

Secondly, the centralization of power only takes place within the SSM and SRM. There may therefore be tension between Member States that participate in the SSM and SRM (currently, the Eurozone Member States) and non-participating Member States.[43]

It can be read in the SRMR that the establishment of the SRM only within the Eurozone is not considered to impair the internal market, since the SRM is open to all Member States.[44] In addition, it is noted in literature that Member States that participate in the SRM have to participate in all elements of the European Banking Union. Cherry-picking is not allowed.[45] The question is, however, whether this is also conceived in such a way by others, such as the non-participating Member States.[46] The UK may be an example of such a Member State that reconsidered its position against the background of the further development of the economic and monetary union – *inter*

40 Recital (9) BRRD.
41 Dewatripont *IJoIO* 2014, p. 41.
42 See section 1.4.1.3 in relation to the development of such common backstop. See also Bierens 2015, p. 21.
43 Lo Schiavo mentions that a new separate Treaty for the Eurozone seems to be more practicable (Lo Schiavo 2018, p. 177).
44 Article 6(2) SRMR.
45 Schimmelfennig *WEP* 2016, p. 490; Spolc 2014, p. 10.
46 See e.g. Schimmelfennig *WEP* 2016, p. 484; Belke et al *J.E.A.*, 2016, p. 8, 18. Geeroms and Karbownik *Documentatieblad Federale Overheidsdienst Financiën – België* 2014, p. 212-213. Beukers 2017, p. 286-287. Craig and Markakis 2017, p. 302-304.

alia, through the SRM[47] – in the Eurozone and the impact thereof on non-Eurozone Member States.[48] Unfortunately, this resulted in the Brexit.

Thirdly, the home state principle is not completely replaced within the SRM and SSM. The home state principle still applies in relation to the exercise of powers by the national competent authorities and resolution authorities to banks and banking groups in scope of the SSM and SRM.[49] This makes that there is a certain complexity of the resolution process, that may not necessarily contribute to the efficiency thereof.

4.3.1.2 The secondary law sources

The secondary law sources of the resolution framework consist of the BRRD and the SRMR. Both the BRRD and the SRMR have been established by adopting the *Lamfalussy* approach.[50] This approach provides for financial regulation to be passed at multiple levels.

Level 1 instruments
At 'Level 1', framework legislation setting out the core principles and defining implementing powers is adopted by co-decision of the European Parliament and the Council after a full and inclusive consultation process following a proposal from the Commission. The BRRD and the SRMR together form the Level 1 framework legislation. The substantial and procedural rules for resolution can be found in the BRRD and the SRMR. The BRRD is a directive adopted by the European Parliament and the Council following a proposal from the Commission. The BRRD had to be implemented by the Member States by 31 December 2014, albeit that the provisions in relation to the bail-in tool had to be implemented by 1 January 2016.[51] All Member States have transposed the BRRD in their jurisdiction.[52] The BRRD provides for minimum harmonization only. This allows

47 President of the European Council Report 2012, p. 5.
48 Decision of the Heads of State or Government concerning a new settlement for the United Kingdom within the European Union, OJ C 69I , 23.2.2016, Section A. See also Teixeira *EBOLR* 2017, p. 557-559.
49 The division of tasks between the SRB and the national resolution authorities within the SRM is discussed in more detail in section 4.5.1.
50 Lamfalussy Report 2001. See Schaub *J.F.R.& C.* 2005 for an explanation of the *Lamfalussy* approach.
51 Article 130 BRRD.
52 EC, BRRD – transposition status, available on the website of the Commission: www.ec.europa.eu.

Member States to adopt additional measures at national level, as long as the measures are compatible with the principles and objectives set out in the BRRD.[53]

The SRMR is a regulation adopted by the European Parliament and the Council following a proposal from the Commission. The SRMR directly applies in the Member States as of 1 January 2016 (albeit that a part already applied as of 19 August 2014, e.g. in relation to the set-up of the SRB).[54] A specific feature of the SRMR is that it establishes uniform rules for the resolution of banks and banking groups that are established in the participating Member States of the SSM only. Those uniform rules are applied by the SRB together with the Council and the Commission and the national resolution authorities within the framework of the SRM established by the SRMR.[55] It is not possible for Member States to adopt more stringent rules than are included in the SRMR for the resolution of banks and banking groups that are in scope of the SRMR. The SRMR fully harmonizes the range of available tools for resolution.

> An interesting question, is whether Member States can still apply national resolution or bail-out measures in relation to banks and banking groups outside the resolution framework. For example, the Dutch government opted not to revoke national resolution provisions when bringing its national legislation in line with the SRM and implementing the BRRD. On the basis of the Dutch Intervention Act (as laid down in Part 6 of the Dutch Financial Supervision Act), the Dutch Minister of Finance still has the capacity to nationalize financial institutions, including banks.[56]

Level 2 instruments
Both the BRRD and the SRMR delegate to the Commission the power to adopt delegated acts in accordance with Article 290 TFEU.[57] In addition,

53 Article 1(2) BRRD.
54 Article 99 SRMR.
55 Article 1 SRMR.
56 See Busch, Van Rijn and Louisse *EBLR* 2019 on the question whether this power is in line with the resolution framework (p. 582-589). See also De Serière and Milione *JIBLR* 2019, p. 74.
57 Article 115 BRRD. Article 93 SRMR. Pursuant to Article 290 TFEU, a legislative act may delegate to the Commission the power to adopt non-legislative acts of general application that supplement or amend certain non-essential elements of the legislative act. The objectives, content, scope and duration of the delegation of power have to be explicitly defined in the legislative act. The essential elements of an area are reserved for the legislative act itself and accordingly may not be the subject of a delegation of power.

the BRRD delegates to the Commission the power to adopt implementing acts.[58] Under the SRMR this power is delegated to the Council in order to specify the application of the methodology for the calculation of individual contributions to the SRF, as well as the technical modalities for computing the flat contribution and the risk-adjusted contribution.[59] Where the level 2 measures require the expertise of supervisory experts, the BRRD and SRM determine that these measures are regulatory technical standards, based on drafts developed by the European Supervisory Authorities. The regulatory technical standards (RTS) are adopted by the Commission by means of a delegated act. The implementing technical standards (ITS) are adopted by means of an implementing act.

> At the time of writing this dissertation, the Commission had adopted three delegated acts on the basis of the SRMR, all in relation to the SRF. In addition, the Commission had adopted twelve delegated acts – of which eight in the form of RTS – relating to various topics on the basis of the BRRD. Moreover, the Commission had adopted five implementing acts on the basis of the BRRD. These all relate to the way in which information is provided or disclosed in the framework of the BRRD. The Council had adopted an implementing regulation.[60]

The SRMR explicitly states that the SRB, the Council and the Commission are subject to binding regulatory and implementing technical standards developed by EBA and adopted by the Commission within the scope of the BRRD.[61]

Level 3 instruments
The EBA has an important role to contribute to consistent and convergent implementation of the resolution framework by securing more effective cooperation between national resolution authorities and the convergence of resolution practices. This is 'Level 3' of the process.

58 Pursuant to Article 291(1) TFEU, responsibility for implementing legally binding EU acts lies primarily with the Member States. However, some legally binding EU acts require uniform conditions for the implementation.
59 Recital (114) SRMR. Article 70(7) SRMR.
60 Council Implementing Regulation (EU) No 2015/81.
61 Article 5(2) SRMR.

The EBA publishes guidelines and recommendations in relation to the BRRD and SRMR. For certain topics, the BRRD provides for the obligation of the EBA to publish guidelines (e.g. in relation to recovery planning, powers to address or remove impediments to resolvability and conditions for group financial support). In areas not covered by regulatory or implementing technical standards, EBA is able to issue guidelines and recommendations on the application of Union law under its own initiative.[62] The SRMR explicitly states that the SRB, the Council and the Commission are subject to guidelines and recommendations issued by the ECB within the scope of the BRRD.[63]

The EBA can also carry out non-binding mediation between the competent authorities and/or resolution authorities of the Member States, on request of a competent or resolution authority.[64] On request of a competent or resolution authority, the EBA can also go a step further by setting a time limit (the conciliation phase) for conciliation between the relevant authorities in respect of certain decisions that have to be adopted.[65] If the relevant authorities fail to reach an agreement within the conciliation phase, the EBA may take a decision requiring the relevant authorities to take specific action or to refrain from action in order to settle the matter, with binding effects for the relevant authorities concerned, in order to ensure compliance with EU law. Where a relevant authority does not comply with the decision of the EBA, and thereby fails to ensure that a bank complies with requirements directly applicable to it by the BRRD, the EBA may adopt an individual decision addressed to a bank requiring the necessary action to comply with its obligations under the BRRD, including the cessation of any practice.[66] The SRMR provides that the SRB shall also be subject to any decisions of EBA taken in its coordination function.[67]

In addition, the EBA acts as a central hub for information on crisis prevention, management and resolution. The BRRD and the SRMR provide for the obligation for Member States, competent authorities, resolution authorities and the SRB to notify the EBA of certain events (e.g. the designation of resolution authorities by the Member States, if a bank is deemed not

62 Recital 115 BRRD.
63 Article 5(2) SRMR.
64 Article 31 EBA Regulation.
65 Article 8(3), (4) and (7), 13(5), (6) and (9), 18(6), (7) and (9), 20(7), 30(6) and (7), 45(9) and (10) BRRD.
66 Article 19 EBA Regulation.
67 Article 5(2), second paragraph SRMR.

to be resolvable, the minimum requirement for own funds and eligible liabilities, etc.). Pursuant to the BRRD, the competent and resolution authorities also have the general obligation to provide the EBA with all the information necessary to carry out its duties assigned to it by the EBA Regulation.[68] The EBA maintains a list of notifications of resolution cases on its website.[69] The EBA also maintains central databases of penalties reported to it by competent authorities and resolution authorities that are imposed for violations of the (national provisions transposing the) BRRD. The databases are only accessible to resolution authorities and competent authorities, respectively.[70]

Level 4 instruments

'Level 4' is where the Commission enforces the timely and correct transposition of the EU legislation into national law.[71]

> The Commission has the responsibility to review the implementation of the BRRD by 1 June 2018 and to assess in particular the need for any amendments with regard to minimising divergences at national level and the functioning and efficiency of the role conferred on the EBA in the BRRD, including carrying out of mediation.[72] The Commission also has the responsibility to review the application of the SRMR by 31 December 2018, with a special emphasis on monitoring the potential impact on the smooth functioning of the internal market.[73] The Commission has published this review in April 2019.[74] Where appropriate, the Commission will prepare legislative proposals to amend the BRRD and the SRMR.[75] In its review, it however considered this to be premature at this stage.[76]

68 Article 128 BRRD in conjunction with Article 35 of the EBA Regulation.
69 Article 83(4)(b) BRRD. See www.eba.europa.eu.
70 Article 113 BRRD.
71 EC, Communication, Review of the Lamfalussy process: Strengthening supervisory convergence, COM(2007) 727 final, 20 November 2007, p. 2.
72 Article 129 BRRD.
73 Article 94 SRMR.
74 EC Report on application and review resolution framework 2019.
75 Already, the Commission published the Banking Package that, *inter alia*, provides for amendment of the BRRD and SRMR.
76 EC Report on application and review resolution framework 2019, p. 12.

4.3.2 *The three phases covered by the resolution framework and the alternative phase*

The resolution framework that is formed by the BRRD and SRMR does not only cover the *resolution* of banks (hereinafter referred to as the resolution phase).[77] It also covers the preparation of recovery and resolution plans of banks and banking groups (hereinafter referred to as the preparatory phase) and the recovery of banks (hereinafter referred to as the recovery phase).[78]

In the preparatory phase, the banks prepare for recovery and resolution by drafting a recovery plan and by assisting the resolution authorities in drafting a resolution plan. Preparing these plans should ensure the resolvability of banks.[79] Resolvability means that it is feasible and credible for the resolution authority to either wind up the bank (or its group) in normal insolvency proceedings or to resolve it by applying the different resolution tools and powers to the bank while avoiding to the maximum extent possible any significant adverse effect on the financial system, including in circumstances of broader financial instability or system-wide events, of the Member State in which the bank is established, or other Member States or the Union and with a view to ensuring the continuity of critical functions carried out by the bank.[80]

Recovery is mainly an internal process of a bank that is supervised by the national competent authorities or the ECB on the basis of the recovery plans that are prepared by the banks. Recovery should lead to the restoration of the financial position of a bank following a significant deterioration thereof.[81] If the own actions of the bank are not sufficient in that respect, recovery can also take place through intervention by the competent authorities, e.g. by taking early intervention measures or supervisory measures.[82]

77 This dissertation focuses on banks. The resolution framework, as laid down in the BRRD and SRMR however also applies to other institutions, such as investment firms and certain financial institutions. See section 4.3.4.

78 For completeness sake, the author notes that the preparation of recovery and resolution plans and the recovery of banks is also covered by certain provisions in CRD IV (See Article 74(4), 86(11), 104 CRD IV).

79 As Bierens mentions, the requirement that a bank is resolvable is a *going concern* requirement. It is not a direct applicable norm, but a described situation (Bierens *Ondernemingsrecht* 2017, p. 3).

80 Article 15(1), second paragraph BRRD.

81 The author refers to the definition of recovery capacity in point (103) of Article 2(1) BRRD, in the absence of a definition of recovery.

82 See sections 2.4.7 and 2.5.4.

It is not necessary for a bank to go through the recovery phase, before it comes in the insolvency or resolution phase.

Resolution is the situation in which a bank is failing or likely to fail, while there is no alternative private sector measure or supervisory action to prevent such failure, and public interest necessitates the application of one or more of the resolution tools by the resolution authorities to achieve one or more of the resolution objectives.[83] These resolution tools are the sale of business tool, the bridge institution tool, the asset separation tool and the bail-in tool.[84]

Lastly, an 'alternative phase' can be distinguished. The alternative phase concerns a phase that is not covered by the resolution framework, namely the insolvency phase.[85] If the financial position of a bank cannot be restored, the winding up of a failing bank through normal insolvency proceedings should always be considered before resolution tools are applied.[86] Once a resolution authority has taken the decision to put a bank in resolution, normal insolvency proceedings should be excluded, except if they need to be combined with the use of the resolution tools and at the initiative of the resolution authority.[87] The winding up of a bank through normal insolvency proceeding can therefore also be part of the resolution process.

> The focus of this dissertation is on the resolution phase. One should bear in mind that in the preparatory and recovery phase (in other words, the pre-resolution phase) already actions can be taken, by the bank itself or the authorities involved, to prevent the need for public funding in solving future problems of the bank. Although section 7.2.1.3 covers this to some extent, the author refers to existing literature for a more extensive discussion.[88]

83 Point (1) of Article 2(1) BRRD, in combination with Article 32 BRRD.
84 Article 37(3) BRRD. As further discussed in section 4.4.3.
85 Harmonization of national insolvency regimes is a topic that is discussed in the framework of the Capital Markets Union, as discussed in section 1.4.2.
86 Recital (36) BRRD.
87 Recital (44) BRRD.
88 See e.g. Haentjens and Wessels 2014, ch. 2; Ordónez 2014; Campbell and Moffatt 2019. In all phases there may be a need for public funding. See also Grünewald 2014, p. 30-47.

4.3.3 The geographical scope of the resolution framework

The geographical scope of the BRRD and SRMR differs. The BRRD applies to all EU Member States. In addition, the BRRD has been incorporated in the EEA Agreement by means of a Decision by the EEA Joint Committee.[89]

The SRMR only applies to the Member States that are participating Member States of the SSM.[90] These are the Eurozone Member States and other Member States that have opted to participate in the SSM. At the time of writing this dissertation, there are no Member States outside the Eurozone that made use of this option. As long as supervision in a Member State remains outside the SSM, that Member State should remain responsible for the financial consequences of a bank failure. The SRM therefore only extends to banks and banking groups established in Member States participating in the SSM and subject to the supervision of the ECB and the national authorities within the framework of the SSM. Banks and banking groups established in Member States not participating in the SSM are not subject to the SRM. Subjecting these Member States to the SRM would create the wrong incentives for them. In particular, supervisors in those Member States may become more lenient towards banks in their jurisdictions as they would not have to bear the full financial risk of their failures. Therefore, in order to ensure parallelism with the SSM, the SRM only applies to Member States participating in the SSM. As Member States join the SSM, they also automatically become subject to the SRM. Ultimately, the SRM could potentially extend to all Member States.[91]

4.3.4 The material scope of the resolution framework

This section discusses the material scope of the resolution framework. This scope is determined on the basis of the entities to which the resolution framework applies. The preceding sections only refer to banks as being in scope of the resolution framework. The scope of the BRRD and the SRMR is however broader, meaning that also other entities than banks can be

89 Decision of the EEA Joint Committee, No 21/2018, 9 February 2018. At the time of writing this dissertation, the entry into force of the Decision was still pending. The legal status can be tracked on the website of EFTA: http://www.efta.int.

90 Article 1 BRRD. Article 2 SRMR.

91 Recital (17) SRMR. 26 Member States (all EU Member States, except for Sweden and the UK) signed the SRF Agreement on 21 May 2014. The SRF Agreement has been ratified by 20 Member States, including all 19 Eurozone Member States and Hungary

subject to resolution under the 'resolution framework for the banking sector'.[92] The material scope of the BRRD and of the SRMR differ as further discussed in the following sections.

4.3.4.1 Material scope of the BRRD

The BRRD applies to:
1. Institutions that are established in a Member State;
2. Financial institutions that are established in a Member State and form part of the group of an institution;
3. Parent companies that are established in a Member State; and
4. Branches located in a Member State of third-country institutions (Union branches).[93]

<u>Ad 1: Institutions</u>
An institution within the meaning of the BRRD is a credit institution or an investment firm.[94] A credit institution within the meaning of the BRRD is a credit institution within the meaning of CRR, also referred to as bank.[95]

> EP Members Markus Ferber and Wolf Klinz have, unsuccessfully, proposed to exempt banks in public ownership and/or provided with explicit guarantee arrangements from the scope of the BRRD. Their reasoning for this exemption was that these banks would be shielded from failure.[96] In addition, EP Member Peter Simon has, unsuccessfully, proposed to exempt bridging institutions and development banks from the scope of the BRRD.[97]

In addition to banks, it was considered that investment firms also need to be part of the resolution framework, as the GFC has showed that their failure (i.e. Lehman Brothers) could have serious systemic consequences.[98]

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92 See Busch and Van Rijn *EBOLR* 2018 on the possibilities for and necessity of resolution regimes, other than the resolution regime for the banking sector.
93 Article 1 BRRD.
94 Article 2(1)(23) BRRD.
95 Article 2(1)(2) BRRD, in conjunction with Article 4(1)(1) CRR. The author also refers to section 2.2.1. Article 2(5) CRD IV excludes certain entities from the scope of CRD IV. These include e.g. credit unions in several Member States. These entities do not qualify as institutions within the meaning of the BRRD.
96 Committee on Economic and Monetary Affairs, Amendments 141-383, 2012/0150 (COD), p. 84.
97 Committee on Economic and Monetary Affairs, Amendments 141-383, 2012/0150 (COD), p. 84.
98 Impact Assessment BRRD, p. 7.

The definition of investment firm under the BRRD differs from the definition of investment firm under CRR and MiFID II. Pursuant to Article 2(1)(3) BRRD an investment firm is an investment firm as defined in Article 4(1)(1) CRR that is subject to the initial capital requirement laid down in Article 28(2) CRD IV. The investment firms that are in scope of the BRRD are therefore only these investment firms that are required to hold initial capital of EUR 730,000. These are the investment firms that conduct one of the three investment activities (dealing on own account, but not qualifying as local firm, operating a multilateral trading facility or operating an organized trading facility) or conduct underwriting activities on a firm commitment basis. In this dissertation, this category of investment firms is referred to as 'BRRD investment firms'.

> In its Report on Investment Firms of 14 December 2015, the EBA mentioned that the vast majority of investment firms, irrespective of their activity, do not present either the same type or scale of consequences as banks do, should they fail. As such, the resolution tools of the BRRD may generally be overly complex and less relevant to them; for example, being relatively small and without holding deposits, it is more difficult to envisage many situations where, bail-in or bridge bank tools would be required. Rather, in practice the 'resolution' tool of choice for the vast majority of investment firms is most likely to be to allow the firm to enter insolvency, or any particular national administration regime that applies to investment firms, with regulatory attention focused more on winding up and managing the impact of failure.[99] The new prudential regime for investment firms that has been proposed by the Commission following the advice by the EBA[100] provides that the largest, systemically important investment firms will need to obtain a license as a credit institution and stay fully subject to CRD IV/CRR.[101] Other investment firms will fall under a new prudential regime and will no longer be covered by CRD IV/CRR. All investment firms will stay subject to MiFID II/MiFIR. The proposals for the new prudential

99 EBA, Report on Investment Firms, EBA/Op/2015/20, p. 77.

100 EC, Proposal for a Regulation of the European Parliament and of the Council on the prudential requirements of investment firms and amending Regulations (EU) No 575/2013, (EU) No 600/2014 and (EU) No 1093/2010, COM(2017) 790 final (the IFR Proposal) and EC, Proposal for a Directive of the European Parliament and of the Council on the prudential supervision of investment firms and amending Directives 2013/36/EU and 2014/65/EU, COM(2017) 791 final (the IFD Proposal).

101 Article 60 IFR Proposal.

regime do not set out how this will impact the coverage of investment firms under the resolution regime. It seems likely that only the largest, systemically important investment firms will stay in scope of the resolution regime. However, the text adopted at first reading by the European Parliament seems to assume that investment firms that will fall under the new prudential regime could still be in scope of the resolution framework.[102] At the time of writing this dissertation, the final text was not yet available.

Ad 2: Financial institutions

Financial institutions are undertakings, other than institutions (banks and BRRD investment firms), the principal activity of which is to acquire holdings or to pursue one or more of the banking activities listed in points 2 to 12 and point 15 of Annex I to CRD IV, including a financial holding company, a mixed financial holding company, a payment institution within the meaning of the Payment Services Directive II (PSD II)[103], and an asset management company (i.e. a manager of undertakings for collective investment in transferable securities (UCITS) or alternative investment funds (AIFs)), but excluding insurance holding companies and mixed-activity insurance holding companies. [104]

Financial institutions are in scope of the BRRD, if they are a subsidiary of an institution or of a parent company thereof and they are covered by the supervision of the parent company on a consolidated basis in accordance with Articles 6 to 17 CRR.

Ad 3: Parent companies

Parent companies are:

1. Financial holding companies: financial institutions the subsidiaries of which are exclusively or mainly institutions or financial institutions, at least one of these subsidiaries being an institution, and which are not mixed financial holding companies;[105]

102 EP, legislative resolution of 16 April 2019 on the proposal for a directive of the European Parliament and of the Council on the prudential supervision of investment firms and amending Directives 2013/36/EU and 2014/65/EU (COM(2017) 0791 – C8-0452/2017 – 2017/0358(COD)). See Article 62.

103 Directive (EU) 2015/2366 (PSD II).

104 Article 2(1)(4) of BRRD in conjunction with Article 4(1)(26) CRR and Article 4(1)(19) CRR. See also EIOPA Opinion 2017.

105 Article 2(1)(9) BRRD in conjunction with Article 4(1)(20) CRR.

2. Mixed financial holding companies: parent undertakings[106], other than regulated entities (that is, banks, insurance undertakings or investment firms), which together with their subsidiaries, at least one of which is a regulated entity which has its head office in the EU, and other entities, constitute a financial conglomerate;[107]
3. Mixed-activity holding companies: parent undertakings other than financial holding companies, institutions or mixed financial holding companies, the subsidiaries of which include at least one institution.[108]

Ad 4: Union branches

Union branches[109] are places of business located in a Member State, which form a legally dependent part of an institution (bank or BRRD investment firm) that is established outside the EU (a third-country institution), and which carry out directly all or some of the transactions inherent in the business of these institutions.[110]

4.3.4.2 Material scope of the SRMR

The SRMR applies to:

1. Banks established in a participating Member State of the SSM;
2. Parent companies established in a participating Member State of the SSM, where they are subject to consolidated supervision carried out by the ECB in accordance with Article 4(1)(g) SSMR;
3. BRRD investment firms and financial institutions established in a participating Member State of the SSM, where they are covered by the consolidated supervision of the parent company carried out by the ECB.[111]

Ad 1, 2 and 3

Banks are in scope of the SRMR, if they are established in a participating Member State of the SSM.

106 Parent undertakings are parent undertakings as defined in Article 1 Directive 83/349/EEC.
107 Article 2(1)(10) of BRRD in conjunction with Article 4(1)(21) CRR and Article 2(15) Directive 2002/87/EC (FICOD).
108 Article 2(1)(11) BRRD in conjunction with Article 4(1)(22) CRR.
109 Article 2(1)(89) BRRD.
110 Article 2(1)(17) BRRD in conjunction with Article 4(1)(17) CRR.
111 Article 2 SRMR.

> This concerns both significant and less-significant banks. Several EP Members have, unsuccessfully, proposed to restrict the scope of the SRMR to banks that are subject to direct supervision carried out by the ECB in accordance with the SSMR (i.e. significant banks). In their view significant banks should be subject to a resolution mechanism at the European level, while less-significant banks should be resolved at national level (that is, outside the scope of the SRM).[112]

Standalone BRRD investment firms[113] do not fall in scope of the SRMR. Only, if they are part of a banking group, they can come in scope of the SRMR. Branches of third-country institutions are also outside the scope of the SRMR. Standalone BRRD investment firms and branches of third-country institutions can therefore only be put in resolution in accordance with the BRRD.

Entities other than banks (that is parent companies, BRRD investment firms and financial institutions), can only be subject to resolution under the SRMR, if they are covered by consolidated supervision carried out by the ECB. In accordance with Article 4(1)(g) in conjunction with Article 6(4) up to (6) SSMR, the ECB carries out supervision on a consolidated basis on a holding company, if (i) the holding company is established in a participating Member State of the SSM, and (ii) it heads a significant banking group, a cross-border banking group in relation to which the ECB has decided that it carries out consolidated supervision,[114] or another banking group in relation to which the ECB has decided that it carries out consolidated supervision.[115]

The restriction of the scope of the SRMR to banking groups in relation to which the ECB carries out consolidated supervision seems to be incorrect, taking into account that pursuant to Article 7 SRMR the SRB is responsible for adopting all decisions relating to cross-border banking groups, in addition to the banking groups which are considered to be significant, while the national resolution authorities are responsible for the resolution

112 Committee on Economic and Monetary Affairs, Amendments 83-403, 2013/0253 (COD), p. 97-101.

113 Since the SRMR does not include a definition of 'investment firm', the definition of investment firm as included in the BRRD applies (Article 3(2) SRMR).

114 The ECB can under certain circumstances on its own initiative carry out consolidated supervision on cross-border banking groups (Article 6(4) SSMR).

115 If it concerns a less significant banking group that, in accordance with Article 6(5) (b) SSMR, is assigned by the ECB as a group that it will directly supervise.

of banking groups that are not considered to be significant or cross-border groups. Banking groups that are not significant and in relation to which ECB has not decided to carry out consolidated supervision are subject to consolidated supervision carried out by the relevant national competent authority in accordance with the SSMR. According to the text of Article 2 SRMR, these groups cannot be resolved under the SRMR, because they are not subject to consolidated supervision by the ECB. These banking groups are however in scope of the SSM. The outcome that these groups are not in scope of the SRM seems to be incorrect and also unintended. Recital (15) SRMR states that the SRMR applies only in respect of banks whose home supervisor is the ECB *or the national competent authority* in Member States whose currency is the euro or in Member States whose currency is not the euro which have established a close cooperation with the ECB. It therefore seems that the scope of Article 2 SRMR should be read as including all banking groups that are in scope of the SSM, including the banking groups that are subject to consolidated supervision by the national competent authorities within the SSM.

4.3.4.3 Summary of material scope of BRRD and SRMR

Taking into account the complexity of the material scope of the BRRD and SRMR, the below schedule summarizes this scope.

Table 5: Summary of material scope of BRRD and SRMR

	BBRD	**SRMR**
Standalone banks[116]	Yes, if the bank is established in a Member State.	Yes, if the (significant or less-significant) bank is established in a participating Member State.
Standalone BRRD investment firms[117]	Yes, if the BRRD investment firm is established in a Member State.	No.
Banks that form part of a group (a banking group)	Yes, if the bank is established in a Member State.	Yes, if the (significant or less-significant) bank is established in a participating Member State.

116 These are banks that are not part of a group.

117 These are investment firms that fall in scope of the BRRD and that are not part of a group.

BRRD investment firms that form part of a group	Yes, if the BRRD investment firm is established in a Member State.	Yes, if the BRRD investment firm is (a) established in a participating Member State and (b) covered by the consolidated supervision of the parent undertaking by the ECB (or the national competent authority on the basis of the SSMR).
Parent companies	Yes, if the parent company is established in a Member State.	Yes, if the parent company is (a) established in a participating Member State and (b) subject to consolidated supervision by the ECB (or the national competent authority on the basis of the SSMR).
Group companies of a group that includes at least one bank (a banking group)	Yes, if these group companies (a) qualify as financial institution, (b) are established in a Member State, and (c) are covered by the consolidated supervision of the parent undertaking in accordance with CRR.	Yes, if these group companies (a) qualify as BRRD investment firm or financial institution, (b) are established in a participating Member State, and (c) are covered by the consolidated supervision of the parent undertaking by the ECB (or the national competent authority on the basis of the SSMR).
Group companies of a group that includes at least one BRRD investment firm, but no bank (a non-banking group)	Yes, if these group companies (a) qualify as financial institution, (b) are established in a Member State, and (c) are covered by the consolidated supervision of the parent undertaking in accordance with CRR.	No.
Branches of third-country institutions	Yes, if the branch of the third-country institution is established in a Member State.	No.

4.3.5 The relationship between the BRRD and the SRMR

The scope of the BRRD and the SRMR is partly overlapping. For example, a bank established in a Eurozone Member State is both in scope of the BRRD and the SRMR. The question may therefore arise whether such a bank should be put in resolution under the SRMR or the BRRD. There is no guidance given in respect of the hierarchy of the BRRD and the SRMR.

They are both legislative acts within the meaning of Article 289(3) TFEU. One could however argue that the SRMR supersedes national laws incompatible with its substantive provisions, including national law transposing the BRRD in such a way that it conflicts with the SRMR.[118] In this view, a bank established in a participating Member State should be put in resolution under the SRMR, and not under the BRRD.

The importance thereof is twofold. First, unlike the SSMR, the SRMR, in addition to institutional aspects, contains substantive law provisions.[119] Although the SRMR is allegedly consistent with the BRRD and adapts the rules and principles of the BRRD to the specificities of the SRM,[120] there are some important differences in the substantive law provisions.[121] For example, the provisions on the financing of resolution in the SRMR differ from the provisions in the BRRD.

> For example, Article 27(11) SRMR sets out that Article 44(8) BRRD does not apply. Article 44(8) BRRD sets out the provisions under which a national resolution fund may make a further contribution to a bank in resolution to which the bail-in tool is applied. In addition, the SRMR includes specific provisions on the use of the SRF instead of the national resolution funds.[122] The SRF is considered to replace the national resolution funds of the participating Member States from 1 January 2016.[123]

Another example is that the SRMR does not provide for the possibility for the SRB or the national resolution authorities to seek funding for a bank in resolution from the Member States through the so-called government financial stabilisation tools. The provision of State aid is however also not ruled out under the SRM.[124]

118 EP, 'Sources and Scope of European Union Law', May 2018, p. 2.
119 Carriero *EBLR* 2017, p. 640.
120 Recital (18) SRMR.
121 Apart from the fact, that the BRRD only provides for minimum harmonisation.
122 Article 67 and further SRMR.
123 Article 96 SRMR.
124 Article 19 SRMR. The use of government financial stabilisation tools within the SRM is further discussed in section 5.3.5.5.

Secondly, there may be a procedural impact, since the competent resolution authority[125] on the basis of the SRMR may be the SRB instead of a national resolution authority. Whether the competent resolution authority within the SRM is the SRB or the national resolution authority depends on the division of tasks between the SRB and the national resolution authorities as set out in Article 7 SRMR and further discussed in section 4.5.1.1.

Although the SRMR does not provide further guidance as to the hierarchy between it and the BRRD, it does contain certain provisions that cover the relationship between the two legislative acts. First, it clarifies that when the SRB, the Council and the Commission[126] exercise the powers conferred on them by the SRMR, they are subject to the delegated acts, and regulatory and implementing technical standards, guidelines and recommendations adopted by the EBA within the scope of the BRRD.[127] In addition, when the Commission adopts delegated acts pursuant to the SRMR it has to ensure consistency with the delegated acts adopted pursuant to the BRRD.[128]

Secondly, it stipulates that national resolution authorities have to exercise their powers under national law transposing the BRRD and in accordance with the conditions laid down in national law when taking the necessary actions to implement the decisions of the SRB or when acting as resolution authority within the SRM. [129] In addition, when implementing those decisions or acting as resolution authority within the SRM, the national resolution authorities have to ensure that the applicable safeguards provided for in the BRRD are complied with.[130] This is without prejudice to the SRB, together with the Council and the Commission, and the national resolution authorities applying the uniform rules and procedures that are set out in the SRMR.[131]

125 'Competent resolution authority' refers to the resolution authority that can take the decision to put the bank in resolution. As will be seen in section 4.5.1.2, even when the SRB is the competent resolution authority, the national resolution authorities are still involved in the implementation of the resolution scheme adopted by the SRB.
126 The different roles of the SRB, the Commission and the Council in relation to the resolution process are further discussed in section 4.5.1.
127 Recital (18) SRMR.
128 Article 93(3) SRMR.
129 Article 29(1) and Article 7(3) SRMR.
130 Article 29(1) SRMR. The SRMR does not contain provisions equivalent to Chapter VI BRRD (that covers the resolution powers).
131 Article 1 SRMR. Article 7(3) SRMR also specifies that the national resolution authorities apply the relevant provisions of the SRMR.

4.4 The concept of resolution

Resolution is defined in Article 2 BRRD as '*the application of a resolution tool or a tool referred to in Article 37(9) in order to achieve one or more of the resolution objectives referred to in Article 31(2)*'. Resolution basically is the situation in which a bank is failing or likely to fail, while there is no alternative private sector measure or supervisory action to prevent such failure, and public interest necessitates the application of one or more of the resolution tools to achieve one or more of the resolution objectives.[132] The main elements of resolution are (a) the application of one or more resolution tools, (b) to achieve one or more resolution objectives, (c) in a situation in which the conditions for resolution are met. These elements are discussed in more detail in the following sections. First the conditions for resolution are discussed, because resolution tools can only be applied when these are met.

4.4.1 The conditions for resolution

The resolution tools should be applied, if the resolution authority considers that the conditions for resolution are met.[133] These conditions are (a) the determination that the bank is failing or is likely to fail has been made, (b) there is no reasonable prospect that any alternative private sector measure, supervisory action or write down or conversion of capital instruments would prevent the failure of the bank within a reasonable timeframe, and (c) a resolution action is necessary in the public interest. The resolution conditions are discussed in more detail in the following sections.

The resolution authorities should ensure that a valuation of the assets and liabilities of the bank or banking group to be put in resolution is carried out by an independent valuer to inform the determination on whether the conditions for resolution are met, and more specifically the first resolution condition.[134] The EBA refers to this valuation as Valuation 1 (decision on the resolution). [135]

132 Point (1) of Article 2(1) BRRD, in combination with Article 32 BRRD.
133 Article 32(1) BRRD.
134 Article 36(1) and (4)(a) BRRD. Article 20(1) and (5)(a) SRMR. Lastra and Olivares-Caminal 2018, p. 6.
135 EBA Valuation RTS 2017, p. 3.

4.4.1.1 The determination that the bank is failing or is likely to fail has been made

A bank is deemed to be failing or likely to fail (FOLTF) in one or more of the following circumstances (i) the bank infringes or there are objective elements to support a determination that the bank will, in the near future, infringe the requirements for continuing authorisation in a way that would justify the withdrawal of the authorisation, (ii) the assets of the bank are or will, in the near future, be less than its liabilities, (iii) the bank is or will, in the near future, be unable to pay its debts or other liabilities as they fall due, (iv) extraordinary public financial support (EPFS) is required, except in certain cases.[136]

FOLTF does therefore not mean only actual or impending balance-sheet insolvency or inability to pay debts as they fall due (illiquidity), in harmony with the usual criteria insolvency law. It may also include vaguely defined situations, such as raising the need for public financial support as well as, situations involving the actual or impending infringement by the bank of its regulatory requirements for continuing authorisation.

> The BRRD does not include a specific numerical indicator for violation of the regulatory requirements for continuing authorisation, to serve as a clear quantitative trigger.[137] It can however be derived from the EBA Pillar 2 Roadmap that a breach of the Pillar 2 capital requirements, other than Pillar 2 non-legally binding capital guidance, is considered a potential condition for meeting the FOLTF condition.[138]

The criteria are hence rather fluid and imprecise, but they certainly mean that the trigger for resolution can be crossed at a point well before the bank has reached the financial state of balance-sheet insolvency.[139] In other words, resolution can take place at a point when a bank is still solvent.

> For Banco Popular, the ECB considered that it was likely in the near future to be unable to pay its debts or other liabilities as they fall due, because of excessive deposit outflows, the speed at which liquidity

136 Article 32(4) BRRD. The cases in which EPFS can be granted without triggering resolution are discussed in section 5.3.2. This entails the so-called precautionary recapitalisation and precautionary guarantees.
137 Hadjiemmanuil, 2015, p. 243.
138 EBA Pillar 2 Roadmap 2017, p. 4.
139 Hadjiemmanuil, 2015, p. 243.

was being lost from the bank and the inability of the bank to generate further liquidity.[140] The ECB considered that Banca Popolare di Vicenza was failing or likely to fail, because it infringed the requirements for continuing authorisation in a way that would justify the withdrawal of the authorisation by the competent authority.[141] It came to the same conclusion in relation to Veneto Banca.[142]

Within the SRM, the assessment whether or not the FOLTF condition is met, is made by the ECB (or the national competent authority)[143], after consulting the SRB (or the national resolution authority).[144] The SRB (or the national resolution authority) may also make this assessment, but only after informing the ECB (or the national competent authority) of its intention and only if the ECB (or the national competent authority), within three calendar days of receipt of that information, does not make this assessment.[145] The division of tasks between the SRB and the national resolution authorities is further discussed in section 4.5.1.

In the case of ABLV Bank and ABLV Bank Luxembourg, the ECB determined that they were failing or likely to fail.[146] In particular, the ECB considered that there were objective elements to support a determination that the banks would, in the near future, be unable to pay its debts or other liabilities as they fall due.[147] ABLV Bank brought an action before the CI to annual the decision of the ECB that ABLV Bank and ABLV Bank Luxembourg are FOLTF. In an order of 6 May 2019, the CI decided that the action of ABLV Bank is inadmissible. It assessed that the FOLTF assessment by the ECB is a mere assessment, which does not in any way bind the SRB. Therefore, the FOLTF assessments for ABLV Bank and ABLV Bank Luxembourg must be considered to be preparatory measures in the

140 ECB, 'Failing or Likely to Fail' Assessment of Banco Popular Español, 6 June 2017.
141 ECB, 'Failing or Likely to Fail' Assessment of Banca Popolare di Vicenza Società per Azioni, 23 June 2017.
142 ECB, 'Failing or Likely to Fail' Assessment of Veneto Banca Società per Azioni, 23 June 2017.
143 Depending on the division of tasks set out in the SSMR.
144 Article 18(1) SRMR.
145 Article 18(1), second paragraph SRMR.
146 ECB, ECB determined ABLV Bank was failing or likely to fail, 24 February 2018.
147 SRB, Notice summarising the decision taken in respect of ABLV Bank Luxembourg S.A.

> resolution procedure, which are designed to allow the SRB to take a decision regarding the resolution of the banks in question, and cannot, for that reason, form the subject of an action for annulment.[148]

Under the BRRD, the FOLTF assessment is made by the national competent authority, after the national resolution authority is consulted.[149] Member States may also provide that the assessment can be made by the national resolution authorities, after consulting the competent authorities.[150]

4.4.1.2 The failure of the bank cannot be prevented within a reasonable timeframe

The second condition to put a bank in resolution is that there is no reasonable prospect that any alternative private sector measures, including measures by an institutional protection scheme (IPS), or supervisory action, including early intervention measures or the write-down or conversion of relevant capital instruments in accordance with the PONV conversion power, taken in respect of the entity, would prevent its failure within a reasonable timeframe.

An alternative private sector measure would for example be a voluntary recapitalisation. Alternative private sector measures also include measures by an IPS. An IPS is a contractual or statutory liability arrangement entered into by a bank with a counterparty which protects the bank and in particular ensures its liquidity and solvency to avoid bankruptcy where necessary.[151]

> 50% of the total number of banks in the Eurozone are members of an IPS, representing 10% of the total assets of the Eurozone banking system.[152] According to Véron, German savings and cooperative banks are practically exempt from the application of the BRRD by the IPS to which they belong.[153] The reason is that the second resolution condition will never be met, if the IPS is able to prevent

148 GC, 6 May 2019, T-281/18, ECLI:EU:T:2019:296 (*ABLV Bank v ECB*), par. 34-36. Louisse *JOR* 2019-1. ABLV Bank lodged an appeal against this order (C-551/19 P), *inter alia*¸ because the GC would have based its order on an incorrect interpretation of Article 18(1) SRMR.
149 Article 32(1)(a) BRRD.
150 Article 32(2) BRRD.
151 Article 113(7) CRR.
152 Vesala 2016, p. 5.
153 Véron *Bruegel Policy Contribution* 2017, p. 8-9.

> the failure of the bank. At the time of writing this dissertation, the use of IPS is assessed by the Commission in respect of the support plan of Nord/LB. In this plan, the existing shareholders of Nord/LB, which are the State of Lower Saxony and the State of Saxony-Anhalt, intend to contribute to a capital injection in the bank, besides the Sparkassen Finanzgruppe, which is an IPS.[154] The outcome of this assessment, including potential qualification as State aid, is still unknown at the time of writing this dissertation.

A supervisory action would, for example, be an early intervention measure.[155] A supervisory action also includes the exercise of the PONV conversion power, as further discussed in section 4.5.2.[156]

Within the SRM, an assessment of this condition should be made by the SRB or, where applicable, the national resolution authorities, in close cooperation with the ECB or the national competent authority.[157] Under the BRRD, this assessment should be made by the national resolution authority in consultation with the national competent authority.[158]

> For example, in the case of Banca Popolare di Vicenza, the ECB considered that there were no effective supervisory measures or early intervention measures available which would restore the compliance with capital regulatory requirements. It considered that an effective and timely implementation of the plan to recapitalise Banca Popolare di Vicenza and Veneto Banca, merge them and create the conditions for a new viable business model in the future was implausible. In addition, Banca Popolare di Vicenza had shown to be incapable of raising capital in the open market.[159]

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154 Choulet *EcoFlash* 2019. EP, Measures to strengthen NordLB's capital position, PE 624.414, February 2019.
155 Article 13 BRRD.
156 The exercise of the PONV conversion power is however not a supervisory action, because it is a power of the resolution authority. See also section 4.5.2. The text of Article 32(1)(b) BRRD and Article 18(1)(b) SRMR seems therefore to be incorrect by including the exercise of the PONV conversion power as a supervisory action.
157 Article 18(1) SRMR.
158 EBA, Single Rulebook Q&A, Question ID: 2015_2519.
159 ECB, 'Failing or Likely to Fail' Assessment of Banca Popolare di Vicenza Società per Azioni, 23 June 2017, p. 4-5.

In the case of ABLV Bank Luxembourg, the SRB considered that no alternative private measures and supervisory actions could prevent the failure of the bank taking into account several elements, including the bank's inability to obtain financial support from its parent company (ABLV Bank), the lack of other implementable measures in the group recovery plan, the absence of available supervisory or early intervention measures that could restore the liquidity position of the bank and the inability of a write-down and conversion of capital instruments to prevent the failure of the bank.[160]

4.4.1.3 Resolution is necessary in the public interest

The last condition to put a bank in resolution, is that this is necessary in the 'public interest'. This is the case, if resolution is necessary for the achievement of and is proportionate to one or more of the resolution objectives and winding up of the bank in normal insolvency proceedings would not meet those resolution objectives to the same extent.[161] The resolution objectives are discussed in detail in section 4.4.2. The assessment whether resolution is necessary in the public interest is made by the resolution authority.[162] This can be the SRB or the national resolution authority within the SRM. Under the BRRD, this is the national resolution authority.

At the time of writing this dissertation, the SRB has taken five decisions in relation to the application of the 'public interest test'. In four of these decisions, it decided that resolution was not in the public interest and that the banks should be wound up in normal insolvency proceedings.

The only decision in which the SRB stated that resolution was in the public interest so far, is the case of Banco Popular. The SRB assessed that Banco Popular provides critical functions, consisting of deposit taking from households and non-financial corporations, lending to SMEs and payment and cash services. In addition, it considered that the situation of Banco Popular entailed an increased risk of significant adverse effects on financial stability in Spain. In this assessment, it took into account the size and nature of the business of

160 SRB, Notice summarising the decision taken in respect of ABLV Bank Luxembourg S.A.

161 Article 32(5) BRRD.

162 Article 32(1) BRRD. Article 18(1) SRMR.

Banco Popular. Lastly, the SRB concluded that the resolution actions would meet the other resolution objectives at least to the same extent as insolvency proceedings.[163]

In relation to Veneto Banca, the SRB assessed that the bank did not provide critical functions. In addition, the SRB assessed that the failure of the bank, on a standalone basis, was not likely to result in significant adverse effects on financial stability in Italy, because it size was rapidly declining, the bank had not been classified as systemically important by the Banca d'Italia, the relatively low financial and operational interconnections with other financial institutions and there would be no significant impact at national level, although a potential adverse impact on retail customers and SMEs in certain regions could not be excluded. In addition, it was assessed that the protection of investors and depositors, client funds and client assets could be achieved to the same extent in normal insolvency proceedings.[164] The SRB made the same assessment in relation to Banca Popolare di Vicenza. It also considered that the simultaneous failure of Veneto Banca and Banca Popolare di Vicenza might have an impact on financial stability, but that this would likely not be significant, due to the low interconnectedness of the banks with other financial institutions, the highly diversified funding structure of the banks, the small combined market share for lending and deposit-taking, the diminishing role of the banks for credit supply, the deteriorating market share of the banks without having a measurable impact and the fact that market perception of the banks had already deteriorated significantly.[165]

In relation to ABLV Bank and ABLV Bank Luxembourg, the SRB assessed that resolution was not in the public interest, because neither of the banks provide critical functions, and their failure is not expected to have a significant adverse impact on financial stability in Latvia, Luxembourg or other Member States. For ABLV Bank Luxembourg, the SRB considered relevant in that respect the limited size of the bank and the absence of ties to the Luxembourgish real

163 SRB, Decision of 7 June 2017 concerning the adoption of a resolution scheme in respect of Banco Popular Español, S.A., SRB/EES/2017/08, p. 12-19.

164 SRB, Decision of 23 June 2017 concerning the assessment of the conditions for resolution in respect of Veneto Banca S.p.A., SRB/EES/2017/11, p. 11-21.

165 SRB, Decision of 23 June 2017 concerning the assessment of the conditions for resolution in respect of Banca Popolare di Vicenza S.p.A., SRB/EES/2017/12, p. 17-18.

> economy. For ABLV Bank, the SRB considered that the low financial and operational interconnections with other financial institutions justified the outcome that the failure of the bank was not likely to result in significant adverse effects on financial stability in Latvia or in other Member States.[166] The decisions of the SRB are challenged by ABLV Bank before the CI.[167] ABLV Bank, *inter alia*, argues that the SRB lacks the competence for the decision as to liquidation. At the time of writing this dissertation, the CI had not yet assessed the case.

It seems that the SRB considers continuity of critical functions and significant adverse effects on financial stability the two most important resolution objectives for the decision whether or not resolution is necessary in the public interest. In relation to the other resolution objectives, the SRB seems to restrict its assessment to whether winding up of the bank in normal insolvency proceedings would not meet those resolution objectives to the same extent. And even if that is the case (see the decision in relation to Banco Popular), it still considers resolution necessary in the public interest as long as the other two resolution objectives are met.

It is considered in the recitals of the BRRD that all banks can potentially have a systemic nature, as a result of which it is crucial, in order to maintain financial stability, that authorities have the possibility to resolve any bank.[168] Both the FSB[169] and Basel Committee have however acknowledged that the risks for financial stability and moral hazard are higher for institutions that are global systemically important.[170] The SRB decisions show that the *size of the bank* also plays a role in the public interest test. In all four decisions in which the SRB assessed that resolution was not necessary in the public interest, it took into account the limited size of the bank and/or the lack of interconnections with other financial institutions (the contagion risk).

166 SRB, Notice summarising the decision taken in respect of ABLV Bank Luxembourg S.A. SRB, Notice summarising the decision taken in respect of ABLV Bank, AS.
167 CI, T-280/18, Action brought on 3 May 2018 (*ABLV Bank v SRB*).
168 Recital (29) BRRD. Recitals (46) and (47) SRMR.
169 FSB Report 2010.
170 See also similar Lastra and Olivares-Caminal 2018, p. 13. See section 2.4.3 for the conditions under which a bank is considered global systemically important.

> In its decisions in respect of Veneto Banca and Banca Popolare di Vicenza, the SRB referred to the banks' score for systemic relevance in accordance with the EBA O-SII Guidelines as one of the indicators it took into account in its assessment whether there was a significant adverse effect on financial stability in Italy.[171] In relation to ABLV Bank, the SRB mentioned the low financial and operational interconnections with other financial institutions.[172] In respect of ABLV Bank Luxembourg, the SRB took into account the limited size of the bank and the absence of ties to the Luxembourgish real economy.[173]

National resolution authorities seem to take a different approach.

> The Bank of Greece concluded that, in view of the current fragile political and financial environment in Greece and despite the fact that Bank of Peloponnese is not a systemic credit institution, the winding up of that bank in normal insolvency proceedings, with the subsequent loss of the uncovered deposits, would pose a significant threat to financial stability. It would exacerbate even further the disarray among market participants and depositors. The Bank of Peloponnese was therefore put in resolution.[174]
>
> The Bank of Italia came to the same conclusion in relation to Banca Etruria, Cassa di Risparmio di Ferrara (Carife**)** and Cassa di Risparmio della Provincia di Chieti (Carichieti). Notwithstanding the small size of each of the banks involved (it was estimated that, in the aggregate, the four banks accounted for approximately 1% of total deposits in Italy), it held that a resolution action was 'necessary in the public interest'.[175]
>
> Binder sees a risk in the application of the resolution toolbox to small or even medium-sized institutions taking into account that the resolution action should be proportionate to one or more resolution objectives and winding up of the bank in normal insolvency

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171 See e.g. SRB, Decision of 23 June 2017 concerning the assessment of the conditions for resolution in respect of Veneto Banca S.p.A., SRB/EES/2017/11, p. 15.

172 SRB, Notice summarising the decision taken in respect of ABLV Bank, AS.

173 SRB, Notice summarising the decision taken in respect of ABLV Bank Luxembourg S.A.

174 EC, 17 December 2015, C(2015) 9682 final (SA.43886 – Cooperative Bank of Peloponnese), par. 2, 19.

175 Clearly Gottlieb Steen & Hamilton LLP, Implementation and First Application of the BRRD in Italy, 15 December 2015, p. 2.

proceedings would not meet the resolution objectives to the same extent. He takes the stance that this could normally not be said about cases involving smaller or even medium-sized institutions.[176] Lannoo acknowledges that there is not a single definition of a systemic bank. He takes the stance that resolution tools are applicable to a bank that is systemic and if they don't qualify for the label, the bank should be allowed to fail.[177] He however does not further address when a bank should qualify as systemic. In the author's view, a distinction should be made between an idiosyncratic shock and a systemic crisis. In a systemic crisis, there may be a public interest to put even small banks in resolution due to the contagion risk. This may be different in case of an idiosyncratic shock. See also section 7.5.4.3. As long as no further clarity is given in that respect, interpretations may differ (between the SRB and the national resolution authorities) as a result of which resolution of a bank may be justified by merely regional considerations.

4.4.2 The resolution objectives

The resolution objectives are (a) to ensure the continuity of critical functions, (b) to avoid a significant adverse effect on the financial system, in particular by preventing contagion, including to market infrastructures and by maintaining market discipline, (c) to protect public funds by minimising reliance on extraordinary public financial support, (d) to protect depositors and investors, and (e) to protect client funds and client assets.

As set out in section 4.4.1.3, the resolution objectives play a role in the decision whether a bank should be put in resolution in the first place. Only if winding up of the bank in normal insolvency proceedings e.g. jeopardizes financial stability, interrupt the provision of critical functions or affect the protection of depositors, it should be considered that there is a public interest to put the bank in resolution.[178] In addition, the resolution objectives also provide guidance as to which resolution tools should be chosen when a bank is put in resolution.

176 Binder *ECFR* 2016, p. 595.
177 Lannoo 2017, p. 3.
178 Recital (45) BRRD.

The resolution objectives are of equal significance and resolution authorities should balance them as appropriate to the nature and circumstances of each case, provided that no other provision of the BRRD or SRMR dictates otherwise.[179] The resolution authorities are provided with wide discretion to act as they consider appropriate on a case-by-case basis.[180] They should however always seek to minimise the cost of resolution and avoid destruction of value unless necessary to achieve the resolution objectives.[181] The resolution objectives are further discussed in the following sections.

4.4.2.1 To ensure the continuity of critical functions

The first resolution objective is to ensure the continuity of critical functions. Critical functions are the activities, services or operations the discontinuance of which is likely in one or more Member States to lead to the disruption of services that are essential to the real economy or to disrupt financial stability due to the size, market share, external and internal interconnectedness, complexity or cross-border activities of a bank or group, with particular regard to the substitutability of those activities, services or operations.[182] In accordance with the definition in the BRRD, criticality should not be assessed only on its direct impact on the real economy but also on its impact on financial markets.[183]

The concept of critical function has been further detailed in Delegated Regulation (EU) 2016/778. Pursuant to this delegated regulation, a function shall be considered critical if (a) it is provided by a bank to third parties not affiliated to the bank or group, and (b) the sudden disruption of that function would likely have a material negative impact on the third parties, give rise to contagion or undermine the general confidence of market participants due to the systemic relevance of the function for the third parties and the systemic relevance of the bank or group in providing the function.[184] In order for a function to be qualified as critical, it should in addition thereto not be possible to substitute the function on acceptable terms within a reasonable timeframe.[185]

179 Article 31(3) BRRD. See however section 4.4.1.3 on the SRB's approach.
180 Tokatlides 2017, p. 148.
181 Article 31(2), last paragraph BRRD. Article 14(2), last paragraph SRMR.
182 Article 2(1)(35) BRRD.
183 EBA Technical Advice on Critical Functions and Core Business Lines 2015, p. 6.
184 Article 6(1) Delegated Regulation (EU) 2016/778.
185 Article 6(3) Delegated Regulation (EU) 2016/778. EBA Technical Advice on Critical Functions and Core Business Lines 2015, p. 7.

Examples of critical functions can include deposit taking, lending and loan services, payment, clearing, custody and settlement services, wholesale funding markets activities, and capital markets and investments activities.[186]

In the resolution of Banco Popular resolution action was considered necessary by the SRB to achieve this resolution objective (alongside the resolution objective of avoiding adverse effects on financial stability). It was considered that Banco Popular's critical functions, consisting of deposit taking from households and non-financial corporations, lending to SMEs and payment and cash services should be ensured by the transfer to Banco Santander.[187]

In the case of Veneto Banca, the SRB considered that the deposits taking and lending activities and payment services were not critical functions, since they were only provided to a limited number of third parties and could be replaced in an acceptable manner and within a reasonable timeframe.[188] The SRB reached the same conclusion on the same grounds in relation to Banca Popolare di Vicenza.[189] In relation to ABLV Bank, the SRB also concluded that the functions performed by the bank, e.g. deposit-taking, lending activities and payment services, were not critical. In this case, the motivation for this conclusion was however that their discontinuance would lead neither to the disruption of services that are essential to the real economy of Latvia nor to the disruption of financial stability in Latvia or in other Member States.[190] The same motivation was given for the conclusion of the SRB in relation to the activities of ABLV Bank Luxembourg. These were not considered to be critical, because their discontinuance would lead neither to the disruption of services that are essential to the real economy of Luxembourg nor to the disruption of financial stability in Luxembourg or in other Member States.[191]

186 Recital (4) Delegated Regulation (EU) 2016/778.
187 SRB, Notice summarising the effects of the resolution action taken in respect of Banco Popular Espanol pursuant to Article 29(5) SRMR.
188 SRB, Notice summarising the effects of the decision taken in respect of Veneto Banca S.p.A.
189 SRB, Notice summarising the effects of the decision taken in respect of Banco Popolare di Vicenza S.p.A.
190 SRB, Notice summarising the decision taken in respect of ABLV Bank, AS.
191 SRB, Notice summarising the decision taken in respect of ABLV Bank Luxembourg S.A.

It is considered in literature that the resolution objective of continuity of critical functions partly overlaps with the second resolution objective of avoiding significant adverse effects on financial stability, because both objectives consider contagion or spillover effects.[192] This can, for example, be seen in the case of ABLV Bank and ABLV Bank Luxembourg.

4.4.2.2 To avoid a significant adverse effect on the financial system

The second resolution objective is to avoid significant adverse effects on the financial system, in particular by preventing contagion, including to market infrastructures, and by maintaining market discipline.[193] The wording of this resolution objective slightly differs in the SRMR. The SRMR does not use the term 'financial system', but 'financial stability'. It may be that these different terms intend to express that the SRB and the national resolution authorities, when acting on the basis of the BRRD, may have different interests to take into account. When acting on the basis of the BRRD, a national resolution authority has a more national dimension in contrast to the EU (or Eurozone) dimension that the SRB and national resolution authorities have when acting on the basis of the SRMR.[194] However, the SRB should ensure that appropriate account is taken of national financial stability.[195]

This is a particular point of attention in the case of the resolution of BES. In this case senior bonds were retransferred from Novo Banco to BES, thereby effectively wiping out the value of these bonds. Banco de Portugal, acting as the resolution authority, justified the selection of the senior bonds to be retransferred to BES by stating that it aimed to safeguard financial stability.[196] The five series of bonds that were retransferred – out of a total of 52 outstanding series of notes – were all governed by Portuguese Law (save for one small series of notes, the other 46 were all governed by English law). According to the affected bondholders the reason was not so much the protection of financial stability, but rather to avoid litigation outside of Portugal

192 De Groen 2017, p. 8.
193 Article 31(2)(b) BRRD.
194 Article 47(1) and (2) SRMR.
195 Recital (39) SRMR. See also Kleftouri *ERA Forum* 2017, p. 277. According to Kleftouri it is likely that the spirit of the two provisions is identical.
196 FT, The Novo Banco debacle and the rule of law in Europe, 19 January 2018.

> and to fundamentally improve Novo Banco's financial condition.[197] They warn for an image of resolution authorities that can do what they want as long as they say it is in the 'public interest'.[198]

Lastly, it can be derived from the recitals of the BRRD, that if the problem arises in an individual bank and the rest of the financial system is not affected, authorities should be able to exercise their resolution powers without much concern for contagion effects. In a fragile environment, on the other hand, greater care should be exercised to avoid destabilising financial markets.[199]

> This resolution objective was specifically mentioned in relation to the resolution of the Bank of Peloponnese, Panellinia Bank, BES, BANIF and Banco Popular. The reasoning behind the application of this resolution objective was in some cases explained as the prevention of the destabilization of financial markets and triggering a general crisis of confidence (BES and BANIF).[200] In the case of Panellinia Bank it was considered that this bank plays a central role in the smooth operation of the cooperative banks as a result of which liquidation would very seriously jeopardize the continuity of the banking operations of all cooperative banks and consequently financial stability.[201] In the case of Bank of Peloponnese it was considered that, despite the fact that it was not a systemic bank, the winding up of that bank in normal insolvency proceedings, with the subsequent loss of the uncovered deposits, would pose a significant threat to financial stability in view of the current fragile political and financial environment in Greece.[202] In the case of Banco Popular, it was considered by the SRB that the situation of the bank entailed an increased risk of significant adverse effects on financial stability in Spain, taking into account the size and relevance of the bank and the nature of its business. The SRB mentioned that the similarity of the bank's business

197 The Novo Note Group, Situation Summary, available on the website of Novo Note Group: www.novonotegroup.com.
198 The Parliament Magazine, Europe can't afford to ignore Novo Banco, 5 March 2018.
199 Recital (7) BRRD.
200 EC, 21 December 2015, C(2015) 9763 final (SA.43977 – BANIF), par. 124. EC, 3 August 2014, C(2014) 5682 final (SA.39250 – BES), par. 70.
201 Bank of Greece, Meeting 21/17.4.2015.
202 EC, 17 December 2015, C(2015) 9682 final (SA.43886 – Bank of Peloponnese), par. 19.

> model to that of other Spanish commercial banks might contribute to the potential for indirect contagion to these banks which might be perceived as facing the same difficulties.[203]

4.4.2.3 To protect public funds

The third resolution objective focuses on the protection of public funds by minimizing reliance on EPFS. EPFS includes State aid within the meaning of Article 107(1) TFEU or any other public financial support at supranational level, which, if provided for at national level would constitute State aid, that is provided in order to preserve or restore the viability, liquidity or solvency of a bank or of a group.[204] The concept of EPFS is discussed in more detail in section 5.2.1.

> Out of the ten resolution cases that have been notified by the SRB and the national resolution authorities to the EBA at the time of writing this dissertation, seven involve a decision by the Commission on the compatibility of State aid granted to the bank in resolution, albeit that this is often granted through the national resolution funds.[205] For example, in the case of MKB Bank, it was considered that the provision of State aid was absolutely necessary, as the sale of the assets on the market was not successful within a short deadline, but it was not possible to wait for favourable changes in market conditions in the hope of a better market price. It was still considered that public funds were protected by putting the bank in resolution, because the requirement of minimization was met in the case of the support.[206]

4.4.2.4 To protect depositors and investors

The fourth resolution objective concerns the protection of depositors of which the deposits are covered by a deposit guarantee scheme of a Member State and investors of which the securities are covered by an investor compensation scheme of a Member State. Under the deposit guarantee schemes of Member States deposits are covered up to an amount of

203 SRB, Decision of 7 June 2017 concerning the adoption of a resolution scheme in respect of Banco Popular Español S.A., SRB/EES/2017/08, p. 17-18.
204 Article 2(1)(28) BRRD.
205 See section 5.3.5.1.
206 Magyar Nemzeti Bank, Summary of Decision No. H-SZN-I-75/2016 to terminate the resolution process of MKB Bank Zrt., 30 June 2016.

EUR 100,000 per depositor.[207] Deposits are basically credit balances which result from funds left in an account or from temporary situations deriving from normal banking transactions.[208] All deposits maintained with banks authorized in a Member State, including – in principal – branches of third country banks, are covered by the deposit guarantee schemes, with the exception of certain deposits.[209]

The investor compensation schemes of Member States protect investors by providing compensation if an investment firm (or a bank providing investment services) fails to return the investor's assets. Claims typically arise if there is fraud or other administrative malpractice or when an investment firm is unable to fulfil its obligations as a result of operational errors. Under the investor compensation schemes, a minimum level of compensation per investor of EUR 20,000 should be ensured.[210] Member States may provide that certain investors are excluded from coverage.[211]

Resolution does not constitute grounds for the activation of the procedure for compensating depositors and investors under the deposit guarantee scheme or investor compensation scheme.[212] Deposit guarantee schemes can however be used for resolution financing.[213]

> This resolution objective was mentioned in the resolution case of Andelskassen. In this case, the bail-in tool was also applied in respect of obligations of Andelskassen relating to deposits from natural persons and micro, small and medium-sized enterprises, which exceeded the maximum coverage amount under the Danish deposit guarantee scheme. Only the covered deposits were saved.[214]

207 Article 6 DGS Directive.
208 Article 2(3) DGS Directive.
209 Article 4(3), 15 and 5 DGS Directive. The exclusions mainly relate to deposits by other financial institutions or public authorities.
210 Article 4(1) ICS Directive.
211 Article 4(2) ICS Directive in conjunction with Annex I.
212 Gortsos 2016, p. 8.
213 See section 5.3.5.3.
214 Finansiel Stabilitet, First decision on the resolution of Andelskassen J.A.K. Slagelse, 5 October 2015, p. 1.

4.4.2.5 To protect client funds and client assets

The fifth resolution objective is to protect client funds and client assets. Taking into account that the protection of depositors and investors covered by a deposit guarantee scheme and investor compensation scheme, respectively, already is a separate resolution objective, it is the author's understanding that this objective entails the protection of other client funds and client assets. One could, for example, think of deposits or securities of clients that exceed the coverage maximum of a deposit guarantee scheme or of an investor compensation scheme, respectively.

> In the cases of the Bank of Peloponnese and Panellinia Bank it was specifically considered that the application of resolution measures would safeguard public confidence, especially with regard to depositors, in the domestic financial system, considering that the mere withdrawal of the authorisation of the banks without the implementation of resolution measures would have a significant destabilising impact on the financial system. In particular, the withdrawal of the license of both banks would result in losses on the non-covered part of deposits. In relation to the Bank of Peloponesse it was estimated that, under the current adverse circumstances, these losses would cause negative reactions on the part of depositors of the other banks.[215]

4.4.3 The resolution tools

The resolution tools are included in Article 37(3) BRRD. These are the sale of business tool, the bridge institution tool, the asset separation tool and the bail-in tool.[216] In addition to the resolution tools set out in Article 37(3) BRRD, the Member States may confer additional tools and powers on resolution authorities pursuant to Article 37(9) BRRD, provided that those additional powers do not pose obstacles to effective group resolution when applied to a cross-border group and they are consistent with the resolution objectives and the general principles governing resolution.[217]

215 Bank of Greece, Meeting 21/17.4.2015 and Meeting 28/18.12.2015.
216 Article 37(5) BRRD.
217 According to the IMF, one-third of the Member States established additional resolution tools (IMF Country Report 2018, p. 11, 44).

When applying the resolution tools, resolution authorities should have regard to the resolution objectives and choose the tools that best achieve the objectives that are relevant in the circumstances of the case.[218] The resolution objectives have been discussed in section 4.4.2. The resolution tools may be applied individually or in any combination.[219] The asset separation tool may however only be applied together with another resolution tool.

The resolution authorities should ensure that a valuation of the assets and liabilities of the bank or banking group to be put in resolution is carried out by an independent valuer to inform the decision on the appropriate resolution action to be taken in respect of the bank or banking group.[220] The EBA refers to this valuation as Valuation 2 (determination of the tools).[221] This valuation is meant to assess the economic value and not the accounting value of the bank's assets and liabilities.[222]

4.4.3.1 The sale of business tool

The sale of business tool entails the power of a resolution authority to transfer (once or more than once) to a purchaser that is not a bridge institution (a) shares or other instruments of ownership issued by a bank in resolution, or (b) all or any assets, rights or liabilities of a bank in resolution.[223] The application of the sale of business tool is discussed in more detail in section 4.5.3.

The sale of business tool has so far been applied in Hungary, Portugal, Croatia, Greece and Spain.

> The Hungarian bank MKB Bank was put in resolution on 18 December 2014. According to the resolution strategy determined by the Central Bank of Hungary, as the designated national resolution authority, the preferred resolution tool was the sale of business tool for divesting

218 Article 31(1) BRRD. Article 14(1) SRMR.
219 Article 37(4) BRRD.
220 Article 36(1) and (4)(b) BRRD. Article 20(1) and (5)(b) SRMR.
221 EBA Valuation RTS 2017, p. 3.
222 Lastra and Olivares-Caminal 2018, p. 6.
223 Article 38(1) BRRD.

certain portfolio elements from MKB Bank. Nine loan claims were sold to third parties, including other banks.[224]

On 20 December 2015 the Government and Central Bank of Portugal decided to sell, as part of a bank resolution, most of the assets and liabilities of BANIF to Banco Santander Totta for EUR 150 million.[225]

In Croatia, the sale of business tool was applied in order to sell 100% of the ordinary shares in Jadranska Banka.[226] At the time of writing this dissertation, Croatia's central bank had given approval to Hrvatska Postanska Banka for the acquisition of 100% of the shares in Jadranska Banka.[227]

In Greece, the sale of business tool was applied to Bank of Peloponnese and Panellinia Bank. All deposits of Bank of Peloponnese were transferred to National Bank of Greece.[228] In addition, selected activities of Panellinia Bank have been transferred and integrated into Piraeus Bank, following an open and non-discriminatory sales process.[229]

On 7 June 2017, the SRB adopted a resolution scheme in respect of Banco Popular providing for the application of the sale of business tool to the bank. In the first resolution scheme adopted by the SRB it decided to transfer Banco Popular to Banco Santander.[230]

224 Central Bank of Hungary, Summary to the decision No. H-SZN-I-6/2015. of the Central Bank of Hungary on the application of the sale of business tool in the ongoing resolution process in respect of MKB Bank Zrt; Central Bank of Hungary, Summary to the decision No. H-SZN-I-28/2015. of the Central Bank of Hungary on the application of the sale of business tool in the ongoing resolution process in respect of MKB Bank Zrt; Central Bank of Hungary, Summary to the decision No. H-SZN-I-27/2015. of the Central Bank of Hungary on the application of the sale of business tool in the ongoing resolution process in respect of MKB Bank Zrt.

225 Banco de Portugal, Information on Banif – frequently asked questions, 15 January 2016.

226 State Agency for Deposit Insurance and Bank Resolution, Public Call for Expression of Interest for the Acquisition of 100% of the Ordinary Shares of Jadranska Banka d.d. Sibenik.

227 SeeNews, Croatia's c-bank approves acquisition of Jadranska Banka by HPB, 5 July 2018.

228 Bank of Greece, Transfer of Cooperative Bank of Peloponnese Coop Ltd deposits to the National Bank of Greece S.A., 18 December 2015.

229 EC, State aid: Commission approves resolution aid for the resolution of Greek Panellinia Bank, STATEMENT/15/4799, 17 April 2015.

230 SRB, Notice summarising the effects of the resolution action taken in respect of Banco Popular Español pursuant to Article 29(5) SRMR, 7 June 2017.

4.4.3.2 The bridge institution tool

The bridge institution tool entails the power of a resolution authority to transfer (once or more than once) to a bridge institution (a) shares or other instruments of ownership issued by a bank in resolution, or (b) all or any assets, rights or liabilities of a bank in resolution.[231]

A bridge institution is a legal person that is (i) wholly or partially owned by one or more public authorities which may include the national resolution authority or the national resolution fund and is controlled by the resolution authority, and (ii) created for the purpose of receiving and holding some or all of the shares, instruments of ownership, assets, rights or liabilities with a view to maintaining access to critical functions and selling the bank, or its assets, rights or liabilities, to one or more private sector purchasers.[232] The resolution authority approves the bridge institution's constitutional documents, management body and their remuneration and responsibilities, strategy and risk profile.[233]

A bridge institution is normally operated for two years, unless a sale – or merger – takes place prior to the expiry thereof. This may be extended by the resolution authority, if, for example, it is necessary to ensure the continuity of essential banking or financial services. After expiry of the – extended – period of time, or in case of a sale of all or substantially all assets, rights or liabilities to a third party, the bridge institution is wound up in normal insolvency proceedings.[234] The application of the bridge institution tool is discussed in more detail in section 4.5.3.

The bridge institution tool has so far been applied in Portugal, Denmark and Italy.

231 Article 40(1) BRRD.
232 Article 40(2) BRRD. There is no separate definition of bridge institution under the SRMR. This seems to imply that a bridge institution cannot be owned by the SRB or the SRF. The SRF may however make contributions to a bridge institution in accordance with Article 76(1)(c) SRMR.
233 Article 41(1)(a), (b), (c) and (d) BRRD.
234 Article 41 (5), (6), (7) and (8) BRRD.

In Portugal, the bridge institution tool has been applied in relation to BES.[235] BES's sound business activities – all deposits and senior debt and most of the assets - were transferred to a bridge bank (Novo Banco), being the subsidiary of the Central Bank of Portugal.[236] Novo Banco was sold to U.S. private equity firm Lone Star.[237] Lone Star, negotiated and agreed with Portugal on the conditions for the sale of the bridge bank Novo Banco. In particular Lone Star agreed to inject EUR 1 billion in capital into Novo Banco and to implement an in-depth restructuring of the bank. In addition, Novo Banco planned to raise EUR 400 million on the market by means of issuing Tier 2 capital instruments. In turn, the Portuguese Resolution Fund agreed that if and when the capital ratio falls below a threshold due to losses on a legacy asset portfolio, it will inject capital of up to EUR 3.89 billion, and if the issuance of Tier 2 capital instruments cannot be completed successfully from private means, it will subscribe the remainder (the amount of which is offset against its commitment to inject capital). Finally, only to the extent that capital needs arise under severe adverse circumstances, which cannot be addressed by Lone Star or other market players, Portugal will provide limited, additional capital.[238] The Commission has approved on the Portuguese aid for the sale of Novo Banco.[239]

In Denmark, the bridge institution tool has been applied in relation to Andelskassen. The Danish resolution authority, Finansiel Stabilitet, established a new subsidiary, Broinstitut I A/S, that took over the ownership of Andelskassen.[240] Andelskassen was subsequently divested to Netfonds.[241]

235 The application of the bridge institution tool took place on the basis of the Portuguese resolution framework that was in place at that time, since the BRRD was not implemented in Portugal yet at that time.

236 EC BES Press Release 2014.

237 FT, Lone Star seals deal for stake in rescued Novo Banco after three-year process, 18 October 2017. The sale to Lone Star is the subject of legal proceedings started by the old bondholders of BES (FT, The Novo Banco debacle and the rule of law in Europe, 19 January 2018).

238 EC, State aid: Commission approves Portuguese restructuring plan and support for sale of Novo Banco, completing 2014 resolution of Banco Espírito Santo, 11 October 2017, IP/17/3865.

239 EC, 11 October 2017, C(2017) 6896 final (SA.49275 – BES).

240 Finansiel Stabilitet, Notification to relevant entities in respect of the resolution of Andelskassen J.A.K. Slagelse under kontrol, 9 October 2015.

241 Finansiel Stabilitet, Finansiel Stabilitet reach agreement to sell Andelskassen J.A.K. Slagelse, 18 March 2016.

In Italy, Banca Marche, Banca Etruria, Carife and Carichieti were put in resolution by a decision of the Banca d'Italia dated 21 November 2015. Part of the assets and liabilities (including bad loans) were transferred to four bridge banks. Subordinated debts that were not eligible for write-down were left in the banks in resolution, in order to be liquidated.[242] On 10 May 2017, the four bridge banks were subsequently transferred to Unione di Banche Italiane S.p.A. (UBI), as a result of which they ceased to qualify as bridge banks and continued their business within the UBI Group.[243]

4.4.3.3 The asset separation tool

Th asset separation tool entails the power of a resolution authority to transfer assets, rights or liabilities of a bank in resolution or a bridge institution to one or more asset management vehicles.[244] The asset separation tool may only be applied, if (a) the situation of the particular market for those assets is of such a nature that the liquidation of those assets in normal insolvency proceedings could have an adverse effect on one or more financial markets, (b) such a transfer is necessary to ensure the proper functioning of the bank in resolution or bridge institution, or (c) such a transfer is necessary to maximize liquidation proceedings.[245] The asset separation tool may only be applied together with another resolution tool.[246]

An asset management vehicle is a legal person that is (i) wholly or partially owned by one or more public authorities which may include the national resolution authority or the national resolution fund and is controlled by the resolution authority, and (ii) created for the purpose of receiving some or all of the assets, rights or liabilities of one or more banks in resolution or a bridge institution.[247] An asset management vehicle manages the assets transferred to it with a view to maximising their value through eventual sale or winding up in an orderly manner.[248] The resolution authority approves the asset management vehicle's constitutional documents,

242 Banca d'Italia, EBA. Notification according to art. 83 of BRRD, 25 November 2015.
243 Banca d'Italia, EBA. Notification according to art. 83 of BRRD, 5 June 2017.
244 Article 42(1) BRRD.
245 Article 42(5) BRRD.
246 Article 37(5) BRRD.
247 Article 42(2) BRRD.
248 Article 42(3) BRRD. There is no separate definition of asset management vehicle under the SRMR. This seems to imply that an asset management vehicle cannot be owned by the SRB or the SRF. The SRF may however make contributions to an asset management vehicle in accordance with Article 76(1)(c) SRMR.

management body and their remuneration and responsibilities, strategy and risk profile.[249] The application of the asset separation tool is discussed in more detail in section 4.5.3.

So far, the asset separation tool has been used by national resolution authorities in Hungary, Italy, Portugal and Croatia.

> Following the sale of loan claims by MKB Bank under the application of the sale of business tool, assets which were indicated to be divested but could not be sold due to a lack of potential buyers on the market were transferred to MKB Pénzügyi Zrt. for the purpose of encouraging the implementation of the asset separation tool. The shares in MKB Pénzügyi Zrt. were transferred to the Hungarian Resolution Property Management Private Company (the Resolution Company).[250]
>
> In Italy, the asset separation tool was applied to Banca Marche, Banca Etruria, Carife and Carichieti in combination with the bridge institution tool. The bad loans were transferred to an asset management vehicle.[251]
>
> In Portugal, the asset separation tool was used in combination with the sale of business tool in relation to BANIF. Some of BANIF's assets were transferred to an asset management vehicle specifically set up for this purpose. This asset management vehicle was set up by Banco de Portugal to receive and manage the rights and obligations transferred, with a view to their subsequent sale or liquidation.[252]
>
> In Croatia, the asset separation tool was used in combination with the sale of business tool in relation to Jadranska Banka. The Croatian resolution authority established a special purpose vehicle (SPV) to manage the non-performing assets of Jadranska Banka. On

249 Article 42(4) BRRD.
250 Central Bank of Hungary, Summary to the decision No. H-SZN-I-6/2015. of the Central Bank of Hungary on the application of the sale of business tool in the ongoing resolution process in respect of MKB Bank Zrt.
251 Banca d'Italia, EBA. Notification according to art. 83 of BRRD, 25 November 2015.
252 Banco de Portugal, Information on Banif – frequently asked questions, 15 January 2016.

31 December 2016, this SPV purchased non-performing assets at the market economic value of the concerned assets.[253]

4.4.3.4 The bail-in tool

The bail-in tool entails the power of a resolution authority to write-down and convert liabilities of a bank in resolution, unless they are excluded from the scope of the bail-in tool.[254] A bail-in entails that the principal amount of subordinated debt that is not AT 1 or Tier 2 capital is reduced. If this is not sufficient to restore the viability of the bank, the principal amount of, or outstanding amount payable in respect of, the rest of the eligible liabilities is reduced.[255] The application of the bail-in tool is discussed in more detail in section 4.5.3.4.

The application of the bail-in tool is always preceded by the exercise of the write down and conversion powers set out in Article 59 BRRD (Article 21 SRMR), hereinafter referred to as the PONV conversion power. The application of the PONV conversion power entails that CET 1 items are reduced first in proportion to the losses and to the extent of their capacity, after which the principal amount of AT 1 instruments is written down or converted in CET 1 instruments or both and/or the principal amount of Tier 2 instruments is written down or converted into CET 1 instruments or both.[256] If, following the exercise of the PONV conversion power, the bank is still failing or likely to fail (for example because the write down or conversion alone was not sufficient to ensure the return to viability) and the conditions for resolution are met, the resolution authority can use the bail-in tool, provided that other resolution tools are not more appropriate in the specific case.[257] The exercise of the PONV conversion power is discussed in more detail in section 4.4.5.2.

253 State Agency for Deposit Insurance and Bank Resolution – Resolution Authority, Public Call for Expressions of Interest for the Acquisition of 100 % of the Ordinary Shares of JADRANSKA BANKA d.d. Šibenik, February 2017.
254 Article 2(1)(57), Article 43 and Article 44 BRRD. Article 3(1)(33), Article 27 SRMR.
255 Article 48(1) BRRD.
256 Article 60(1) BRRD.
257 EBA, Single Rulebook Q&A, Question ID: 2016_2956.

The PONV conversion power and bail-in tool have so far been used in the following cases:

Use of PONV conversion power not in combination with bail-in tool

In relation to Banco Popular the SRB exercised the PONV conversion power prior to the transfer to Banco Santander, to address the shortfall in the value of Banco Popular. In particular, all the existing shares (CET 1), and the AT 1 instruments were written down, while the Tier 2 instruments were converted into new shares, which were transferred to Banco Santander for the price of EUR 1.[258]

In the resolution of Banca Marche, Banca Etruria, Carife and Carichieti equity and subordinated debt eligible for own funds were fully written down.[259]

In the case of Panellinia Bank equity and preference shares remained in the entity in liquidation and were written down. Panellinia Bank had no outstanding subordinated debt at that time.[260]

Also, in the case of MKB Bank, equity was fully written down. The equity was held by the Hungarian State. MKB Bank had no outstanding subordinated debt.[261]

In the resolution of BANIF, shareholders and subordinated creditors were bailed-in, but senior creditors were not.[262] The credit claims of the senior creditors were sold to Banco Santander Totta.[263]

Use of PONV conversion power in combination with bail-in tool

The case of HETA is the first case in which the bail-in tool was applied, although it was not a real 'BRRD' case, as further explained below. The Austrian Financial Market Authority (FMA), in its capacity as the resolution authority, initiated the resolution of HETA on 1 March 2015, in accordance with the Federal Act on the Recovery

258 SRB, Notice summarising the effects of the resolution action taken in respect of Banco Popular Español pursuant to Article 29(5) SRMR, 7 June 2017.
259 Banca d'Italia, EBA. Notification according to art. 83 of BRRD, 25 November 2015.
260 EP At a Glance 2016.
261 EP At a Glance 2016.
262 EP At a Glance 2016.
263 Banco de Portugal, Information on Banif – frequently asked questions, 15 January 2016.

and Resolution of Banks (BaSAG) which transposed the BRRD. In order to prepare for the application of resolution tool(s) and since no resolution plan was drawn up *ex ante*, the FMA imposed a temporary moratorium on the liabilities of HETA until 31 May 2016. The final bail-in decision was adopted in April 2016.[264] As a result, the CET 1 positions, the principle amount of Tier 2 capital and all other subordinated debt as well as the interest accrued thereon up to 28 February 2015 was written down to zero. In addition, the principal amount or outstanding amount of the remaining eligible liabilities (senior debt), as well as the interest accrued thereon up to 28 February 2015 was written down to a quota of 46.02%.[265] This case is controversial due to two reasons. First, HETA is an asset management vehicle which has no banking authorisation and is therefore outside the material scope of the BRRD. The law transposing the BRRD into Austrian national law however explicitly required that HETA was covered.[266] Secondly, part of the liabilities in scope of the bail-in tool were secured by a guarantee by the Land of Carinthia.[267] However, since the bail-in decision did not cancel the guarantee provided by the Land of Carinthia, the creditors sued Carinthia to recover the difference between the amount repaid and their bonds' full face value. Eventually, a settlement was reached with the holders of the guaranteed bonds.[268]

In the case of the resolution of Andelskassen, the contributed capital was cancelled. This implied that the members of Andelskassen stopped being members. All relevant capital instruments were written down to zero. In addition, all subordinated obligations of Andelskassen were written down to zero. The bail-in tool was also applied in respect of obligations of Andelskassen relating to deposits from natural persons and micro, small and medium-sized

264 World Bank Report 2016, p. 9.

265 Financial Market Authority, Notification of the application of resolution measures in respect of Heta Asset Resolution AG according to Article 116 para 5 BaSAG.

266 In a request for a preliminary ruling, the Landgericht Frankfurt am Main has requested the ECJ whether the BRRD is to interpreted as meaning that its scope of application also covers an asset management vehicle which has no banking authorisation such as HETA. This request has however been withdrawn (ECJ, C-394/16, Request for a preliminary ruling from the Landgericht Frankfurt am Main (Germany) lodged on 14 July 2016 – *FMS Wertmanagement AöR v Heta Asset Resolution AG*).

267 Such liabilities do not qualify as secured liabilities excluded from the scope of the bail-in tool (EBA, Single Rulebook Q&A, Question ID 2015_1779).

268 World Bank Report 2016, p. 13-14. See also Binder 2019, p. 9-10.

enterprises, which exceeded the maximum coverage amount under the Danish deposit guarantee scheme.[269]

In the case of the resolution of Jadranska Banka, all provisions and all share capital was written off and all shares of the bank were withdrawn - cancelled in order to cover all losses. Given that the established losses were higher than the amount of provisions and share capital, all relevant equity instruments were converted into ordinary capital by issuing new shares and the equity was subsequently written off and the shares cancelled in order to cover the losses. All bank's deposits and liabilities not covered under the deposit guarantee scheme were converted into new share capital of the bank by issuing new shares. The remaining amount of losses was covered by the write off of a part of the newly created capital.[270]

A specific case concerns the case of BES. In that case certain senior bonds were first transferred to the bridge bank, but subsequently retransferred to the residual entity that was to be wound up. As a result, they also contributed to the losses of BES. This did however not entail the application of the bail-in tool, but was the result of the retransfer of these bonds.

BES was subject to the bridge institution tool as a result of which BES's sound business activities were transferred to a bridge bank (Novo Banco). The senior bonds were also transferred to Novo Banco, while all shareholders and subordinated creditors remained in BES, which was wound up. On 29 December 2015 however, the Bank of Portugal, acting as a resolution authority, ordered the retransfer of five senior bonds (out of 52 senior bonds) from the balance sheet of Novo Banco to that of BES. Conversely, the bonds became backed by BES assets (instead of Novo Banco assets), leading to a drop in prices of about 80%. As a result, not only the shareholders and subordinated debt holders, but also the holders of this senior debt contributed to the losses of BES. This approach raised questions about the principle of equal treatment amongst bondholders, taking into account that other holders of senior debt remained

269 Finansiel Stabilitet, Second decision on the resolution of Andelskassen J.A.K. Slagelse under control, 5 October 2015.

270 Jadranska Banka d.d. Sibenik, Financial Statements for 2016 and Independent Auditor's Report, April 2017, p. 18-20.

> in Novo Banco.[271] It comes as no surprise that many holders of senior debt that was transferred back to BES started legal proceedings.

There may also be cases in which there are no capital instruments or eligible liabilities available to exercise the PONV conversion power or apply the bail-in tool.

> In the case of the Bank of Peloponnese all remaining assets and liabilities (other than the assets and liabilities transferred to National Bank of Greece under the sale of business tool), including equity, were put into liquidation.[272] It was explicitly acknowledged that no capital instruments or eligible liabilities were available to be converted into equity in order to recapitalise the Bank of Peloponnese.[273]

4.5 The resolution process

After having discussed the concept of resolution in the previous section, this section aims to provide more insight in the actual resolution process, setting out the procedural outline and discussing the application of the resolution tools and the exercise of the resolution powers in accordance with the resolution principles and safeguards.

4.5.1 The procedural outline

The resolution process entails two steps. The first step is the decision to put the bank in resolution and the second step is the implementation of this decision by the application of one or more resolution tools and the exercise of one or more resolution powers in accordance with the resolution principles and safeguards.

4.5.1.1 The decision to put the bank in resolution

The first step to resolution is the adoption of a decision by a resolution authority to put the bank or banking group in resolution (the resolution decision). This decision follows the assessment of the resolution conditions as set out in section 4.4.1, including the valuation of the assets and liabilities

271 EC BES Press Release 2014. Alimi 2016. EP At a Glance 2016.
272 EP At a Glance 2016.
273 Bank of Greece, decision in relation to application of sale of business tool to Cooperative Bank of Peloponnese Coop Ltd, 18 December 2015.

of the bank or banking group to be put in resolution.[274] If the conditions for resolution are met, the resolution authorities have to adopt a resolution decision.[275] There is no discretion in that regard.

Resolution decision by the SRB within the SRM

Under the SRM, the resolution decision is taken by the SRB in the form of a 'resolution scheme' when it concerns significant banks and banking groups directly supervised by the ECB as well as other pan-European banking groups.[276] This resolution scheme places the bank or banking group in resolution, determines the application of the resolution tools and determines the use of the SRF to support the resolution action.[277] If resolution requires recourse to the SRF, the SRB always adopts the resolution decision, irrespective of whether the bank is significant or the banking group is directly supervised by the ECB or is a pan-European banking group.[278]

Immediately after the adoption of a resolution scheme by the SRB, the SRB has to transmit it to the Commission. The Commission subsequently has 24 hours to either endorse the resolution scheme or object to it with regard to the discretionary aspects of the resolution scheme.[279] The resolution scheme may enter into force only, if no objection has been expressed by the Council or the Commission within 24 hours after its transmission.[280]

The Commission may, within 12 hours from the transmission of the resolution scheme, propose to the Council to (a) object to the resolution scheme on the ground that it does not fulfil the third resolution condition of public interest or (b) approve or object to a material modification – as proposed by the Commission – of the amount of the SRF provided for in the resolution scheme.[281] A change of 5% or more to the amount of the SRF compared with the original proposal of the SRB should be considered to

274 Article 36(1) BRRD. Article 20(1) SRMR.
275 Article 18(1) SRMR. Article 32(1) BRRD.
276 Article 7(2) SRMR. See also the Decision of the SRB of 17 December 2018 establishing the framework for the practical arrangements for the cooperation within the SRM between the SRB and the National Resolution Authorities (SRB/PS/2018/15), Part III.
277 Article 18(6) SRMR.
278 Article 7(3), second paragraph, SRMR. Busch *EBLR* 2017, p. 450-452. See on the role of the Member States in the decision-making process within the SRM, Busch *EBLR* 2017, p. 454-455 and Busch, Van Rijn and Louisse *EBLR* 2019, p. 589-594. See also De Serière and Milione *JIBLR* 2019, p. 75.
279 Article 18(7), first and second paragraph SRMR.
280 Article 18(7), fifth paragraph SRMR.
281 Article 18(7), third paragraph SRMR.

be material. The Council should approve or object to the Commission's proposal for modification of the resolution scheme without amending it.[282] If the Council approves the Commission's proposal, the SRB has to modify, within 8 hours, the resolution scheme.[283] The same applies if the Commission objects to the resolution scheme.[284]

> The SRMR does not provide what happens, if the Council objects to the Commission's proposal. In the author's view, there are two logical possible outcomes. Either the SRB can, in such a case, adopt the resolution scheme based on the original amount of the SRF, or the Commission should adopt a new proposal for approval of the Council, taking into account its objections.

If the Council objects to the placing of a bank in resolution on the ground that the public interest condition is not fulfilled, the relevant entity shall be wound up in an orderly manner in accordance with applicable national law.[285]

Considering that resolution action requires a very speedy decision-making process, the Council and the Commission should cooperate closely and the Council should not duplicate the preparatory work already undertaken by the Commission.[286]

> The first Commission decision endorsing a resolution scheme was taken on 7 June 2017 in relation to the resolution of Banco Popular. This decision states that the Commission agrees with the resolution scheme. In particular, it agrees with the reasons provided by the SRB of why resolution is necessary in the public interest. It therefore endorses the resolution scheme.[287]

The involvement of the Commission and the Council in the adoption of the resolution scheme by the SRB is prompted by the principle of delegation of powers to agencies as interpreted by the ECJ. This is further discussed in section 6.2.2.

282 Recital (26) SRMR.
283 Article 18(7), seventh paragraph SRMR.
284 Article 18(7) , second and seventh paragraph SRMR.
285 Article 18(8) SRMR.
286 Recital (26) SRMR. See critically on the SRM decision-making procedure Lo Schiavo 2018, p. 182-184.
287 Commission Decision (EU) 2017/1246 of 7 June 2017 endorsing the resolution scheme for Banco Popular Español S.A., OJ L 178, 11.7.2017, p. 15.

Resolution decision by the national resolution authorities within the SRM
Where it concerns less significant banks or banking groups that are not directly supervised by the ECB or that are not pan-European banking groups, but that are established in a participating Member State of the SSM,[288] the national resolution authorities have the power to take the resolution decision, unless the resolution involves the use of the SRF.[289] They shall closely coordinate with the SRB.[290]

The SRB may issue a warning to the relevant national resolution authority, if it considers that the draft decision of the national resolution authority does not comply with the SRMR or with its general instructions.[291] It may also at any time decide to exercise its powers in respect of any bank established in a participating Member State, where necessary to ensure the consistent application of high resolution standards.[292] The SRB can for example exercise this power when a national resolution authority does not appropriately address a warning given by the SRB. Lastly, a participating Member State may decide that the SRB exercises its powers in respect of any bank established in this participating Member State. A participating Member State that intends to make use of this option should notify the SRB and the Commission accordingly.[293]

Resolution decision by the national resolution authorities outside of SRM
Outside the SRM, the power to make the resolution decision always lies with the national resolution authorities.[294] The SRB plays no role in the resolution process outside the SRM.

4.5.1.2 The implementation of the resolution decision

After the resolution decision has been taken, this is implemented by the relevant resolution authority by taking a resolution action. This entails the application of one or more resolution tools and/or the exercise of one or more resolution powers, as further discussed in sections 4.5.3 and 4.5.4.

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288 A banking group is established in a participating Member State of the SSM, when the parent company is established in a participating Member State of the SSM.
289 Article 7(3) SRMR in conjunction with Article 18(6) SRMR.
290 Article 7(3) SRMR. See also the Decision of the SRB of 17 December 2018 establishing the framework for the practical arrangements for the cooperation within the SRM between the SRB and the National Resolution Authorities (SRB/PS/2018/15), Part IV.
291 Article 7(4)(a) SRMR in conjunction with Article 31 SRMR.
292 Article 7(4)(b) SRMR.
293 Article 7(5) SRMR. The notification shall take effect from the day of its publication in the Official Journal of the EU. At the time of writing this dissertation, no notification was published in the Official Journal of the EU.
294 Article 32(1) BRRD.

In order to take a resolution action, resolution authorities can either (a) issue an executive order in accordance with national administrative competences and procedures, without exercising control over the bank in resolution or (b) exercise control over the bank in resolution.[295] If the resolution authorities take control of a bank in resolution they can exercise all the rights and powers conferred on the shareholders, other owners and the management body of the bank in resolution.[296] This power can be applied to operate and conduct the activities and services of the bank in resolution with all the powers of its shareholders and management body, and to manage and dispose of the assets and property of the bank in resolution.[297] The control may be exercised directly by the resolution authority or indirectly by a person or persons appointed by the resolution authority. The voting rights conferred by shares or other instruments of ownership of the bank in resolution cannot be exercised by the shareholders or other owners of instruments during the period of resolution.[298]

Resolution tools

Both in and outside the SRM, the application of the resolution tools takes place by the national resolution authorities. Where the SRB has adopted a resolution scheme, this sets out the details of the resolution tools to be applied by the national resolution authorities to the bank or banking group in resolution. The national resolution authorities apply these in accordance with the relevant provisions of the BRRD as transposed into national law.[299]

> In the case of Banco Popular, the Spanish resolution authority (the FROB) adopted a resolution to adopt the measures required to implement the resolution scheme of the SRB.[300]

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295 Article 72(2) and (3) BRRD.
296 Article 63(1)(b) BRRD.
297 Article 72(1) BRRD.
298 Article 71(1), last paragraph BRRD.
299 Article 23, first paragraph SRMR. See also the Decision of the SRB of 17 December 2018 establishing the framework for the practical arrangements for the cooperation within the SRM between the SRB and the National Resolution Authorities (SRB/PS/2018/15), Articles 11 and 13.
300 FROB, 7 June 2017 of the FROB Governing Committee adopting the measures required to implement the Decision of the Single Resolution Board in its Extended Executive Session of 7 June 2017 concerning the adoption of the resolution scheme in respect of Banco Popular Español, S.A., addressed to FROB, in accordance with Article 29 of Regulation (EU) No. 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (FROB Resolution 2017).

Resolution powers
The exercise of the resolution powers also takes place by the national resolution authorities, both in and outside the SRM. The resolution powers are set out in Articles 63 up to 72 BRRD. The SRMR does not provide for equivalent provisions. When the SRB adopts a resolution scheme, the national resolution authorities should take all necessary measures to implement this by exercising their resolution powers under national law transposing Articles 63 up to 72 BRRD and in accordance with the conditions laid down in national law.[301]

> The SRB closely monitors the execution of the resolution scheme by the national resolution authorities. For that purpose the national resolution authorities should provide certain information to the SRB. On the basis of the information provided, the SRB may give instructions.[302] Where a national resolution authority has not applied or has not complied with a decision by the SRB or has applied it in a way which poses a threat to any of the resolution objectives or to the efficient implementation of the resolution scheme, the SRB may order a bank or banking group in resolution:
> (a) to transfer to another person specified rights, assets or liabilities;
> (b) to require the conversion of any debt instruments which contain a contractual term for conversion;
> (c) to adopt any other necessary action to comply with the decision in question.[303]

4.5.2 *Exercise of the PONV conversion power*

When the determination is made that the conditions for resolution have been met and a resolution decision is adopted, the PONV conversion power should be exercised before any resolution action is taken.[304] This section therefore starts with the discussion of the PONV conversion power. Sections 4.5.3 and 4.5.4 discuss the application of the resolution tools and the exercise of the resolution powers.

301 Recital (26) SRMR. Article 18(9) SRMR. Article 29(1), second paragraph SRMR.
302 Article 28 SRMR.
303 Article 29(2) SRMR.
304 Article 59(3)(a) BRRD. Article 21(1)(a) SRMR. The exercise of the PONV conversion power is not a resolution action. See section 4.5.2.2.

As set out in section 4.4.3.4, the exercise of the PONV conversion power entails that CET 1 items are reduced in proportion to the losses and to the extent of their capacity, after which the principal amount of AT 1 instruments is written down or converted in CET 1 instruments or both and/or the principal amount of Tier 2 instruments is written down or converted into CET 1 instruments or both.[305] The PONV conversion power is exercised by the national resolution authorities, both in and outside the SRM.

> It is not entirely clear from the SRMR that the PONV conversion power is exercised by the national resolution authorities, also if the SRB adopts the resolution scheme. Article 18(9) SRMR only refers to resolution actions, which include the application of resolution tools or the exercise of one or more resolution powers, but not the exercise of the PONV conversion power.[306] That it is intended that national resolution authorities exercise the PONV conversion power may be derived from Article 22(1) SRMR. It can also be read in the resolution that was adopted by the FROB to adopt the measures required to implement the resolution scheme of the SRB in relation to Banco Popular that it exercised the PONV conversion power.[307]

The PONV conversion power should be distinguished from the bail-in tool, because (i) the triggers for the exercise of the PONV conversion power are different, (ii) the PONV conversion power is not a resolution action, (iii) the PONV conversion power is exercised in relation to relevant capital instruments and (iv) the resolution authority has no discretion in the exercise of the PONV conversion power.[308]

4.5.2.1 Triggers for the exercise of the PONV conversion power

The PONV conversion power should not only be applied where the determination is made that conditions for resolution have been met, before any resolution action is taken, but also (i) when the appropriate authority[309] determines that unless the PONV conversion power is exercised the bank or the banking group will no longer be viable and (ii) when EPFS is required by the bank or banking group, except in the case of precautionary

305 Article 60(1) BRRD.
306 Article 2(1)(40) BRRD.
307 FROB Resolution 2017, p. 7-11.
308 EBA, Single Rulebook Q&A, Question ID: 2016_2956.
309 This is the authority identified in accordance with Article 61 BRRD. This may be the resolution authority or the competent authority.

recapitalisation.[310] The PONV conversion power can therefore be applied independently of a resolution action. It can even actually prevent that a bank is put in resolution, namely where the exercise of the PONV conversion power would effectively restore the bank's financial position so that it would no longer be considered non-viable.[311]

> An example of the latter is the exercise of the PONV conversion power in case of precautionary guarantees (see section 5.3.3). See however section 6.5.1 for a critical remark.

A bank or banking group is considered no longer viable, if the bank or banking group is FOLTF[312] and there is no reasonable prospect that any action other than the exercise of the PONV conversion power, independently or in combination with a resolution action, would prevent the failure of the bank or the banking group within a reasonable timeframe. This basically means that, if the resolution authority considers that the resolution conditions, apart from the condition that resolution is necessary in the public interest, are met, the PONV conversion power should be exercised, if this prevents the failure of the bank or the banking group within a reasonable timeframe. In the author's view, one could question why the resolution authority should exercise the PONV conversion power outside of resolution. This power could also be mandated to the competent authority, as is the case with the early intervention powers. This seems to be justified and also more efficient, since the exercise of the PONV conversion power takes place in the pre-resolution phase in that case.

> It can be read in the decisions in relation to Veneto Banca, Banca Popolare di Vincenza, ABLV Bank and ABLV Bank Luxembourg that the SRB did specifically consider whether the exercise of the PONV conversion power independently of any resolution action would prevent the failure of these banks within a reasonable timeframe. In all four cases, the SRB considered that this was not the case. The decisions and notices available do not specify the reasoning for this conclusion.

310 Article 59(3) BRRD. Article 21(1) SRMR.
311 Wojcik *CML Rev.* 2016, p. 112.
312 Within the meaning of Article 32(4) BRRD or Article 18(4) SRMR.

4.5.2.2 Exercise of the PONV conversion power is not a resolution action

Although the PONV conversion power is exercised by the resolution authorities, the exercise of the PONV conversion power is not a resolution action, contrary to the exercise of the bail-in tool. The importance of this distinction lies in the applicability of the principles and safeguards as discussed in more detail in section 4.5.5. The principles and safeguards only apply in case of resolution action; this includes the application of the resolution tools or the exercise of one or more resolution powers. This means that, if the PONV conversion power is exercised outside of resolution, the principles and safeguards do not apply. If the PONV conversion power is exercised in resolution, there will always be a combination with a resolution action as a result of which the principles and safeguards do apply. It is not clear from the resolution framework, whether it was indeed intended to not apply the principles and safeguards to the exercise of the PONV conversion power outside of resolution. In the author's view, there is no logical explanation for this difference. See also section 4.5.5.

> The distinctive character of the PONV conversion power also follows from the qualification of the exercise of the PONV conversion power as a crisis prevention measure, while a resolution action qualifies as a crisis management measure.[313]

4.5.2.3 PONV conversion power is exercised in relation to relevant capital instruments

A third distinction between the PONV conversion power and the bail-in tool, is that the PONV conversion power is exercised in relation to relevant capital instruments, while the bail-in tool applies to eligible liabilities.

> In BRRD II and SRMR II, the scope of the PONV conversion power is extended to include 'eligible liabilities' as defined in BRRD II and SRMR II.[314] See section 2.5.3.2 for a discussion of this new definition under the BRRD II and SRMR II. The consequence is that the scope of liabilities that can be written down or converted under the bail-in tool will be more restricted under BRRD II and SRMR II. In addition, taking into account that the PONV conversion power should always

313 Article 2(1)(101) and (102) BRRD.
314 BRRD II, Article 59(1). SRMR II, Article 21(1). In Article 21(1), the reference to eligible liabilities as referred to in paragraph 7a seems to be incorrect.

be exercised before a resolution tool is applied, it means that the resolution authority should always write down capital instruments and eligible liabilities prior to the application of a resolution tool, whether this tool is a transfer tool or the bail-in tool. BRRD II and SRMR II provide that the scope of eligible liabilities that can be converted or written down using the PONV conversion power is more restricted when it is exercised outside of resolution.[315]

4.5.2.4 No discretion in exercise of the PONV conversion power

A last distinction can be found in the fact that the PONV conversion power does not allow any exemption, while the bail-in tool leaves the option to exempt certain eligible liabilities under Article 44(3) BRRD (Article 27(5) SRMR). When exercising the PONV conversion power, the resolution authority therefore has no discretion to leave certain capital instruments (and eligible liabilities under BRRD II and SRMR II) out of scope.

4.5.3 Application of the resolution tools

This section discusses the application of the resolution tools by the resolution authorities. As set out in section 4.5.1.2, the resolution tools are always applied by the national resolution authorities, also if the resolution scheme is adopted by the SRB, in accordance with the relevant provisions of the BRRD as transposed into national law.[316]

The sale of business tool, bridge institution tool and asset separation tool are hereinafter together referred to as the 'transfer tools'. They have as a purpose the transfer of shares, other instruments of ownership, assets, rights or liabilities of the bank in resolution in order to ensure continuity of critical functions and/or maximizing the value of transferred assets through eventual sale or winding up in an orderly manner, as applicable. The transfer tools can be distinguished from the bail-in tool that has as its purpose to recapitalise the bank in resolution or to absorb losses by converting to equity or reducing the principal amount of claims or debt instruments that are transferred under a transfer tool. Taking into account these different purposes, the conditions for the application of the transfer tools are more or less the same, while the conditions for the application

315 BRRD II, Article 59(1a). SRMR II, Article 21(7a).
316 Article 23, first paragraph SRMR.

of the bail-in tool are different. These conditions are therefore discussed separately in the following sections.

4.5.3.1 General conditions for the application of the transfer tools

In case one of the transfer tools is applied by the resolution authority, the following general conditions apply:

a) The transfer does not have to comply with any procedural requirements;
b) The transfer has to take place conform the valuation conducted under Article 36 BRRD;
c) The transfer has to take place in accordance with the State aid regime;
d) The transfer may take place more than once; and
e) The transfer may be reversed.

<u>Ad a: Procedural requirements</u>
Where shares, instruments of ownership, assets, rights or liabilities are transferred under a transfer tool to a private sector purchaser, bridge institution or asset management vehicle, respectively, this does not have to comply with any procedural requirements under company or securities law.[317] Member States may however require that the application of the transfer tool is subject to *ex ante* judicial approval, provided that the procedure relating to the application for approval and the court's consideration are expeditious.[318] In addition, Member States have to ensure that all persons affected by a decision to apply the sale of business tool have the right to appeal against that decision.[319]

<u>Ad b: The valuation requirement</u>
Before applying a transfer tool, a fair, prudent and realistic valuation of the assets and liabilities of the bank in resolution has to be carried out by a person independent from any public authority, including the resolution authority, and the bank in resolution (hereinafter referred to as: *ex ante* valuation). Where an *ex ante* valuation is not possible, resolution authorities may carry out a provisional valuation followed by an *ex post* valuation

317 Article 38(1), last paragraph, Article 40(1), last paragraph, Article 42(1), last paragraph BRRD.
318 Article 85(1) BRRD.
319 Article 85(3) BRRD.

carried out by an independent valuer and complying with all the requirements set out in Article 36 BRRD (Article 20 SRMR).[320]

The objective of the *ex ante* (or provisional) valuation is to assess the value of the assets and liabilities in order to:

1. when the bridge institution tool or asset separation tool is applied, inform the decision on the assets, rights, liabilities or shares or other instruments of ownership to be transferred and the decision on the value of any consideration to be paid to the bank in resolution or, as the case may be, to the owners of the shares or other instruments of ownership;
2. when the sale of business tool is applied, to inform the decision on the assets, rights, liabilities or shares or other instruments of ownership to be transferred and to inform the resolution authority's understanding of what constitutes commercial terms;
3. in all cases, to ensure that any losses on the assets of the bank in resolution are fully recognised at the moment the resolution tools are applied.[321]

This valuation carried out before applying a transfer tool (Valuation 2) forms part of the same valuation that is carried out to determine that the resolution conditions are met and which resolution tool(s) should be applied (Valuation 1). This valuation should be distinct from the valuation carried out for the purpose of assessing whether shareholders and creditors would have received better treatment, if the bank in resolution had entered into normal insolvency proceedings (Valuation 3).[322] Valuation 3 is discussed in more detail in section 4.5.5.

> Preparing the highly technical and complex valuation report before the resolution action is taken has proven to be difficult in practice. In its valuation report prepared on Banco Popular, Deloitte pointed out the constraints of preparing a report in an extremely short period of time (i.e. 12 days instead of six weeks).[323]

320 Article 36(2), (9) and (10) BRRD. Article 20(2), (3), (10) and (11) SRMR.
321 Article 36(1)-(4) BRRD. Article 20(1)-(5) SRMR.
322 Article 74(1) BRRD. Article 20(16) SRMR. Delegated Regulation (EU) 2018/344. Delegated Regulation (EU) 2016/1075.
323 Lastra and Olivares-Caminal 2018, p. 4, 10.

Ad c: In compliance with the State aid regime
It is not further specified in the BRRD and SRMR what is meant with a transfer in accordance with the State aid regime. It seems to refer to the fact that under the State aid regime, the sale of (part of) a bank during an orderly liquidation procedure or resolution may entail State aid to the buyer, unless the sale is organised via an open and unconditional competitive tender and the assets are sold to the highest bidder.[324]

> The assessment whether a transfer involved State aid to the buyer was made by the Commission in relation to the transfer of economic activities of Novo Banco to Lone Star. In its decision, the Commission verified whether the sales process had been fair, open, competitive and transparent, that the sale happened on market terms and that the offer chosen maximized the value of the assets and liabilities sold. The Commission concluded that Lone Star was not a beneficiary of State aid.[325]

Although this is not mentioned in the resolution framework as a condition, the transfer tools should also be applied in compliance with the merger control exercised by the Commission or the national competition authorities.[326]

Ad d: More than once
The transfer tools may be used more than once in order to make supplemental transfers of shares or other instruments of ownership issued by the bank in resolution or, as the case may be, assets, rights or liabilities of the bank in resolution.[327]

Ad e: Re-application
Following the application of a transfer tool, a resolution authority may, with the consent of the purchaser, re-apply the transfer tool in order to transfer the shares, ownership instruments, assets, rights or liabilities, as applicable, back to the original owners or the bank, as the case may be. The original owners and the bank are obliged to take back any such shares, instruments of ownership, assets, rights or liabilities.[328] In case of application

324 See section 3.5.6.2. The economic activity that is sold may also be the subject of State aid.
325 EC, 11.10.2017, C(2017) 6896 final (SA.49275 – BES), par. 148-158.
326 See, on this topic, Barata and Smoleńska 2017.
327 Article 38(5), Article 40(5), Article 42(9) BRRD.
328 Article 38(6), Article 40(6) and (7), Article 42(9) and (10) BRRD.

of the bridge institution tool, the shares, ownership instruments, assets, rights or liabilities may also be transferred by the resolution authority to a third party.[329] Re-application of the bridge institution and the asset separation tool may only take place, provided that this possibility is expressly stated in the instrument by which the transfer was made or the specific shares, instruments of ownership, assets, rights or liabilities do not, in fact, fall within the classes of, or meet the conditions for transfer.[330]

> In the case of BES the Portuguese resolution authority, the Banco de Portugal, approved to retransfer certain senior bonds from the bridge institution Novo Banco to BES. This measure was deemed necessary to ensure that the losses of BES were absorbed by the bank's shareholders and creditors. A group of 14 asset managers started legal proceedings against the Banco de Portugal following this retransfer.[331]

4.5.3.2 Specific conditions for the application of the sale of business tool and bridge institution tool

Where the sale of business tool and bridge institution tool are applied, the following conditions apply in addition to the general conditions:

a) The transfer may involve shares, instruments of ownership, assets, rights or liabilities of the bank in resolution;
b) The transfer has to take place on commercial terms, having regard to the circumstances;
c) The transfer has to take place conform certain marketing requirements;
d) The transfer has to take place to an authorized purchaser; and
e) In the event of a partial transfer, the residual part of the bank in resolution should be wound up in normal insolvency proceedings.

Ad a: Scope
Both under the sale of business tool and bridge institution tool shares, instruments of ownership, or all or any assets, rights or liabilities of the bank in resolution may be transferred.

329 Article 40(6)(b) BRRD.
330 Article 40(7) and Article 42(10) BRRD.
331 Reuters, Fund firms sue Portugal's central bank over Novo Banco debt, 5 April 2016.

> The scope of the liabilities transferred to Novo Banco was the subject of legal proceedings started by Goldman Sachs. Goldman Sachs had arranged for a loan to be extended to BES by Luxembourg-based vehicle Oak Finance in 2014, just before BES collapsed and was put in resolution under the Portuguese resolution regime that implemented the BRRD. Some assets and liabilities of BES were transferred to the bridge institution Novo Banco, while others remained with BES in order to be wound up. In December 2014, the Portuguese resolution authority, the Banco de Portugal, specified that the Oak liability was not eligible for transfer and had never been transferred to Novo Banco. The reason therefore was that under the Portuguese Banking Law, that implemented the BRRD, no liability could be transferred to a bridge institution, if it was owed to an entity holding more than 2% of the original bank's share capital. This was the case for Goldman Sachs. Goldman Sachs started legal proceedings against Novo Banco for sums due in respect of the Oak loan before the English courts based on the jurisdiction clause in the facility agreement between BES and Oak Finance. In a judgment of 4 July 2018, the Supreme Court in England rejected the claim, because it followed from the agreed propositions of Portuguese law and from the requirement of Article 3(2) of the Reorganisation and Winding Up Directive that an English court must treat the Oak liability as never having been transferred to Novo Banco. Novo Banco was therefore never party to the jurisdiction clause.[332]

In respect of the bridge institution tool, it is specified that the total value of liabilities transferred to a bridge institution may not exceed the total value of the rights and assets transferred to the bridge institution from the bank in resolution or provided by other sources.[333]

Ad b: On commercial terms
Resolution authorities have to take all reasonable steps to obtain commercial terms for the transfer that conform with this valuation, having regard to the circumstances and the costs and expenses incurred in the resolution process.[334] In order to establish that the transfer takes place on commercial terms, a valuation has to be carried out (Valuation 2).[335]

332 Supreme Court in England, 4 July 2018, [2018] UKSC 34 (*Goldman Sachs v Novo Banco*), point 28.
333 Article 40(3) BRRD. Article 25(3) SRMR.
334 Article 38(3) BRRD. Article 24(2)(b) SRMR.
335 Article 38(3) BRRD. This is the valuation as referred to in Article 36 BRRD.

In respect of the bridge institution tool, the requirement that the transfer is made on commercial terms applies when the resolution authority seeks to sell the bridge institution or it assets, rights or liabilities.[336]

Ad c: The marketing requirements

The marketing requirements apply when the transfer takes place to a private sector purchaser. In the case of the sale of business tool, this transfer takes place between the bank in resolution and the private sector purchaser. In the case of the bridge institution tool, this transfer may take place between the bridge institution and a private sector purchaser.[337]

In relation to the sale of business tool, the marketing requirements entail that the marketing should be as transparent as possible, should not discriminate, should be free from any conflict of interest, should not confer any unfair advantage on a potential purchaser, should take account of the need to effect a rapid resolution action and should aim at maximizing, as far as possible the sale price for the shares or other instruments of ownership, assets, rights or liabilities.[338] These marketing requirements do not prevent the resolution authority from soliciting particular potential purchasers.[339]

In addition, the resolution authority may apply the sale of business tool without complying with the marketing requirements, when it determines that compliance with this requirement would be likely to undermine one or more of the resolution objectives, and in particular, if it considers that (a) there is a material threat to financial stability arising from or aggravated by the failure or likely failure of the bank in resolution, and (b) compliance with the marketing requirement would be likely to undermine the effectiveness of the sale of business tool in addressing that threat or achieving the resolution objective of avoiding a significant adverse effect on the financial system/stability.[340]

336 Article 41(4) BRRD.
337 Article 41(4) BRRD.
338 Article 39(2) BRRD.
339 Article 39(2), second paragraph BRRD.
340 Article 38(2) and Article 39 BRRD. Article 24(3) SRMR. See also EBA, Guidelines on factual circumstances amounting to a material threat to financial stability and on the elements related to the effectiveness of the sale of business tool under Article 39(4) of Directive 2014/59/EU, EBA/GL/2015/04, 7 August 2015, Title III.

> In the case of Banco Popular the Spanish resolution authority, the FROB, had to start an open tender process to sell Banco Popular. The SRB notified the FROB that it had the option, in light of the gravity of the situation of Banco Popular, of determining existing market interest based on the non-binding offers that had been received in the private process of sale conducted by Banco Popular. The FROB subsequently analyzed the potential interest in Banco Popular based on the preliminary work that was conducted by Banco Popular during the private sale process. The outcome hereof was that the shares in Banco Popular were sold to Banco Santander.[341]

In relation to the bridge institution tool, the marketing requirements entail that the bridge institution or the relevant assets or liabilities are marketed openly and transparently by the resolution authorities, and that the sale does not materially misrepresent them or unduly favour or discriminate between potential purchasers.[342]

> 75% of the shares in Novo Banco, the bridge institution that acquired the good assets of BES, was sold to Lone Star after three years of efforts to sell the bank. The other 25% stays with the Portuguese resolution fund. A first attempt to sell Novo Banco failed in September 2015, when the Banco de Portugal rejected offers from a number of market participants because it considered the offers to be too low.[343]

If a bridge bank cannot be put back on the market it should be wound up in normal insolvency proceedings.[344]

<u>Ad d: Authorisation requirement</u>
The sale of business tool does not set aside the obligation for the purchaser to have the appropriate authorisation to carry out the business it acquires (by means of a transfer of assets, rights or liabilities) or to acquire a declaration of no-objection (DNO), if it acquires a qualifying holding in a bank (by means of a transfer of shares or other ownership rights). The competent authorities have to ensure that they consider an application in

341 FROB Resolution 2017, p. 12-13.
342 Article 41(4) BRRD.
343 FT, Lone Star seals deal for stake in rescued Novo Banco after three-year process, 18 October 2017.
344 Recital (65) BRRD.

a timely manner that does not delay the application of the transfer tool and prevent the resolution action from achieving the relevant resolution objectives.[345]

A bridge institution should dispose of the appropriate authorisation and comply with the requirements of CRR, CRD IV and MiFID II, as applicable, albeit that the bridge institution may be established and authorized without complying with CRD IV or MiFID II for a short period of time at the beginning of its operation.[346] For the purposes of the 'EU passport', a bridge institution is considered to be a continuation of the bank in resolution. It may therefore continue to exercise the rights of the bank to provide services on a cross-border basis or through a branch in another Member State. This also applies to the rights of membership and access to payment, clearing and settlement systems, stock exchanges, investor compensation schemes and deposit guarantee schemes of the bank in resolution, provided that the bridge institution meets the criteria for participation in these systems.[347] Also for other purposes, resolution authorities may consider the bridge institution to be a continuation of the bank in resolution.[348]

4.5.3.3 Specific conditions for the application of the asset separation tool

Where the asset separation tool is applied, the following conditions apply in addition to the general conditions set out in section 4.5.3.1:

a) The transfer can only involve assets, rights or liabilities of the bank in resolution;
b) The transfer can only take place after the necessity test;[349]
c) The asset management vehicle does not have to be authorized as a bank; and
d) The asset separation tool can only be applied in combination with another resolution tool.[350]

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345 Article 38(7) and (8) BRRD. Article 38(9) BRRD provides for the possibility to deviate from the requirement to have obtained a declaration of no objection prior to the acquisition of a qualifying holding in the bank in resolution.

346 Article 41(1)(e) and (f) and last paragraph BRRD.

347 Article 40(9) and (10) BRRD. Article 40(10), second paragraph, provides for some exceptions to the condition that the bridge institution meets the criteria for participation.

348 Article 40(9), last paragraph BRRD.

349 Article 38(2) and (3), Article 39(2), Article 41(g), Article 42(6) BRRD.

350 Article 37(5) BRRD. Article 22(4) SRMR.

Ad a: Scope
Under the asset separation tool only assets, rights or liabilities of the bank in resolution can be transferred. Shares and other instruments of ownership cannot be transferred under the asset separation tool.

Ad b: The necessity test
The asset separation tool may only be applied to transfer assets, liabilities or rights of a bank in resolution, if (a) the situation of the particular market for those assets is of such a nature that the liquidation of those assets in normal insolvency proceedings could have an adverse effect on one or more financial markets, (b) this transfer is necessary to ensure the proper functioning of the bank in resolution or bridge institution, or (c) this transfer is necessary to maximize liquidation proceeds.[351] The necessity test does not apply in relation to the sale of business tool and bridge institution tool.

Ad c: No bank authorisation
An asset management vehicle does not necessarily have to be authorized as a bank.[352] The BRRD and the SRMR do not provide for the requirement for an asset management vehicle to have a banking license. However, it will depend on the factual activities thereof, whether a banking license is required on the basis of CRD IV. In addition, competent authorities may have the possibility on the basis of national legislation to provide a certain period of time to unwind the activities of the bank when withdrawing its license.[353]

> The status of the asset management vehicle being entitled to carry out (banking) transactions for the sole purpose of portfolio divestment while not having a banking authorisation, was the subject of a request for a preliminary ruling of the ECJ. HETA qualifies as an asset management vehicle that does not have a banking authorisation. HETA was created to deal with the bad assets from the Austrian banking group HGAA. In 2015, HETA notified the Austrian resolution authority, FMA, that it was likely to go into default. The

351 Article 42(5) BRRD. See also EBA, Guidelines on the determination of when the liquidation of assets or liabilities in normal insolvency proceedings could have an adverse effect on one or more financial markets under Article 42(14) of Directive 2014/59/EU, EBA/GL/2015/05, 7 August 2015.
352 Gleeson 2015, p. 417. Lannoo 2017, p. 3.
353 In the Netherlands, the competent authority may do so on the basis of Article 1:104 (3) of the Dutch Act on Financial Supervision.

FMA subsequently announced that it would apply the bail-in tool to HETA.[354] In a request for a preliminary ruling, the Landgericht Frankfurt am Main requested the ECJ whether the BRRD is to be interpreted as meaning that its scope of application also covers an asset management vehicle which has no banking authorisation. This request was however withdrawn, as a result of which the ECJ was not able to give its view on the matter.[355]

The purpose of the asset management vehicle is to maximise the value of the assets, rights and liabilities through an eventual sale or winding up in an orderly manner. The BRRD and SRMR do not contain any provisions in relation to the way in which a sale should take place. It seems plausible that the same conditions apply as those that apply when a bridge institution sells assets, rights and liabilities. This would entail that the transfer has to take place on commercial terms, having regard to the circumstances, and conform certain marketing requirements.

In the case of HETA, press releases show that all sales by HETA take place through structured, open, transparent and international tender processes.[356]

4.5.3.4 Conditions for the application of the bail-in tool

As said, the bail-in tool should be distinguished from the transfer tools due to the fact that it has as its purpose:

1. to recapitalise a bank that meets the conditions for resolution to the extent sufficient to restore its ability to comply with the conditions for authorisation and to continue to carry out the activities for which it is authorized under CRD IV or MIFID II and to sustain sufficient market confidence in the bank, or

354 FMA, Emergency Administrative Decision in relation to Heta Asset Resolution AG, 10 April 2016.

355 ECJ, C-394/16, Request for a preliminary ruling from the Landgericht Frankfurt am Main (Germany) lodged on 14 July 2016 – *FMS Wertmanagement AöR v Heta Asset Resolution AG*. GRR, Austria wins over creditors in EUR11bn Heta debt deal, 12 October 2016.

356 See e.g. Heta Asset Resolution AG, Sale of all Skiper Group Companies to the best bidder ISTRIAN HOTELS, 17 October 2017. Heta Asset Resolution AG, HETA announces details of further sales transactions on AAA platform, 10 July 2017.

2. to convert to equity or reduce the principal amount of claims or debt instruments that are transferred (i) to a bridge institution with a view to providing capital for that bridge institution or (ii) under the sale of business or the asset separation tool.[357]

The bail-in tool may only be used for recapitalisation purposes, if there is a reasonable prospect that the application of that tool will, in addition to achieving relevant resolution objectives, restore the bank to financial soundness and long-term viability.[358] Where these conditions are not met, the bail-in tool may still be used for the purpose set out under 2.[359]

The conditions under which the bail-in tool can be applied, are the following:

a) The bail-in tool should be applied conform the valuation conducted under Article 36 BRRD;
b) The bail-in tool can only be applied in relation to eligible liabilities;
c) The bail-in tool should be applied in accordance with the required sequence of write down and conversion;
d) The bail-in tool should be applied in accordance with the hierarchy of claims in normal insolvency proceedings;
e) The bail-in tool should be applied in accordance with the equality principle; and
f) The bail-in tool should be accompanied by a business reorganisation plan.

Ad a: Valuation

Before applying the bail-in tool, a valuation has to be carried out to inform the decision of the resolution authority on the extent of the write down or conversion of eligible liabilities (Valuation 2).[360] In addition, the valuation has to indicate the subdivision of the creditors in classes in accordance with their priority levels under the applicable insolvency law and give an estimate of the treatment that each class of shareholders and creditors would have been expected to receive, if the bank in resolution were wound up in normal insolvency proceedings.[361]

357 Article 43(2) BRRD. Article 27(1) SRMR.
358 Article 43(3) BRRD. Article 27(2) SRMR.
359 Article 43(3), last paragraph BRRD.
360 Article 36(4)(d) and Article 46(1) BRRD. Article 20(5)(d) SRMR.
361 Article 36(8) BRRD. That estimate shall not affect the application of the NCWO principle, as further discussed in section 4.5.5.

Ad b: Scope

The bail-in tool applies to 'eligible liabilities'. Eligible liabilities are the liabilities and capital instruments that:

1. do not qualify as Tier 1 or Tier 2 instruments of a bank, and
2. are not excluded from the scope of the bail-in tool by virtue of Article 44(2) BRRD (Article 27(3) SRMR).[362]

In accordance with Article 44(2) BRRD (Article 27(3) SRMR), the following liabilities are excluded from the scope of the bail-in tool:

a) deposits covered under deposit guarantee schemes,[363]
b) secured liabilities,[364]
c) any liability that arises by virtue of the holding by the bank of client assets or client money, including client assets or client money held on behalf of undertakings for collective investment in transferable securities (UCITS) or alternative investment funds (AIFs), provided that such a client is protected under the applicable insolvency law,
d) any liability that arises by virtue of a fiduciary relationship between the bank and another person provided that such a beneficiary is protected under the applicable insolvency or civil law,
e) liabilities to institutions, excluding entities that are part of the same group, with an original maturity of less than seven days,
f) liabilities with a remaining maturity of less than seven days, owed to (operators of) payment or settlement systems or their participants and arising from the participation in such a system,
g) a liability to an employee, in relation to accrued salary, pension benefits or other fixed remuneration,[365] a commercial or trade creditor arising from the provision to the bank of goods or services that are critical to the daily functioning of its operations, including IT services, utilities and the rental, servicing and upkeep of premises, tax and social security authorities, provided that those liabilities are

362 Article 2(1)(71) BRRD. Article 3(1)(49) SRMR. See also section 2.5.2.2.

363 Resolution authorities may however exercise their powers in relation to any amount of a deposit that exceeds the coverage level provided for in Article 6 of the DGS Directive (Article 44(2), fourth paragraph, BRRD, Article 27(4) SRMR).

364 Resolution authorities may however, where appropriate, exercise their powers in relation to any part of a secured liability or a liability for which collateral has been pledged that exceeds the value of the assets, pledge, lien or collateral against which it is secured (Article 44(2), third paragraph BRRD, Article 27(4) SRMR).

365 The variable component of remuneration of material risk takers is in scope of the bail-in powers (Article 44(2), second paragraph, BRRD, Article 27(3), second paragraph SRMR).

preferred under applicable law and deposit guarantee schemes arising from contributions due in accordance with the DGS Directive.

In exceptional circumstances the resolution authorities may exclude or partially exclude other liabilities where certain conditions are met.[366] These conditions are:

1. it is not possible to bail-in that liability within a reasonable time notwithstanding the good faith efforts of the relevant national resolution authority;
2. the exclusion is strictly necessary and is proportionate to achieve the continuity of critical functions and core business lines in a manner that maintains the ability of the bank in resolution to continue key operations, services and transactions;
3. the exclusion is strictly necessary and proportionate to avoid giving rise to widespread contagion, in particular as regards eligible deposits held by natural persons and micro, small and medium-sized enterprises, which would severely disrupt the functioning of financial markets, including of financial market infrastructures, in a manner that could cause a serious disturbance to the economy of a Member State or of the EU; *or*
4. the application of the bail-in tool to those liabilities would cause a destruction in value such that the losses borne by other creditors would be higher than if those liabilities were excluded from bail-in.

Where an eligible liability or class of eligible liabilities is excluded or partially excluded, the level of write-down or conversion applied to other eligible liabilities may be increased to take account thereof, provided that the level of write-down and conversion applied to other eligible liabilities complies with the ‘no creditor worse off principle’, as further discussed in section 4.5.5.[367]

<u>Ad c: Sequence of write down and conversion</u>
As set out in section 4.4.3.4, prior (or simultaneously) to the application of the bail-in tool, the PONV conversion power has to be exercised. As a result of the exercise of the PONV conversion power, CET 1 items, AT 1 and Tier 2 instruments will be cancelled, transferred and/or diluted. Where this is not sufficient to restore the net asset value of the bank in resolution and/or its CET 1 ratio, subordinated debt should be converted or written

366 Article 44(3) BRRD. Article 27(5) SRMR.
367 Article 44(4), second paragraph BRRD. Article 27(5), second paragraph SRMR.

down under the application of the bail-in tool. Senior liabilities should be converted or written down, if the subordinated classes have been converted or written down entirely.[368]

Ad d: Hierarchy of claims

Where the bail-in tool is applied, the principal amount of subordinated debt that is not AT 1 or Tier 2 capital should be reduced in accordance with the hierarchy of claims in normal insolvency proceedings.[369] Only, if this is still insufficient may the outstanding senior eligible liabilities be reduced in accordance with the hierarchy of claims in normal insolvency proceedings. Certain derogations however apply in accordance with Article 108 BRRD:

1. The part of eligible deposits from natural persons and micro, small and medium-sized enterprises which exceeds the coverage level of deposit guarantee schemes (that is, EUR 100,000) and deposits that would be eligible deposits for coverage by deposit guarantee schemes from natural persons and micro, small and medium-sized enterprises, were they not made through branches located outside the EU of banks established within the EU rank higher than the ranking provided for the claims of ordinary, unsecured, non-preferred creditors (hereinafter referred to as 'semi-covered deposits'); and
2. Deposits that are covered by the deposit guarantee scheme and that do not exceed the coverage level of deposit guarantee schemes (also referred to as 'covered deposits'[370]) and deposit guarantee schemes subrogating to the rights and obligations of covered depositors in insolvency rank higher than the ranking provided for the semi-covered deposits.[371]

Article 108 BRRD was amended by BRRD II bis.[372] In accordance with BRRD II bis, Member States should ensure in their national laws governing normal insolvency proceedings, that ordinary unsecured claims have a higher priority ranking than that of unsecured claims resulting from debt instruments that meet the following conditions:

368 Article 48 BRRD. Recital (77) BRRD.
369 At that time, the CET 1, AT 1 and Tier 2 instruments have already been written down and reduced under the PONV conversion power (Article 48 BRRD. Article 27(15) SRMR).
370 See Article 2(1)(5) DGS Directive.
371 Article 108 BRRD.
372 BRRD II bis, Article 108(4), (5) and (7) provide for transitional arrangements.

(a) the original contractual maturity of the debt instruments is of at least one year;
(b) the debt instruments contain no embedded derivatives and are not derivatives themselves;[373]
(c) the relevant contractual documentation and, where applicable, the prospectus related to the issuance explicitly refer to the lower ranking.

In addition, unsecured claims resulting from debt instruments that meet the aforementioned conditions have a higher priority ranking than the priority ranking of claims resulting from CET 1, AT 1, Tier 2 and other subordinated debt.

This new asset class of non-preferred senior debt should only be bailed-in in resolution after other capital instruments, but before other senior liabilities.[374]

Ad e: Equality

When exercising the bail-in tool, resolution authorities have to allocate the losses represented by the sum of the amounts necessary to restore the NAV and CET 1 capital ratio of the bank equally between shares or other instruments of ownership and eligible liabilities of the same rank by reducing the principal amount of, or outstanding amount payable in respect of, those shares or other instruments of ownership and eligible liabilities to the same extent *pro rata* to their value, except where a different allocation of losses amongst liabilities of the same rank is allowed. This is allowed where liabilities are excluded from the scope of the bail-in tool (pursuant to Article 44(2) BRRD) or resolution authorities decide to exclude or partially exclude other liabilities in exceptional circumstances (pursuant to Article 44(3) BRRD).[375]

373 Debt instruments with variable interest derived from a broadly used reference rate and debt instruments not denominated in the domestic currency of the issuer, provided that principal, repayment and interest are denominated in the same currency, are not considered to be debt instruments containing embedded derivatives solely because of those features (BRRD II bis, Article 108(6)).
374 See also Janssen 2019, p. 172-175.
375 Article 48(2) BRRD.

Ad f: Business reorganisation plan

Where resolution authorities apply the bail-in tool to recapitalise a bank in resolution, arrangements should be adopted to ensure that a business reorganisation plan for that bank is drawn up and submitted to the resolution authority within one month (extendable up to two months) after the application of the bail-in tool.[376] The contents of the business reorganisation plan are discussed in more detail in section 4.7.1.2.

4.5.4 Exercise of resolution powers

When the national resolution authorities implement a resolution scheme of the SRB or apply a resolution tool on their own decision (in or outside the SRM), they may exercise the resolution powers. In short, the resolution powers assist the resolution authorities in implementing the resolution tools. The powers, for example, include the power to require information, the power to take control of a bank in resolution, the power to transfer shares, assets, rights or liabilities, the power to write down and covert regulatory capital and eligible liabilities, the power to remove or replace the management body and senior management of a bank in resolution and the power to appoint a special manager.[377] When resolution authorities exercise a resolution power, they can also exercise the so-called 'ancillary powers'.[378] These include the powers to require the relevant authority to discontinue or suspend the admission to trading on a regulated market, cancel or modify the terms of a contract, remove rights to acquire further shares or other instruments of ownership, etc.[379]

The resolution powers can be exercised individually or in any combination.[380] If the resolution authorities exercise a resolution power, they are not subject to any requirements to (a) obtain approval or consent from any person either public or private, including the shareholders or creditors of the bank in resolution, or (b) notify any person, including any requirement to publish any notice or prospectus or to file or register any document with any other authority.[381] This is without prejudice to any notification requirements under the State aid regime, the procedural obligations of resolution authorities set out in Article 81 and 83 BRRD and the obligation to inform

376 Article 51 and 52(1) BRRD.
377 The resolution powers are included in Article 35, Article 63-71 BRRD.
378 Article 64(1) BRRD.
379 Article 64(1) BRRD.
380 Article 63(1)(a) BRRD.
381 Article 63(2) BRRD.

the competent ministry, if the resolution authority is not the competent ministry.[382] In addition, Member States may require that a decision to exercise a resolution power is subject to *ex ante* judicial approval.[383]

4.5.5 The principles and safeguards governing the resolution process

When applying the resolution tools and exercising the resolution powers, resolution authorities should take all appropriate measures to ensure that the resolution action is taken in accordance with the principles and safeguards governing the resolution process.[384] These do not confer any powers on the resolution authorities, but bind the resolution authorities in the application of the resolution tools and exercise of the resolution powers. The principles governing resolution are the following:

a) The shareholders of a bank in resolution should first bear losses;
b) The creditors of the bank in resolution should bear losses after the shareholders in accordance with the order of priority of their claims in normal insolvency proceedings, save as expressly provided otherwise in the BRRD;
c) Except where otherwise provided in the BRRD, creditors of the same class are treated in an equitable manner;
d) Deposits that are covered under the national deposit guarantee schemes are fully protected;[385]
e) The management body and senior management of the bank in resolution should be replaced, except in those cases when the retention of the management body and senior management, in whole or in part, as appropriate to the circumstances, is considered to be necessary for the achievement of the resolution objectives;
f) The management body and senior management of the bank in resolution have to provide all necessary assistance for the achievement of the resolution objectives;
g) Natural and legal persons should be made liable, subject to Member State law, under civil or criminal law for their responsibility for the failure of the bank in resolution;
h) If a bank is placed in resolution, no creditor may incur greater losses than would have been incurred, if the bank had been wound up in

382 Article 63(2) in conjunction with Article 3(6) BRRD.
383 Article 63(2) in conjunction with Article 85(1) BRRD.
384 Article 34 BRRD. Article 15 SRMR
385 The principle of burden-sharing does therefore not apply to the holders of such deposits. This is also the case for certain other liabilities of banks in resolution pursuant to Article 44(2) and (3) BRRD.

normal insolvency proceedings. This is also referred to as the 'no creditor worse off' principle or NCWO principle; and

i) The safeguards are taken into account.

Ad h: No creditor worse off principle

If these resolution tools are applied, this may not lead to the situation that creditors incur greater losses than would have incurred in an insolvency situation. In addition, in case of partial transfers, creditors whose claims have not been transferred, should receive in satisfaction of their claims at least as much as what they would have received, if the bank in resolution had been wound up in normal insolvency proceedings.[386]

> Based on the text of the BRRD, the NCWO principle does not apply to the exercise of the PONV conversion power. This has also been recognised by the EBA.[387] However, in practice, the exercise of the PONV conversion power will (often) take place in combination with the application of a resolution tool as a result of which the safeguards, including the NCWO principle, apply. In addition, the EBA considers that resolution authorities must in all circumstances consider their duty to act in accordance with the protection of property rights under the EU Charter of Fundamental Rights, also if the NCWO principle under the BRRD does not apply.[388]
>
> Van der Houwen and De Serière conclude that the NCWO principle is an element that authorities must take into account, when calculating the write-down of capital instruments. In respect of conversion, they differ between instruments that contractually provide for conversion (e.g. contingent convertibles) and instruments that do not. In respect of the latter, they conclude that the NCWO principle would apply, while in respect of the former application of the principle is irrelevant.[389]
>
> It is the author's view that the NCWO principle should be complied with when exercising the PONV conversion power, both in and outside resolution, taken into account the protection of property rights

386 Article 73(a) BRRD.
387 EBA Guidelines on the rate of conversion of debt to equity in bail-in, p. 16.
388 EBA Guidelines on the rate of conversion of debt to equity in bail-in, p. 16.
389 Van der Houwen and De Serière *JIBLR* 2016, p. 378.

> under the EU Charter of Fundamental Rights. When the instrument contractually provides for write-down or conversion, this can be taken into account in applying the NCWO principle.

For the purpose of assessing whether creditors would have received better treatment, if the bank in resolution had entered normal insolvency proceedings, a valuation is carried out by an independent person as soon as possible after the resolution action(s) have been effected (Valuation 3).[390] If the valuation determines that any creditor has incurred greater losses than it would have incurred in a winding up in normal insolvency proceedings, it is entitled to the payment of the difference from the national resolution fund or the SRF (within the SRM).[391] The valuation has to take place in all cases in which resolution action is taken. This is not restricted to the application of the bail-in tool. Also, when one of the transfer tools is applied, the NCWO principle should be complied with. The valuation should disregard any provision of extraordinary public financial support (EPFS) to the bank.[392]

> In the case of Banco Popular, Deloitte provided the Valuation 3 report following the application by the SRB of the sale of business tool in combination with the PONV conversion power. In its Valuation 3 report, Deloitte estimated that for shareholders and subordinated creditors no recoveries would have been expected in normal insolvency proceedings. It further estimated that recoveries for other classes of creditors, unaffected by the resolution and including at other group entities, would have been lower in an insolvency proceeding.[393] Following this report, the SRB concluded on a preliminary basis that it is not required to pay compensation to the shareholders and creditors affected by the resolution (i.e. holders of CET

390 Article 74 BRRD. Article 20(16) SRMR. Delegated Regulation (EU) 2018/344. Delegated Regulation (EU) 2016/1075.

391 Articles 75 BRRD. Taking into account that resolution schemes adopted under the SRM should ensure that the safeguards provided for in the BRD are complied with (Article 29(1) SRMR), this safeguard should also apply under the SRM. This entails that a shareholder or creditor would be entitled to the payment of the difference from the SRF instead of the national resolution fund. This also follows from Article 76(1)(e) SRMR.

392 Article 74(3)(c) BRRD. See further on EPFS Chapter 5.

393 Deloitte, Valuation of difference in treatment Banco Popular Español, non-confidential version.

1, AT 1 and Tier 2 capital).[394] Affected shareholders and creditors have the right to be heard before the SRB adopts its final decision. At the time of writing this dissertation, this final decision had not yet been adopted.[395]

Ad i: Safeguards

The safeguards are included in Chapter VII of Title IV BRRD. The safeguards include the NCWO principle (as already discussed under 'ad h'). In addition, the safeguards ensure that in the situations of (a) partial transfer and (b) cancellation or modification of the terms of a contract to which the bank in resolution is a party or substitute a recipient as a party:

1. There is appropriate protection for counterparties to title transfer financial collateral arrangements, set-off and netting arrangements, security arrangements, structured finance arrangements and covered bonds; and
2. The application of a resolution tool does not affect the operation of trading, clearing and settlement systems.[396]

Proportionality principle and principle of non-discrimination

Besides the principles and safeguards governing resolution, the principles of proportionality and non-discrimination are also important for the application of the resolution tools.

The proportionality principle applies to the use of government intervention powers generally.[397] The resolution framework does not provide for a specific application of the proportionality principle in the application of the resolution tools.

394 SRB, Notice of the SRB of 2 August 2018 regarding its preliminary decision on whether compensation needs to be granted to the shareholders and creditors in respect of which the resolution actions concerning Banco Popular Español S.A. have been effected and the launching of the right to be heard process (SRB/EES/2018/132).

395 The decision of the SRB as a result of which Banco Popular has been taken over by Santander for EUR 1, after equity and subordinated debt was written down and converted, as well as the Commission decision endorsing this decision have been the reason for numerous actions brought before the EU Courts. See also section 4.9.2.2.

396 Articles 76-80 BRRD. The application of the safeguards is further discussed in section 4.8.1.4 (in respect of the transfer tools) and section 4.8.2.4 (in respect of the PONV conversion power and the bail-in tool).

397 Carriero *EBLR* 2017, p. 641.

The resolution framework does provide for a specific application of the proportionality principle in relation to the contents and details of recovery and resolution plans, the date by which the first recovery and resolution plans are to be drawn up, the frequency for updating these plans, the contents and details of the information required, and the level of detail for the assessment of resolvability.[398] The requirements regarding recovery planning, resolution planning and resolvability assessments are applied proportionately, reflecting, *inter alia*, the systemic importance of the bank concerned.[399] For the assessment whether a bank is eligible for 'simplified obligations' quantitative and qualitative indicators are used. G-SIIs, O-SIIs and other SREP Category 1 institutions always have to comply with the full obligations in relation to recovery and resolution plans. [400]

In addition, the proportionality principle also applies in respect of the contributions to be paid by banks to national resolution financing arrangements and the SRF.[401] The resolution authorities determine the annual contributions to be paid by each bank in proportion to its risk profile.[402] The annual contributions for small banks are set as lump-sum amounts, unless the bank has a risk profile that is disproportionate to its small size.[403]

The principle of non-discrimination can be found in the provision that, if creditors within the same class are treated differently in the context of resolution action, this should be neither directly nor indirectly discriminatory on the grounds of nationality.[404] In addition, when the sale of business or bridge institution tool is applied, the marketing should not discriminate between potential purchasers.[405] In the SRMR, it is emphasized that no Member State or group of Member States should be discriminated against,

398 Article 4(1) BRRD.

399 See also EBA, Consultation Paper, Draft Regulatory Technical Standards on simplified obligations under Article 4(6) of Directive 2014/59/EU, EBA/CP/2017/05, p. 6. See also Recitals (14), (21) and (25) BRRD and Recital (49) SRMR.

400 Recitals (8) – (11) Delegated Regulation (EU) 2019/348.

401 Article 103(2) BRRD. Article 70(6) SRMR.

402 Article 4(1) Delegated Regulation (EU) 2015/63. The risk profile is established in accordance with Article 6 Delegated Regulation (EU) 2015/63 and takes, *inter alia*, into account the risk exposure, stability and variety of sources of funding and importance of a bank to the stability of the financial system or economy.

403 Article 10 Delegated Regulation (EU) 2015/63.

404 Recitals (13) and (47) BRRD. Recital (60) SRMR.

405 Articles 39(2)(b) and 41(4) BRRD. In the SRMR it is more broadly stated that the resolution tools should be applied in a non-discriminatory way (Recital (33) SRMR).

directly or indirectly, as a venue for financial services.[406] In addition, no action, proposal or policy of the SRB, the Council, the Commission or a national resolution authority may discriminate against entities, deposit holders, investors or other creditors established in the Union on grounds of their nationality or place of business.[407]

4.6 Group resolution

If a failing bank does not form part of a group, resolution takes place at the level of the bank itself. Most banks are however not standalone entities, but part of a larger (cross-border) group of entities. This section discusses the provisions of the resolution regime in relation to group resolution.[408]

4.6.1 SPE or MPE strategy

A group resolution may entail (a) the taking of a resolution action at the level of the parent company or the bank subject to consolidated supervision, or (b) the coordination of the application of resolution tools and the exercise of resolution powers by resolution authorities in relation to group companies that meet the resolution conditions.[409]

If the resolution action is taken at the level of only one entity, this is considered a single point of entry (SPE) resolution. Under the SPE strategy, usually the parent is resolved, whereas other group entities are not put in resolution, but upstream their losses to the parent. Hence, the group itself is not disrupted. In order for an SPE strategy to be effective, there should be a parent company that can raise bail-inable debt. An SPE strategy can be convenient for a group, where intra-group operations are intensively inter-linked and integrated.

> Resolution authorities may take a resolution action in relation to a parent company when the conditions for resolution are met with regard to both the parent company and with regard to one or more subsidiaries which are institutions, or where the subsidiary is not established in the EU, the third-country authority has determined

406 Recital (12) SRMR.
407 Article 6(1) SRMR.
408 See Grünewald on the specific challenges to the resolution of banking groups (Grünewald 2014, p. 106-108.
409 Article 2(1)(42) BRRD.

> that it meets the conditions for resolution under the law of that third country.[410] In the situation that the parent company does not itself meet the conditions for resolution, the resolution authorities may still take resolution action with regard to this parent company when one or more of the subsidiaries which are institutions comply with the conditions for resolution and their assets and liabilities are such that their failure threatens an institution or the group as a whole or the insolvency law of the Member State requires that groups are treated as a whole and resolution action with regard to the parent company is necessary for the resolution of these subsidiaries which are institutions or for the resolution of the group as a whole.[411]

Banking groups can also apply the multiple point of entry (MPE) strategy. In case of an MPE strategy, the local entities will all be separately resolved by their local resolution authorities. This means that the resolution tools are applied by the different resolution authorities at the level of the local entities that can be resolved. In that case, the group resolution entails the coordination between these resolution authorities. An MPE strategy can be effective, if a banking group is organized into well-defined regional and functional subgroups. In addition common services, such as IT will need to be provided by stand-alone entities that can survive the break-up of an MPE group.[412]

The resolution plan of a banking group has to set out which strategy is applied to a banking group. In order to ensure that a strategy can be applied effectively, it may in some cases be necessary to restructure the banking group. If the MPE strategy is applied to a banking group in scope of the SRMR and the SRB is the designated resolution authority, coordination will be less of an issue, although the implementation of the resolution scheme adopted by the SRB will be done by the local resolution authorities. As a result, coordination between these authorities may still be necessary.

> BRRD II and SRMR II provide for the introduction of the term 'resolution entity' and 'resolution group' in order to improve the effective application of the resolution strategy. See section 2.5.3.1 for the definition of 'resolution entity' and 'resolution group'. In case of an SPE strategy, it will be usually the parent company that will be

410 Article 33(2) BRRD. Article 16(2) SRMR.
411 Article 33(4) BRRD. Article 16(3) SRMR.
412 Tucker 2013, p. 3.

qualified as the resolution entity, while in case of an MPE strategy the operating banking subsidiaries will be the resolution entities. According to BRRD II and SRMR II, the resolution entities and resolution groups will have to be clearly identified in the resolution plans.

4.6.2 *Coordination between resolution authorities in case of a cross-border banking group*

This section discusses the provisions of the resolution regime in respect of coordination between resolution authorities in case of a banking group that is active in multiple Member States by means of subsidiaries or branches in multiple Member States. A distinction is made between resolution on the basis of the BRRD and the SRMR.

4.6.2.1 Coordination between resolution authorities under the BRRD

In case of a (cross-border) banking group, the group-level resolution authority (that is, the resolution authority in the Member State in which the consolidating supervisor is situated[413]) has to establish a resolution college to carry out the tasks in relation to drafting group resolution plans, assessing the group resolvability, setting the MREL and group resolution.[414] The members of the resolution college are the resolution authorities of each Member State in which a subsidiary covered by consolidated supervision, a parent company or a significant branch is established, the consolidating supervisor and the competent authorities, the competent ministries and the authorities responsible for the deposit guarantee scheme of the Member States where the resolution authorities are a member of the resolution college, and the EBA.[415]

A significant branch is a branch that would be considered to be significant in a host Member State in accordance with Article 51(1) CRD IV.[416] Relevant reasons in that respect are (a) whether the market share of the branch in terms of deposits exceeds 2% in the host Member State; (b) the likely impact of a suspension or closure of

413 Article 2(1)(44) BRRD.
414 Article 88(1) BRRD. This would only not be necessary, if other groups or colleges already perform the same function and carry out the same tasks (Article 88(6) BRRD). See also Chapter VI Delegated Regulation (EU) 2016/1075.
415 Article 88(2) BRRD.
416 Article 2(1)(34) BRRD.

the operations of the institution on systemic liquidity and the payment, clearing and settlement systems in the host Member State; (c) the size and the importance of the branch in terms of number of clients within the context of the banking or financial system of the host Member State.

Where a group-level resolution authority decides that a parent undertaking for which it is responsible should be put in resolution, it has to notify the other members of the resolution college of the group in question thereof, including the resolution actions or insolvency measures that it considers to be appropriate.[417]

If resolution at the level of the parent company would not be sufficient or make it likely that the resolution conditions would also be fulfilled in relation to a group entity in another Member State, the resolution actions or insolvency measures that are proposed by the group-level resolution authority may include the implementation of a group resolution scheme.[418] A group-level resolution authority can also decide to implement a group resolution scheme, where it is notified by a resolution authority of the decision that a bank that is a subsidiary of a group meets the resolution conditions, provided that it assesses that the resolution action or other measures would make it likely that the resolution conditions would be satisfied in relation to a group entity in another Member State.[419] A group resolution scheme takes the form of a joint decision of the group-level resolution authority and the resolution authorities responsible for the subsidiaries that are covered by the group resolution scheme.[420] If any resolution authority disagrees with or departs from this scheme or considers that it needs to take independent resolution actions or measures other than those proposed in the scheme for reasons of financial stability, it has to set out in detail the reasons for this disagreement or departure and notify the group-level resolution authority and the other resolution authorities that

417 Article 92(1) BRRD.

418 Article 92(1) BRRD.

419 Article 91(1) and (4) BRRD. If the group-level resolution authority assesses that the resolution action or other measures notified by a resolution authority would *not* make it likely that the resolution conditions would be satisfied in relation to a group entity in another Member State, it will not propose a group resolution scheme. In that case the resolution authority can proceed with the actions or measures as proposed by it.

420 Article 91(7) and 92(3) BRRD.

are covered by the group resolution scheme of the reasons and the actions or measures it will take.[421] This has to be recognised as conclusive and applied by the resolution authorities in the Member States concerned.[422]

> It is the author's understanding that resolution actions cannot be taken against group entities, other than the entities set out in Article 1 BRRD or 2 SRMR (that is, institutions, parent companies and financial institutions). A banking group can, for example, have as a subsidiary, a credit intermediary. If this credit intermediary gets into trouble, it is the author's understanding that it is not possible to apply the resolution tools to this credit intermediary. Group entities that cannot be put in resolution can, however, of course be affected by the resolution of a group entity that can be put in resolution. If, for example, the shares in the capital of the parent company of the credit intermediary are sold under the application of the sale of business tool, the credit intermediary will also, indirectly, have a new shareholder. The SRMR and the BRRD provide that the group recovery and resolution plan should take into account the financial position of other group entities.[423] In addition, the resolution authorities should act in a way that minimises the impact on other group entities and on the group as a whole, when deciding on the application of resolution tools and the exercise of resolution powers.[424]

The BRRD provides that where a transfer tool is applied to assets located in a Member States other than the Member State of the resolution authority or to rights or liabilities under the law of this other Member State, the transfer has effect in or under the law of that other Member State. Shareholders, creditors and third parties affected by this transfer are not entitled to prevent, challenge or set aside the transfer under any provision of law of the Member State where the assets are located or of the law governing the shares, other instruments of ownership, rights or liabilities. Similar provisions apply to the exercise of the PONV conversion power and the application of the bail-in tool.[425]

421 Article 91(8) and 92(4) BRRD.
422 Article 91(10) and 92(6) BRRD.
423 Article 7(4) BRRD. Article 8(12) SRMR.
424 Article 34(2) BRRD. Article 15(2) SRMR.
425 Article 66 BRRD.

4.6.2.2 Coordination within the SRM

If the SRB is the relevant resolution authority, there will be no coordination issues in relation to the resolution authority that can adopt the resolution scheme for the banking group. This is the exclusive mandate of the SRB. Coordination however still needs to take place in relation to the implementation of the resolution scheme by the different national resolution authorities. The SRMR does not provide for any coordination arrangements in that respect.

In addition, it may be the case that the parent company or certain subsidiaries or significant branches of the banking group are located in non-participating Member States as a result of which the resolution authorities of these Member States are involved in the resolution of the banking group on the basis of the BRRD. In that case, the SRB shall:

1. represent the national resolution authorities of the participating Member States for the purposes of consultation and cooperation with the resolution authorities of the non-participating Member States (e.g. in the resolution college); and
2. communicate any plan, decision or measure relevant to the banking group to the competent authorities and/or resolution authorities of the non-participating Member States.[426]

The SRB has to enter into memoranda of understanding with the ECB and the resolution authorities and competent authorities of the non-participating Member States describing in general terms how they will cooperate with one another.[427] These memoranda of understanding should be published subject to the requirements of professional secrecy.[428]

> The SRB has entered into a memorandum of understanding with the ECB.[429]

In addition, the SRB has to enter into memoranda of understanding with the resolution authorities of non-participating Member States that are home to at least one G-SII.

426 Article 32(1) SRMR.
427 Article 32(2) SRMR.
428 Article 32(3) SRMR.
429 Memorandum of Understanding between the SRB and the ECB in respect of cooperation and information exchange, as revised on 30 May 2018.

> The SRB has entered into such memoranda of understanding with the UK and Sweden.[430]

4.6.3 *Resolution of groups with third country presence*

An EU banking group may have parent companies, subsidiaries or branches in third countries, or a third country banking group may have parent companies, subsidiaries or branches in Member States. In these cases, resolution of the group becomes even more complex, since cooperation with third country authorities has to be established. This section discusses the coordination arrangements provided in the BRRD and the SRMR.

> The group resolution plan should identify appropriate arrangements for cooperation and coordination with the relevant authorities of third countries and the implications for resolution within the EU, if a banking group includes entities in third countries.[431]

4.6.3.1 Coordination with third country authorities under the BRRD

Where a bank or parent company established in a third country has subsidiary institutions or significant branches established in two or more Member States, the resolution authorities of these Member States form a European resolution college. The European resolution college performs the tasks of the resolution college (as set out in section 4.6.2.1) with respect to the subsidiary institutions and/or the branches. Where a parent company has been established in a Member State, the European resolution college is chaired by the resolution authority of the Member State where the consolidating supervisor is located.[432]

The Commission may submit to the Council proposals for negotiation of international agreements with third countries for the situations in which groups have a presence in at least two Member States. Until these international agreements have entered into force, Member States may enter into bilateral agreements with a third country. In addition, the EBA may until that time enter into non-binding framework cooperation arrangements

430 Prifti 2017, p. 3.
431 Article 12(3)(c) BRRD. Article 8(11)(d) SRMR.
432 Article 89(1), (2) and (3) BRRD.

with third-country authorities. The competent and resolution authorities can subsequently conclude non-binding cooperation arrangements with the relevant third-country authorities in line with these framework arrangements.[433]

> At the time of writing this dissertation, the EBA had entered into a framework cooperation arrangement with several US financial regulatory agencies.[434]

As long as no cooperation agreement has entered into force in relation to a specific third country, or this does not contain provisions for the recognition and enforcement of third-country resolution proceedings, Article 94 BRRD applies. Article 94 BRRD provides that the European resolution college takes the joint decision on whether to recognise third-country resolution proceedings relating to a third-country institution or parent company. If this has been reached, the recognised third-country resolution proceedings have to be enforced by the respective national resolution authorities. In the absence of a joint decision of the European resolution college, or in the absence of a European resolution college, each resolution authority concerned has to make its own decision on whether to recognise and enforce third-country resolution proceedings.

Resolution authorities may exercise the resolution powers:

(a) in relation to the assets of a third-country institution or parent company that are located in their Member State or governed by the law of their Member State; and
(b) in relation to rights or liabilities of a third-country bank that are booked by the branch located in their Member State or governed by the law of their Member State, or where claims in relation to these rights and liabilities are enforceable in their Member State;
(c) in relation to the parent undertaking, subsidiaries or branches located in their Member State, if this is necessary in order to enforce the third-country resolution proceedings.[435]

433 Article 97 BRRD.
434 Framework Cooperation Arrangement between the EBA and the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the U.S. Securities and Exchange Commission, and the New York State Department of Financial Services
435 Article 94 BRRD.

If assets, rights, liabilities, shares or other instruments of ownership are located in third countries or governed by the law of a third country, the BRRD provides that the resolution authorities may require cooperation from the third country resolution authority. If it is highly unlikely that the transfer, conversion or action will become effective, the resolution authority should not proceed. Any order that has already been given would be void in such a situation.[436]

> The BRRD also provides that banks have to include a contractual term by which the creditor or party to the agreement creating the liability recognises that the liability may be subject to the PONV conversion power and the bail-in tool and agrees to be bound by any reduction of the principal or outstanding amount due, conversion or cancellation effected by the exercise of those powers by a resolution authority, provided that this liability is (a) not excluded from the bail-in scope on the basis of Article 44(2) BRRD, (b) not a semi-covered deposit, (c) governed by the law of a third country and (d) issued or entered into after 1 January 2016.[437] This obligation does not apply where the resolution authority of a Member State determines that the liabilities or instruments can be subject to the PONV conversion power or bail-in tool pursuant to the law of the third country or to a binding agreement concluded with that third country.[438]

The European resolution college - or the respective resolution authorities, where no European resolution college is established, - may also refuse to recognise or enforce third-country resolution proceedings, if it considers that (i) these would have adverse effects on financial stability in a Member State, (ii) if in relation to a branch, independent resolution action is necessary to achieve one or more of the resolution objectives, (iii) creditors would not receive the same treatment as third-country creditors, (iv) there would be material fiscal implications for the Member State or (v) the effects of this recognition or enforcement would be contrary to the national law.[439]

436 Article 67 BRRD.
437 Article 55(1) BRRD. See also Chapter V, Section 1 Delegated Regulation (EU) 2016/1075.
438 Article 55(1) BRRD. BRRD II amends Article 55 BRRD and introduces a new Article 71a in respect of contractual recognition of resolution stay powers.
439 Article 95 BRRD.

Lastly, the BRRD provides for the possibility for resolution authorities of Member States to resolve a Union branch.[440]

4.6.3.2 Coordination with third country authorities within the SRM

In order to ensure a coherent approach vis-à-vis third countries, the taking of divergent decisions in the participating Member States with respect to the recognition of resolution proceedings conducted in third countries in relation to institutions or parent undertakings which have subsidiaries or other assets, rights or liabilities located in the participating Member States should be avoided as far as possible. The SRB is therefore enabled to enter into non-binding cooperation arrangements in line with the EBA framework cooperation arrangements.[441]

> At the time of writing this dissertation, the SRB had entered into a cooperation agreement with the Canada Deposit Insurance Corporation (CDIC), the US Federal Deposit Insurance Corporation (FDIC), the Central Bank of Brazil, the National Bank of Serbia, the Mexico's Institute for the Protection of Bank Savings and the Bank of Albania.[442]

As long as the Commission has not entered into agreements with third countries, or these do not govern the recognition and enforcement of third-country resolution proceedings, the SRB shall assess and issue recommendations to the national resolution authorities on the recognition and enforcement of resolution proceedings conducted by third-country resolution authorities in relation to third-country institutions or parent undertakings that have one or more subsidiaries in participating Member States or assets, rights or liabilities located in one or more participating Member States or governed by the law of these Member States. The SRB can recommend to refuse the recognition or enforcement of these resolution proceedings for the same reasons that the European resolution college can refuse recognition or enforcement. National resolution authorities have to implement the recommendations of the SRB or explain why they cannot do so. [443]

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440 Article 96 BRRD.
441 Article 32(4) BRRD.
442 The cooperation arrangements are available on the website of the SRB: https://srb.europa.eu.
443 Article 33 SRMR.

4.7 Treatment of the bank in resolution

This section discusses the consequences that resolution may have for a bank. When a bank is placed in resolution, it may be subject to a certain restructuring of the capital and funding structure, internal governance and/or business activities of this bank. A bank may also be (partly) wound up in normal insolvency proceedings as part of the resolution process. The restructuring and liquidation process are discussed in the following sections.

4.7.1 Restructuring

Section 3.7.1, discussed that the award of State aid to failing banks is, in principle, accompanied by a restructuring obligation. This is set out in a restructuring plan and can imply structural, behavioural or corporate governance measures. The restructuring is meant to limit distortion of competition and/or to safeguard the return to long-term viability. Under the resolution framework, no such explicit general restructuring obligation exists, unless the bail-in tool is used for recapitalisation purposes. However, the resolution framework provides for the possibility to impose an *ex ante* restructuring obligation through the recovery and resolution plan processes.

4.7.1.1 Recovery and resolution plan

A recovery plan could imply changes to the business organisation of a bank, either to facilitate the update of the plan and its implementation in the future or because the process has identified some impediments complicating the implementation of recovery options. Those organisational preparatory and follow-up actions to be taken by the bank or the group should be described in the recovery plan in order to facilitate effective assessment of whether its implementation is reasonably likely, and to facilitate monitoring of its implementation by the bank or the group, and by competent and resolution authorities, respectively.[444] If a competent authority is of the view that the recovery plan submitted by the bank is not sufficient in that respect, it can impose additional restructuring requirements.[445]

444 Recital (12) Delegated Regulation (EU) 2016/1075.
445 Article 6(4)-(7) BRRD.

In addition, the resolution authority can impose restructuring requirements on a bank through the resolvability assessment. This assessment is made at the same time as and for the purpose of the drawing up and updating of the resolution plan. The requirement for resolution authorities to draw up a resolution plan is suspended until measures proposed by the bank to remove the substantive impediments to resolvability have been accepted or, if the measures proposed by the bank are insufficient, decided on by the resolution authority.[446]

The recovery and restructuring plan also have to provide for the necessary restructuring *in recovery and resolution*. The recovery plan has to include a sufficient number of plausible and viable recovery options which make it reasonably likely that the bank or group would be able to counter different scenarios of financial distress quickly and effectively.[447] The resolution plan has to include a detailed description of the different resolution strategies that could be applied according to the different possible scenarios and the applicable timescales.[448] The resolution authorities are however not bound by the provisions of the recovery and resolution plan.

> In the case of Banca Popolare di Vicenza and Veneto Banca, the resolution plans, adopted in 2015, provided for both banks' resolution action. However due to the loss of significance over the years following on the adoption of the resolution plan, the SRB determined in 2017 that resolution was no longer necessary to protect the public interest.[449] In the case of Banco Popular, the resolution plan provided for the application of the bail-in tool, while the SRB eventually decided to apply the sale of business tool after exercising the PONV conversion power.[450] The resolution or liquidation action that is eventually applied to a failing bank can therefore be very different than foreseen in the resolution plan.

4.7.1.2 Business reorganisation plan

The BRRD and SRMR do not provide for the obligation to draft a restructuring plan, once the bank is in resolution. Only, in case the bail-in tool is applied for recapitalisation purposes to a bank in resolution, a business

446 Articles 15(3) and 17(2) BRRD.
447 EBA Comparative Report on Recovery Options 2017, p. 3.
448 Article 10(7)(j) BRRD.
449 Lastra and Olivares-Caminal 2018, p. 14.
450 Lastra and Olivares-Caminal 2018, p. 15.

reorganisation plan has to be drafted by (the management body of) this bank.[451] The business reorganisation plan can take into account the information contained in the recovery plan and the resolution plan, to the extent that this information is still relevant to the restoration of the long-term viability of the bank and taking into account the application of the bail-in tool.[452]

The business reorganisation plan has to include:

1. A detailed diagnosis of the factors and problems that caused the bank to fail or to be likely to fail and the circumstances that led to its difficulties;
2. A short description of crisis prevention and crisis management measures where these have been applied by the competent authority, the resolution authority or the bank before the submission of the business reorganisation plan;[453]
3. A description of the measures aiming to restore the long-term viability of the bank or its parent company or parts of its business that are adopted;
4. A timetable for implementation of those measures;[454]
5. The projected financial performance of the bank or its parent company during the reorganization period;[455]
6. Sufficient information to allow the resolution authority and the competent authority to assess the feasibility of the proposed measures (viability assessment).[456]

<u>Ad 3: Measures to restore the long-term viability of the bank</u>

The business reorganisation plan has to set out the measures aiming to restore the long-term viability of the bank or its parent company or parts of its business within a reasonable timescale. These measures may, for example, include the reorganisation of the activities of the bank, changes to the operational systems and infrastructure, the withdrawal from loss-making activities, restructuring of existing activities and the sale of assets or business lines.[457] The long-term viability of a bank is deemed restored following resolution if, at the latest by the end of the reorganisation period, the

451 Article 51(1) BRRD.
452 Recital (3) Delegated Regulation (EU) 2016/1400.
453 Article 2(1)(b) Delegated Regulation (EU) 2016/1400.
454 Article 52(5) BRRD.
455 Article 3 Delegated Regulation (EU) 2016/1400.
456 Article 4 Delegated Regulation (EU) 2016/1400.
457 Article 52(4) and (6) BRRD.

bank or banking group is capable of fulfilling its internal capital adequacy assessment process, and all the relevant prudential and other regulatory requirements on a forward-looking basis, and it has a viable business model that is also sustainable in the long-term.[458] Restoration of the long-term viability, even under the worst-case scenario, may not involve further application of resolution tools beyond the scope of the resolution scheme under implementation when the business reorganisation plan was drawn up.[459]

Monitoring arrangements

Although monitoring arrangements do not form part of the business reorganisation plan, the management body or the person or persons appointed by the resolution authority has to implement the business reorganisation plan as agreed by the resolution authority and competent authority, and has to submit a report to the resolution authority at least every six months on progress in the implementation of the plan.[460]

4.7.1.3 Removal or replacement of the management body and senior management

One of the resolution principles is to replace the management body and senior management of the bank, except when the retention thereof is considered necessary for the achievement of the resolution objectives. In accordance with this resolution principle, the resolution power to remove or replace the management body and senior management[461] should therefore normally be exercised as part of the restructuring in resolution, unless the retention thereof is considered necessary for the achievement of the resolution objectives.

> Resolution authorities may appoint a special manager to replace the management body of the bank in resolution. This is made public by the relevant resolution authority. The special manager may exercise all the powers of the shareholders and the management body of the bank under the control of the resolution authority. The special manager has the statutory duty to take all the measures necessary to promote the resolution objectives and implement resolution

458 Recital (6) Delegated Regulation (EU) 2016/1400.
459 EBA Guidelines on the minimum criteria to be fulfilled by a business reorganisation plan, par. 2.6.
460 Article 52(10) BRRD. Article 6 Delegated Regulation (EU) 2016/1400.
461 Article 63(1)(l) BRRD.

actions according to the decision of the resolution authority.[462] These measures may include an increase of capital, reorganisation of the ownership structure or takeovers by entities that are financially and organisationally sound.[463]

4.7.1.4 Continuity arrangements

Resolution authorities have the power to require a bank in resolution, or any of its group companies, to provide any services or facilities that are necessary to enable a recipient to operate effectively the business transferred to it.[464] The services and facilities are restricted to operational services and facilities and do not include any form of financial support.[465] The services or facilities should be provided on the same terms as they were provided under the agreement with the bank in resolution. Where there is no such agreement, the services or facilities have to be provided on reasonable terms.[466]

In addition, when resolution authorities exercise a resolution power, they have the power to provide for the recipient (that is, the private sector purchaser, asset management vehicle or bridge institution to which, where applicable, shares, other instruments of ownership, rights, liabilities or assets are transferred) to be treated as if it were the bank in resolution. This includes in particular the continuity of contracts entered into by the bank in resolution and the substitution for the bank in resolution in any legal proceedings relating to financial instruments, assets, rights or liabilities that have been transferred. However, rights of employees to terminate contracts of employment and rights of parties to a contract, including the right to terminate this contract, in accordance with the terms of the contract by virtue of an act or omission by the bank in resolution prior to the relevant transfer, or by the recipient after the relevant transfer, cannot be affected.[467]

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462 Article 35(1), (2) and (3) BRRD.

463 The special manager should not be confused with the temporary administrator that can be appointed by the competent authority in the early intervention phase in accordance with Article 29 BRRD.

464 Article 65(1) BRRD.

465 Article 65(3) BRRD.

466 Article 65(4) BRRD. Article 37(6) BRRD.

467 Article 64(1)(d), (3) and (4) BRRD.

4.7.2 Winding up under normal insolvency proceedings

Once the resolution authority has taken the decision to put the bank in resolution, normal insolvency proceedings should be excluded except, if they need to be combined with the use of the resolution tools and at the initiative of the resolution authority.[468] In the event of a partial transfer of assets of a bank in resolution to a private sector purchaser or to a bridge bank, the residual part of the bank in resolution should be wound up in normal insolvency proceedings.[469] In addition, where the operations of a bridge institution are terminated, because two years have lapsed since the date on which the last transfer from a bank in resolution pursuant to the bridge institution tool was made, or, in case this period was extended, the extended period of time has lapsed, or the bridge institution's assets are completely wound up and its liabilities are completely discharged, the bridge institution has to be wound up in normal insolvency proceedings.[470] Also in relation to the asset separation tool, it is stated that its purpose is to maximise the value of the assets transferred to it through sale or winding up in an orderly manner.[471]

The winding up process itself is not in scope of the resolution regime. This is still subject to the national insolvency proceedings of the Member States in combination with the Reorganisation and Winding Up Directive.

> The SRB and the ECB have called for further harmonization of insolvency law. The divergence of national insolvency laws is considered a major obstacle towards a fully-fledged European Banking Union.[472]

If a bank fails or is likely to fail and the conditions for resolution are not met, it should in principle be wound up in normal insolvency proceedings. The winding up of a failing bank through normal insolvency proceedings should always be considered before resolution tools are applied.[473]

468 Recital (44) BRRD.
469 Recital (50) BRRD. Article 37(6) BRRD.
470 Article 41(8) BRRD.
471 Article 42(3) BRRD.
472 EP Insolvency Law Briefing 2018, p. 1.
473 Recital (46) BRRD.

The power of the SRB to decide that a bank should be put in liquidation, if the resolution conditions are not met is contested by ABLV Bank in an action brought before the CI on 3 May 2018.[474] At the time of writing this dissertation, the CI had not yet assessed the case. Ms König, Chair of the SRB, emphasized that the FOLTF assessment does not automatically link to the criteria for insolvency/liquidation. Ms Nouy, Chair of the SSM, suggested to amend Article 32 BRRD to add as a criterion for liquidation under national law a FOLTF declaration. This should make clear that absent 'public interest', banks would need to be liquidated under national insolvency law and not resolved.[475] BRRD II introduces a new Article 32b which requires Member States to ensure that a bank in relation to which the resolution authority considers that the resolution conditions, besides the public interest condition, are met, should be wound up in an orderly manner in accordance with the applicable insolvency law.

4.8 Third party treatment

If a bank is placed in resolution, this has not only consequences for the bank itself, but also for its shareholders, creditors and counterparties. For example, shares, other instruments of ownership, rights, assets or liabilities may be transferred to another party, capital instruments and eligible liabilities may be subject to write down or conversion powers or contracts may be cancelled or modified. This section discusses the provisions of the resolution framework that deal with the treatment of third parties.

4.8.1 Transfer of shares, other instruments of ownership, assets, rights or liabilities

If the sale of business or bridge institution tool is applied to a bank in resolution,[476] this may lead to the transfer of the shares or other instruments of ownership issued by the bank to another market party or a bridge institution, respectively (hereinafter referred to as a share transfer). The sale of business tool and bridge institution tool can also be applied to a bank in

474 CI, T-280/18, Action brought on 3 May 2018 (*ABLV Bank v SRB*).
475 EP Insolvency Law Briefing 2018, p. 3.
476 The resolution tools may also be applied to the parent undertakings of banks. This section should be read as also including the application of resolution tools at that level.

resolution to transfer any assets, rights or liabilities of the bank to another market party or a bridge institution, respectively (hereinafter referred to as an asset transfer). This can also take place under the asset separation tool in order to transfer assets, rights or liabilities of the bank or a bridge institution to an asset management vehicle.

4.8.1.1 Consent and procedural requirements

Share transfers and asset transfers can take place without having to obtain the consent of the shareholders of the bank or any third party other than the purchaser or the bridge institution, and without having to comply with any procedural requirements under company or securities law.[477] These transfers may take effect free from any liability or encumbrance affecting the shares or other ownership instruments.[478] In addition, the rules under national insolvency law relating to the voidability or unenforceability of legal acts detrimental to creditors do not apply to asset transfers by virtue of the application of the sale of business, bridge institution or asset separation tool.[479]

If the transfer concerns listed shares or other instruments of ownership, the resolution authority may require the relevant authority to discontinue or suspend the admission to trading on a regulated market or the official listing of these financial instruments.[480]

4.8.1.2 Consideration

The consideration paid for a share transfer or an asset transfer is based on the *ex ante* valuation (Valuation 2). Where a provisional valuation was made instead of an *ex ante* valuation, the consideration can be adjusted based on the *ex post* valuation, if the valuation's estimate of the net asset

477 Article 38(1), last paragraph, Article 40(1), last paragraph and Article 42(1), last paragraph BRRD. Member States may however require that the application of the sale of business, bridge institution or asset separation tool is subject to *ex ante* judicial approval, provided that the procedure relating to the application for approval and the court's consideration are expeditious (Article 85(1) BRRD). In addition, Member States have to ensure that all persons affected by a decision to apply the asset separation tool have the right to appeal against that decision (Article 85(3) BRRD).

478 Articles 63(1)(c) and (d) and 64(1)(a) BRRD.

479 Article 37(8) BRRD.

480 Article 64(1)(c) BRRD.

value (NAV) of the bank in resolution is higher than the provisional valuation's estimate.[481]

Any consideration paid for a share transfer by the purchaser (under the sale of business tool) or the bridge institution (under the bridge institution tool) benefits the owners of the shares or other instruments of ownership that are transferred.[482] Any proceeds generated as a result of the termination of the operation of the bridge institution benefit the shareholders of the bridge institution. The resolution authority and any resolution fund may recover any reasonable expenses properly incurred in connection with the use of the bridge institution tool from these proceeds as a preferred creditor.[483]

Any consideration paid for an asset transfer by the purchaser, bridge institution or asset management vehicle benefits the bank in resolution or the bridge institution, where applicable.[484] In case of application of the asset separation tool, this may be paid in the form of debt issued by the asset management vehicle.[485]

4.8.1.3 Partial transfer

The sale of business and bridge institution tool may also be used to transfer only part of the shares, instruments of ownership, assets, rights or liabilities.[486] In case of application of the sale of business or bridge institution tool (not in combination with the asset separation tool), the residual bank or parent company from which the shares, other instruments of ownership, assets, rights or liabilities are partly transferred, has to be wound up in normal insolvency proceedings.[487] Shareholders and creditors of the bank in resolution whose shares, other rights of ownership, assets, rights or liabilities have not been transferred, do not have any rights over or in relation to the shares, other rights of ownership, assets, rights or liabilities that are transferred.[488]

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481 Article 36(11) BRRD.
482 Article 38(4), Article 40(4) BRRD.
483 Article 41(8), last paragraph BRRD.
484 Article 38(4), Article 40(4) BRRD. In case the asset separation tool is applied in combination with the bridge institution tool, the asset management vehicle may purchase assets, rights or liabilities from the bridge institution. Article 42(8) BRRD.
485 Article 42(7) BRRD.
486 Article 37(6) BRRD.
487 Article 37(6) BRRD.
488 Article 38(13), Article 40(11) and Article 42(12) BRRD.

For example, in the case of the resolution of the Portuguese bank BANIF, the shareholders had no longer available the set of assets and liabilities that had been sold to Banco Santander Totta or transferred to the asset management vehicle.[489]

4.8.1.4 Safeguards

The safeguards provide that, where resolution authorities transfer only parts of the rights, assets and liabilities issued by the bank in resolution, the shareholders and those creditors whose claims have not been transferred, receive in satisfaction of their claims at least as much as what they would have received, if the bank in resolution had been wound up in normal insolvency proceedings at the time when the resolution decision was taken.[490] For this purpose, a valuation (Valuation 3) is carried out.[491]

In addition, counterparties to title transfer financial collateral arrangements, set-off and netting arrangements, security arrangements, structured finance arrangements and covered bonds[492] are protected, if a resolution authority transfers some but not all of the assets, rights or liabilities of a bank in resolution to another entity.[493] This applies irrespective of the number of parties involved in the arrangements.[494] The protection entails that the partial transfer of the covered assets, rights or liabilities under these arrangements is prevented, unless this is necessary to ensure availability of the covered deposits.[495] In addition, if a resolution authority transfers some but not all of the assets, rights or liabilities of a bank in resolution to another entity, this may not affect the operation and rules of clearing and settlement systems.[496]

489 Banco de Portugal, Information on Banif – frequently asked questions, 15 January 2016.
490 Article 73(a) BRRD.
491 Articles 74 and 75 BRRD. Article 20(16) SRMR. Article 76(1)(e) SRMR. Delegated Regulation (EU) 2018/344. Delegated Regulation (EU) 2016/1075. See section 4.5.5.
492 See Delegated Regulation (EU) 2017/867 for a further specification of the classes of arrangements to be protected.
493 Article 76 BRRD.
494 Article 76(3) BRRD.
495 Articles 77, 78 and 79 BRRD.
496 Article 80 BRRD.

4.8.2 *The exercise of the PONV conversion power and the application of the bail-in tool*

Where the PONV conversion power is exercised and/or the bail-in tool is applied, the purpose is to (i) ensure that the net asset value (NAV) of the bank in resolution is (at least) equal to zero (that is, the level of liabilities does not exceed the level of assets), and (ii) the CET 1 capital ratio is restored. The application of the bail-in tool also serves to sustain sufficient market confidence in the bank, and to allow it to carry on the activities, for which it was authorized, for at least one year.[497]

> The bail-in tool may also be used to establish the ratio of a bridge institution, meet the capital needs of an asset management vehicle or enable a transfer under the sale of business tool.

4.8.2.1 Exercise of resolution powers

The PONV conversion power and the bail-in tool are exercised/applied by the resolution authorities through the following resolution powers:
1. to cancel shares or other instruments of ownership issued by a bank in resolution,
2. to transfer shares or other instruments of ownership to bailed-in creditors,
3. to dilute existing shareholders and holders of other instruments of ownership by converting relevant capital instruments or eligible liabilities in shares or other instruments of ownership,
4. to require a bank to issue new capital instruments,
5. to reduce – to zero – the principle or outstanding amount due in respect of eligible liabilities or the nominal amount of shares or other instruments or ownership. [498]

<u>Ad 1 and 2: Cancellation of instruments of ownership or transfer of instruments of ownership to bailed-in creditors</u>
In order to restore the NAV, existing shares or other instruments of ownership issued by a bank in resolution may either be cancelled[499] or transferred to bailed-in creditors. When the NAV is zero or negative, resolution

497 Article 46(2) BRRD. Schillig 2016, p. 293.
498 Article 63(1)(e) up to (i) BRRD.
499 Cancellation means that the shareholders' economic claims and other rights of ownership are completely erased on those shares. EBA Guidelines on the treatment of shareholders in bail-in, p. 3.

authorities should cancel or transfer in full all shares or other instruments of ownership. When the NAV is positive, the extent of cancellation or transfer should be partial and ensure that shareholders retain at least the NAV.[500] In that case, cancellation or transfer is combined with dilution.

Ad 3: Dilution of instruments of ownership by conversion
In order to restore the CET 1 capital ratio of a bank, shares or other types of capital instruments may be diluted as a result of the conversion of capital instruments and eligible liabilities into shares or other types of capital instruments at an 'appropriate rate of conversion'.[501] Restoring the CET 1 capital ratio through dilution is only possible, when the bank in resolution has a positive NAV.

In order to ensure an 'appropriate rate of conversion' the conversion has to be conducted at a rate of conversion that severely dilutes existing holdings of shares or other instruments of ownership.[502] This entails that both the shareholders' percentage of ownership of the bank and the value of the instruments of ownership must be reduced, unless this would breach the safeguards set out in section 4.8.2.4 (more specifically, the NCWO-principle).[503] The conversion rate has to represent appropriate compensation to the affected creditors for any loss incurred by virtue of the exercise of the PONV conversion power and/or the application of the bail-in tool. A different conversion rate may be applied to different classes of capital instruments and liabilities, as long as the conversion rate represents the appropriate compensation and the conversion rate applicable to liabilities that are considered to be senior under applicable insolvency law is higher than the conversion rate applicable to subordinated liabilities.[504]

Ad 5: Reduction of principal amount of eligible liabilities
In certain circumstances, it may not be sufficient to cancel or transfer shares or other instruments of ownership in order to restore the NAV of a bank in resolution. In such a case, eligible liabilities must be written down.[505] In that case, it will be necessary to write down, at least partially, creditors

500 EBA Guidelines on the treatment of shareholders in bail-in, p. 5. See also Janssen 2019, p. 151-152.
501 Article 46(1)(b) and Article 47(1)(b) BRRD. Schillig 2016, p. 294.
502 Article 47(1), last paragraph BRRD.
503 EBA Guidelines on the treatment of shareholders in bail-in, p. 6.
504 Article 50 BRRD. See also EBA Guidelines on the rate of conversion of debt to equity in bail-in.
505 Article 46(1)(a) BRRD.

more senior in insolvency to shares or other instruments of ownership. Writing down other creditors while shareholders retain some value would be inconsistent with both the required sequence of write-down and the respect for the creditor hierarchy in insolvency.[506]

A reduction of the principal amount of eligible liabilities is permanent.[507] No compensation is paid.[508] Only, where the level of the reduction is found to exceed requirements when assessed against the *ex post* valuation,[509] a write-up mechanism may be applied to reimburse creditors to the extent necessary.[510]

Where a resolution authority reduces to zero the principal amount of, or outstanding amount payable in respect of, an eligible liability, that liability and any obligations or claims arising in relation to it not accrued at the time when the power is exercised shall be treated as discharged for all purposes, and shall not be provable in any subsequent proceedings in relation to the bank in resolution or any successor entity in any subsequent winding up.[511] Where a resolution authority reduces in part, but not in full, the principal amount of, or outstanding amount payable in respect of, an eligible liability, the liability shall be discharged to the extent of the amount reduced, and the relevant instrument or agreement that created the original liability shall continue to apply in relation to the residual principal amount of, or outstanding amount payable in respect of the liability, subject to any modification of the amount of interest payable to reflect the reduction of the principal amount, and any further modification of the terms that the resolution authority might make.[512]

4.8.2.2 Procedural requirements

The bank should maintain at all times a sufficient amount of authorized share capital or other CET 1 instruments, so that, in the event that the resolution authority exercises the PONV conversion power or the bail-in tool, the bank is not prevented from issuing sufficient new shares or other

506 EBA Guidelines on the treatment of shareholders in bail-in, p. 5.
507 Article 60(2)(a) BRRD.
508 Article 60(2)(c) BRRD.
509 According to Article 36(10) BRRD.
510 Article 46(3) BRRD. An *ex post* valuation is carried out, in case only a provisional *ex ante* valuation could take place (Article 36(10) BRRD).
511 Article 53(3) BRRD.
512 Article 53(4) BRRD. See also Janssen 2019, p. 143-151.

instruments of ownership to ensure that the conversion of eligible liabilities into shares or other instruments of ownership could be carried out effectively.[513] The resolution authority can decide to lay down this requirement in the resolution plan.[514]

If the PONV conversion power is exercised or the bail-in tool is applied, the reduction of principal or outstanding amount due, conversion or cancellation takes effect and is immediately binding on the bank in resolution and affected creditors and shareholders.[515] The resolution authorities have the power to complete or require the completion of all the administrative and procedural tasks necessary to give effect to the application of the PONV conversion power or the bail-in tool, including (a) the amendment of all relevant registers, (b) the delisting or removal from trading of debt instruments, (c) the listing or admission to trading of new shares or other instruments of ownership, or (d) the relisting or readmission of any debt instruments which have been written down, without the requirement of issuing a prospectus.[516]

4.8.2.3 DNO requirement

Where the application of the bail-in tool or the exercise of the PONV conversion power would result in the acquisition of or increase in a qualifying holding in a bank, competent authorities shall carry out the assessment for the required declaration of no objection (DNO) in a timely manner that does not delay the application of the bail-in tool or the exercise of the PONV conversion power, or prevent resolution action from achieving the relevant resolution objectives. If the competent authority has not completed the assessment required on the date of application of the bail-in tool or the exercise of the PONV conversion power, any acquisition of or increase in a qualifying holding by an acquirer as a result thereof still has immediate legal effect. However, during the assessment period and during any divestment period (if the competent authority opposes an acquisition of shares or other instruments of ownership), the acquirer's voting rights attached to these shares or other instruments of ownership shall be suspended and vested solely in the resolution authority, which has no obligation to exercise any such voting rights and which has no liability

513 Article 54(1) BRRD.
514 Article 54(2) BRRD.
515 Article 53(1) BRRD.
516 Article 53(2) BRRD.

whatsoever for exercising or refraining from exercising any such voting rights.[517]

4.8.2.4 Safeguards

Where resolution authorities apply the bail-in tool, the shareholders and creditors whose claims have been written down or converted to equity do not incur greater losses than they would have incurred if the bank in resolution had been wound up in normal insolvency proceedings immediately at the time when the resolution decision was taken (this is the NCWO principle, as discussed in section 4.5.5).[518] Please note that this safeguard only applies in relation to the application of the bail-in tool. It does not in itself apply in relation to the exercise of the PONV conversion power.[519]

> In relation to retail investors, the exercise of the PONV conversion power and the application of the bail-in tool may have consequences that are undesirable despite the applicable safeguards. As a result, in practice, certain compensatory measures are taken, although this is not arranged for under the resolution framework. Santander has for example launched a EUR 1 billion scheme to compensate retail clients that acquired shares and subordinated debt issued by Banco Popular in Spain.[520] See also section 7.5.4.2.

4.8.3 Cancellation and modification of contractual terms

The resolution authorities have the power to cancel or modify the terms of a contract to which the bank in resolution is a part or substitute a recipient as a party.[521] The resolution authorities also have the power to amend or alter the maturity of debt instruments and other eligible liabilities or alter the amount of interest payable or the date on which the interest becomes payable, including by suspending payment for a temporary period, the power to close out and terminate financial contracts or derivatives contracts.[522]

517 Article 47(4) and (5) and Article 38(9) BRRD.
518 Article 73(b) BRRD.
519 EBA Guidelines on the rate of conversion of debt to equity in bail-in , par. 1.4. See however sections 4.5.2.2 and 4.5.5.
520 FT, Mexian investors ask ECJ to overturn Banco Popular sale, 4 August 2017.
521 Article 64(1)(f) BRRD.
522 Article 63(1)(j) and (k) BRRD.

An example of the exercise of this power can be found in the resolution of HETA. The maturity of all debt instruments issued by HETA, other liabilities and outstanding amounts, which already existed before 1 March 2015, was altered to the date on which the decision to liquidate HETA will be taken or 31 December 2023, whichever is earlier. In addition, the interest rate for eligible liabilities and relevant capital instruments issued by HETA was set at 0% with effect from 1 March 2015.[523]

4.8.3.1 Safeguards

Counterparties to title transfer financial collateral arrangements, set-off and netting arrangements, security arrangements, structured finance arrangements and covered bonds[524] are protected, if a resolution authority cancels or modifies the terms of a contract to which the bank in resolution is a party.[525] This applies irrespective of the number of parties involved in the arrangements.[526] The protection entails that the cancellation and modification of these arrangements is prevented, unless this is necessary to ensure availability of covered deposits.[527] In addition, if a resolution authority cancels or modifies the terms of a contract to which the bank in resolution is a party, this may not affect the operation and rules of clearing and settlement systems.[528]

4.8.4 Further restrictions of rights

In addition to the possibilities for resolution authorities to cancel, modify, reduce and/or convert the rights of shareholders, creditors and counterparties of a bank in resolution, the resolution authorities can also remove, suspend and restrict these rights as further set out below.

523 Financial Market Authority, Notification of the application of resolution measures in respect of Heta Asset Resolution AG according to Article 116 para 5 BaSAG.
524 See Delegated Regulation (EU) 2017/867 for a further specification of the classes of arrangements to be protected.
525 Article 76 BRRD.
526 Article 76(3) BRRD.
527 Articles 77, 78 and 79 BRRD.
528 Article 80 BRRD.

4.8.4.1 Removal of right to acquire further shares

The resolution authorities may remove rights of shareholders to acquire further shares or other instruments of ownership.[529]

4.8.4.2 Suspension of payment and delivery obligations

Resolution authorities have the power to suspend any payment or delivery obligations pursuant to any contract to which the bank in resolution is a party from the publication of a notice of suspension[530] until midnight – in the Member State of the resolution authority of the bank in resolution – at the end of the business day following that date of publication.[531] When a payment or delivery obligation would have been due during the suspension period, this obligation is due immediately on expiry of the suspension period.[532] In case of suspension of payment or delivery obligations of the bank in resolution, the payment or delivery obligations of the counterparties of this bank are also suspended for the same period of time.[533] Payment or delivery obligations in relation to eligible deposits, owed to payment and securities settlement systems or operators of these systems, central counterparties and central banks and eligible claims under investor compensation schemes, cannot be suspended.[534]

> While the BRRD already contains provisions allowing the suspension of payment obligations, these have been implemented in very different ways at national level and may not provide a sufficiently consistent application with respect to important elements, such as the scope, phase of application, trigger conditions and duration of the suspension. On this basis, it was proposed by the Commission in its BRRD II Proposal to introduce two additional moratorium tools for activation in the early intervention and resolution phase, respectively.[535] The Commission proposed to amend Article 27 BRRD to provide for a new moratorium tool to be employed in the pre-resolution phase, and specifically as an early intervention power. Article 29a was introduced outlining the conditions of this moratorium

529 Article 64(1)(b) BRRD.
530 In accordance with Article 83(4) BRRD.
531 Article 69(1) BRRD.
532 Article 69(2) BRRD.
533 Article 69(3) BRRD.
534 Article 69(4) BRRD.
535 BRRD II Proposal, p. 7.

tool. In addition, the Commission proposed the amendment of Article 63 BRRD introducing among the general resolution powers the power to suspend payments when this is needed for a maximum of five working days. The proposed moratorium tools were deemed controversial, since they interfere with creditor rights and have the potential for contagion where creditors anticipate a payments stop.[536]

Both moratorium tools, as proposed by the Commission, are not included in BRRD II. Instead, Article 33a BRRD II provides for the power for the resolution authorities to suspend payment or delivery obligations pursuant to any contract to which the bank (or a group entity) is a party under the conditions set out in Article 33a. This provides resolution authorities with the power to suspend payment and delivery obligations outside of resolution. The period of suspension should be a short as possible and in any event not longer than two business days. The power can also be exercised in respect of eligible deposits, as long as the resolution authorities ensure that depositors have access to an appropriate daily amount from those deposits.

4.8.4.3 Suspension of termination rights

Termination rights of any party to a contract with a bank in resolution can be suspended from the publication of the notice of suspension until midnight – in the Member State of the resolution authority of the bank in resolution – at the end of the business day following that publication, provided that the payment and delivery obligations and the provision of collateral continue to be performed. Not only the termination rights of any party to a contract with a bank in resolution can be suspended. Also termination rights of parties to a contract with a subsidiary of such a bank can be suspended, provided that (a) the obligations under that contract are guaranteed or otherwise supported by the bank in resolution, (b) the termination rights under that contract are solely based on the insolvency or financial condition of the bank in resolution or, (c) in the case of transfer due to application of a resolution tool, either (i) all the assets and liabilities of the subsidiary relating to that contract have been or may be transferred to or assumed by the recipient or (ii) the obligations of the subsidiary are

536 Lehmann 2018, p. 14. Fernandez de Lis and Garcia 2018, p. 8.

otherwise adequately protected.[537] If termination rights of parties to a contract with a subsidiary of a bank are suspended, the suspension takes effect from the publication of the notice of suspension until midnight – in the Member State where the subsidiary is established – on the business day following that publication.[538] Termination rights of payment and securities settlement systems or operators of these systems, central counterparties or central banks cannot be suspended.[539]

If termination rights are suspended, these termination rights may still be exercised, if the resolution authority sends a notice to the person concerned that the rights and liabilities covered by the contract are not transferred to another entity or are not subject to write down or conversion on the application of the bail-in tool for recapitalisation purposes.[540] After the expiry of the period of suspension, the termination rights may again be exercised, provided that a resolution action is not, *per se*, deemed to be an enforcement event or insolvency proceedings that triggers a termination right.[541]

Competent authorities or resolution authorities may require a bank in resolution to maintain detailed records of financial contracts in order to be able to exercise the power to temporarily suspend termination rights.[542]

4.8.4.4 Restriction on the enforcement of security rights

Resolution authorities have the power to restrict secured creditors of a bank in resolution from enforcing security interests in relation to any assets of that bank from the publication of a notice of the restriction until midnight – in the Member State of the resolution authority of the bank in resolution – at the end of the business day following that publication.[543] This power may not be exercised in relation to any security interest of payment and securities settlement systems or operators of these systems, central counterparties, and central banks over assets pledged or provided by way of margin or collateral by the bank in resolution.[544]

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537 Article 71(2) BRRD.
538 Article 71(2), last paragraph BRRD.
539 Article 71(3) BRRD.
540 Article 71(4) BRRD.
541 See Article 68 BRRD. Article 71(5) BRRD.
542 Article 71(7) BRRD.
543 Article 70(1) BRRD.
544 Article 70(2) BRRD.

4.8.4.5 Exclusion of certain contractual terms

A resolution action taken in relation to a bank, including the occurrence of any event directly linked to the application of such a measure[545], is not, *per se*, deemed to be an enforcement event or insolvency proceedings, provided that the substantive obligations under the contract, including payment and delivery obligations and the provision of collateral, continue to be performed.[546] Under these circumstances, the application of a resolution action does not, *per se*, make it possible for anyone to exercise any termination, suspension, modification, netting or set-off rights, obtain possession, exercise control or enforce any security over any property of the bank in resolution or any group entity, or affect any contractual rights of the bank in resolution or any group entity.[547] This applies to (a) contracts entered into by the bank or its parent company, (b) contracts entered into by a subsidiary, the obligations under which are guaranteed or otherwise supported by the parent undertaking or by any other group entity, and (c) contracts entered into by any entity of a group which includes cross-default provisions.

In addition, a resolution action, a suspension of payment and delivery obligations or the suspension of termination rights do not constitute non-performance of a contractual obligation. [548]

4.9 Judicial protection

The previous section described that resolution can have a severe impact on a bank, its shareholders, creditors and counterparties. Effective judicial protection therefore is an important tool to safeguard the interests of the parties involved. This section discusses how action can be taken against decisions of the SRB and the national resolution authorities.

545 Including where third country resolution proceedings are recognised or otherwise where a resolution authority so decides.
546 Article 68(1) BRRD.
547 Article 68(3) BRRD. The right to take such actions is not affected, where that right arises by virtue of an event other than the application of a resolution action or the occurrence of any event directly linked to the application of such an action. Article 68(4) BRRD.
548 Article 68(5) BRRD.

4.9.1 Judicial protection against decisions of national resolution authorities

4.9.1.1 *Ex ante* judicial approval

Member States may require that a decision of a national resolution authority to take a crisis prevention measure or a crisis management measure is subject to *ex ante* judicial approval, provided that in respect of a decision to take a crisis management measure, according to national law, the procedure relating to the application for approval and the court's consideration are expeditious.[549]

> A 'crisis prevention measure' means the exercise of powers to direct removal of deficiencies or impediments to recoverability under Article 6(6) BRRD, the exercise of powers to address or remove impediments to resolvability under Article 17 or 18 BRRD, the application of an early intervention measure under Article 27 BRRD, the appointment of a temporary administrator under Article 29 BRRD or the exercise of the PONV conversion powers under Article 59 BRRD.[550] A 'crisis management measure' means a resolution action or the appointment of a special manager under Article 35 BRRD or a person under Article 51(2) BRRD – with the objective of drawing up and implementing the business reorganisation plan – or under Article 72(1) BRRD – to exercise control over the bank in resolution.[551]

Given the requirement for a crisis management measure to be taken urgently, the national court should give its decision within 24 hours and Member States should ensure that the relevant resolution authority can take its decision immediately after the court has given its approval. This is without prejudice to the right that interested parties might have in making an application to the national court to set aside the decision for a limited period after the resolution authority has taken the crisis management measure.[552]

549 Article 85(1) BRRD. Only Belgium and Ireland have made use of this Member State option (IMF Country Report 2018, p. 44).
550 Article 2(1)(101) BRRD.
551 Article 2(1)(102) BRRD.
552 Recital (92) BRRD.

4.9.1.2 Legal proceedings before national courts

Pursuant to Article 85 BRRD, Member States have to provide for a right of appeal against the decision by a national resolution authority to take a crisis prevention measure, the decision to exercise any power other than a crisis management measure, and the decision to take a crisis management measure (such as the decision to put a bank in resolution). These decisions are addressed to the banks in relation to which the measures are adopted or powers are exercised. Standing before national courts depends on national law.

> An example of legal proceedings before a national court against a decision of a national resolution authority can be found in the legal action that has been started by bondholders of BES against the Banco de Portugal after they were retransferred from Novo Banco (the good bank) to BES (the bad bank) thereby effectively wiping out the value of the bonds.[553]

In respect of the review of a decision to take a crisis management measure, Member States have to ensure that the review is expeditious and that national courts use the complex economic assessments of the facts carried out by the national resolution authority as a basis for their own assessment.

> Crisis management measures taken by national resolution authorities may require complex economic assessments and a large margin of discretion. The national resolution authorities are specifically equipped with the expertise needed for making those assessments and for determining the appropriate use of the margin of discretion. Therefore, it is important to ensure that the complex economic assessments made by national resolution authorities in that context are used as a basis by national courts when reviewing the crisis management measures concerned. However, the complex nature of those assessments should not prevent national courts from examining whether the evidence relied on by the resolution authority is factually accurate, reliable and consistent, whether that evidence

553 FT, The Novo Banco debacle and the rule of law in Europe, 19 January 2018. Updates on the legal proceedings can be followed on the website of the bondholders, organized in the Novo Note Group: www.novonotegroup.com.

> contains all relevant information which should be taken into account in order to assess a complex situation and whether it is capable of substantiating the conclusions drawn therefrom.[554]

The lodging of an appeal against a decision to take a crisis management measure does not entail any automatic suspension of the effects of the challenged decision. The decision of the national resolution authority shall be immediately enforceable and it shall give rise to a rebuttable presumption that a suspension of its enforcement would be against the public interest.[555]

Where it is necessary to protect the interests of third parties acting in good faith who have acquired shares, other instruments of ownership, assets, rights or liabilities of an institution under resolution by virtue of the use of resolution tools or exercise of resolution powers by a resolution authority, the annulment of a decision of a resolution authority shall not affect any subsequent administrative acts or transactions concluded by the resolution authority concerned which were based on the annulled decision. In that case, remedies for a wrongful decision or action by the resolution authorities shall be limited to compensation for the loss suffered by the applicant as a result of the decision or act.[556]

Recognition of national resolution measures

The cross-border effect and recognition of national measures implementing a resolution scheme, as well as the recognition of national resolution measures taken by national resolution authorities, is governed by Article 66 BRRD and the Reorganisation and Winding Up Directive. Article 66 BRRD provides that Member states shall ensure that shareholders, creditors and third parties that are affected by the transfer of shares, other instruments of ownership, assets, rights or liabilities under the law of a Member State other than the Member State of the resolution authority or of assets located in another Member State are not entitled to prevent, challenge, or set aside the transfer under any provision of law of this Member State.

> This provision was discussed by the Supreme Court of England in the case that Goldman Sachs brought against Novo Banco in relation to the Oak liability before that court based on the jurisdiction

554 Recital (89) BRRD. Schillig 2016, p. 117.
555 Article 85(3) and (4) BRRD.
556 Article 85(4) BRRD. See also Tegelaar and Haentjens 2019, p. 280-281.

clause in the facility agreement between BES and Oak Finance.[557] In a judgment of 4 July 2018, the Supreme Court of England assessed that Article 66 BRRD is limited to preventing challenges of 'transfers'. It was therefore not applicable in the case of Goldman Sachs against Novo Banco, because the Oak liability had never been transferred. However, it assessed that Article 3 of the Reorganisation and Winding Up Directive requires the recognition of the entire process of reorganization under the BRRD as a result of which an English court was bound to recognise the effect of decisions taken by the Portuguese resolution authority as a matter of Portuguese law as a result of which the Oak liability had not been transferred. Novo Banco therefore never was party to the jurisdiction clause on the basis of which the English courts had jurisdiction. [558] This is important case-law in respect of the recognition of bank resolution measures originating in another Member State.

Lastly, Member States have to ensure that, if necessary for the effective application of the resolution tools and powers, resolution authorities may request the court to apply a stay for an appropriate period of time in accordance with the objective pursued, on any judicial action or proceeding in which a bank in resolution is or becomes a party.[559] In addition, Member States have to ensure that normal insolvency proceedings may not be commenced against the bank in resolution, except at the initiative of the resolution authority. A decision placing a bank into normal insolvency proceedings may only be taken with the consent of the resolution authority.[560]

4.9.1.3 Reference for preliminary ruling to ECJ

Decisions of national resolution authorities are subject to review by the national courts and not by the EU Courts. National courts may however make a reference for a preliminary ruling to the ECJ on the basis of Article 267 TFEU.[561]

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557 See section 4.5.3.2 for the facts in this case.
558 Supreme Court in England, 4 July 2018, [2018] UKSC 34 (*Goldman Sachs v Novo Banco*), point 28. See also Tegelaar and Haentjens 2019, p. 285-286.
559 Article 86(3) BRRD. See also Article 70 BRRD for the resolution stay that may be imposed on the enforcement of security interests.
560 Article 86(1) and (2) BRRD.
561 The EU Courts also have jurisdiction to review any action brought against the SRB for failure to act (Article 265 TFEU) or to determine the non-contractual liability of the SRB (Article 268 TFEU). Recital (120) SRMR. Article 86(3) SRMR.

> Examples of references for preliminary rulings can be found in the case of Iccrea Banca against Banca d'italia and State Street Bank against Banca d'Italia, both in relation to the contributions for the national resolution fund.[562]

4.9.1.4 Decisions of national resolution authorities within the SRM

National resolution authorities can also take decisions within the SRM. These can involve the decision to put a bank in resolution (e.g., if it concerns a less significant bank), but also the decision to take measures to implement the resolution scheme adopted by the SRB.[563] Recital (120) SRMR states that national judicial authorities should be competent to review the legality of decisions adopted by the resolution authorities of the participating Member States in the exercise of the powers conferred on them by the SRMR.[564]

> At the time of writing this dissertation, only the decision of the Spanish resolution authority (the FROB) on the implementation of the resolution scheme adopted by the SRB in relation to Banco Popular was available. In this decision it is stated that appeal should be lodged before national courts.[565]
>
> Haentjens notes that in relation to the decisions taken by national resolution authorities to take measures to implement the resolution scheme adopted by the SRB, it may also be that the appeal against it must be lodged with the EU Courts directly, if the resolution scheme does not leave the national resolution authority much margin of discretion.[566]
>
> Recital (120) SRMR was explained by the ECJ in the *Iccrea Banca* case. By decisions adopted between 2015 and 2017, the Bank of Italy sought from Iccrea Banca the payment of ordinary, extraordinary

562 ECJ, C-414/18, Request for a preliminary ruling from the Tribunale Amministrativo Regionale per il Lazio (Italy) lodged on 22 June 2018 (*Iccrea Banca SpA Istituto Centrale del Credito Cooperativo v Banca d'Italia*). ECJ, C-255/18, Request for a preliminary ruling from the Tribunale Amministrativo Regionale per il Lazio (Italy) lodged on 11 April 2018 (*State Street Bank International GmbH v Banca d'Italia*).

563 See paragraph 5.1 for the division of tasks between the SRB and the national resolution authorities.

564 See also Tegelaar and Haentjens 2019, p. 267,

565 FROB Resolution 2017, p. 15-16.

566 Haentjens 2017, p. 162-163.

and additional contributions to the Italian national resolution fund. Further, by a communication the Bank of Italy sought from Iccrea Banca, for the year 2016, payment to the SRF of an *ex ante* contribution determined by a decision of the SRB. Iccrea Banca brought an action against those decisions and communication before the *Tribunale amministrativo regionale per il Lazio*. This Italian Court decided to request for a preliminary ruling from the ECJ. The ECJ subsequently had to decide on the admissibility of this request, specifically in relation to the calculation of the contributions to the SRF. On 9 July 2019, Advocate-General Campos Sánchez-Bordona delivered an opinion. In this opinion, he considers that in composite administrative procedures in which national authorities and EU authorities are involved, the exercise of the final decision-making power is the crucial factor for determining whether the EU Courts or the national courts must conduct a judicial review. He discusses that ordinary contributions to the SRF are determined through a composite administrative procedure in which the national resolution authorities are involved, but the final decision falls to the SRB. In respect of Recital (120) SRMR, he mentions that this recital refers to the review by national courts of the decisions of national resolution authorities in areas in which the SRMR grants them decision-making power.[567] The ECJ considers that where EU law prescribes that an EU body, office or agency is to have an exclusive decision-making power, it falls to the EU Courts, by virtue of their exclusive jurisdiction to review the legality of EU acts on the basis of Article 263 TFEU, to rule on the legality of the final decision adopted by the EU body, office or agency concerned and to examine, in order to ensure effective judicial protection of the persons concerned, any defects vitiating the preparatory acts or the proposals of the national authorities that would be such as to affect the validity of that final decision. The ECJ refers to its judgment in the case *Berlusconi v Fininvest*,[568] in which it has held that, where the EU legislature opts for an administrative procedure under which the national authorities adopt acts that are preparatory to a final decision of an EU institution which produces legal effects and is capable of adversely affecting a person, it

567 Opinion of Advocate-General Campos Sánchez-Bordona, 9 July 2019, C-414/18, ECLI:EU:C:2019:574 (*Iccrea Banca SpA Istituto Centrale del Credito Cooperativo v Banca d'Italia*), par. 34-36 and 54.

568 ECJ, 19 December 2018, C-219/17, EU:C:2018:1023 (*Berlusconi v Fininvest*).

seeks to establish between the EU institution and the national authorities a specific cooperation mechanism which is based on the exclusive decision-making power of the EU institution. In order for such a decision-making process to be effective, there must necessarily be a single judicial review, which is conducted, by the EU Courts alone, only once the decision of the EU institution bringing the administrative procedure to an end has been adopted, a decision which is, alone, capable of producing binding legal effects such as to affect the applicant's interests by bringing about a distinct change in his legal position. Moreover, the ECJ confirms the observation by the Advocate-General in respect of Recital (120) SRMR. The ECJ concludes that the aspects of the question referred which relate specifically to the calculation of the *ex ant*e contributions to the SRF must be held to be inadmissible.[569]

4.9.2 Judicial protection against decisions of the SRB

4.9.2.1 Access to the Appeal Panel of the SRB

Certain decisions of the SRB may be contested before the Appeal Panel of the SRB, provided that such a decision is of direct and individual concern to the contestant.[570] These decisions include the decisions in relation to resolvability measures, the application of simplified obligations in relation to drafting resolution plans, the MREL, fines, contributions to the administrative expenditures of the SRB, extraordinary *ex post* contributions to the SRF and refusal of access to documents.

In the aftermath of the resolution of Banco Popular, 74 appeals concerning this resolution were submitted to the Appeal Panel. Of the 74 appeals, 54 appeals have been declared inadmissible. [571] Several of these appeals related to the SRB decision in the resolution of Banco Popular to refuse access to documents. With 11 decisions issued on 19 June 2018, the Appeal Panel concluded that yet further disclosure of documents related to the Banco Popular resolution was necessary.

569 ECJ, 3 December 2019, C-414/18, ECLI:EU:C:2019:1036 (*Iccrea Banca SpA Istituto Centrale del Credito Cooperativo v Banca d'Italia*), par. 39-54, 74.

570 Article 85(3) SRMR. The criteria for standing before the Appeal Panel are similar to those for an annulment action pursuant to Article 263 TFEU. See section 3.9.2.1.

571 SRB, Annual Report 2017, p. 53.

In the course of 2018, the Panel adopted also a number of decisions related to the obligation of banks to contribute to the system of administrative contributions.[572]

4.9.2.2 Legal proceedings before the EU courts

Proceedings may be brought before the EU Courts in accordance with Article 263 TFEU contesting a decision taken by the Appeal Panel or, where there is no right of appeal to the Appeal Panel, by the SRB.[573]

Decisions from the Commission (endorsing the resolution scheme adopted by the SRB) and the Council (to object to the resolution scheme) are also subject to judicial review under Article 263 TFEU, unless they would not qualify as a 'reviewable act'.[574]

Decisions of the SRB that are not subject to review by the Appeal Panel include, *inter alia*, the decision to adopt a resolution scheme, the decision not to put a bank in resolution and the decision on compensation of shareholders and creditors in respect of which resolution actions have been effected.

In the case of Banco Popular, the SRB has decided on a preliminary basis that no compensation is required.[575] In order for the SRB to be able to take its final decision on whether compensation needs to be granted, the SRB has invited the affected shareholders and creditors to express interest in exercising their right to be heard regarding the preliminary decision of the SRB. At the time of writing this dissertation, no final decision had yet been published.

As discussed in section 3.9.2, under Article 263 TFEU, there are four requirements for actions of annulment:

1. The act must be reviewable.
2. The challenge must be made within the specified time limit.

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572 Yearly overview of the Panel's Activities, available on the website of the SRB: www.srb.europa.eu.

573 Article 86(1) and (2) SRMR.

574 See also Recital (120) SRMR. See Tegelaar and Haentjens 2019, p. 269.

575 Announcement with regard to the Notice of the Single Resolution Board of 2 August 2018 regarding its preliminary decision on whether compensation needs to be granted to the shareholders and creditors in respect of which the resolution actions concerning Banco Popular Español SA have been effected and the launching of the right to be heard process (SRB/EES/2018/132).

3. The individual must have an interest in seeing the contested measure annulled.
4. The individual must have *locus standi*.

At the time of writing this dissertation, the EU Courts had not yet decided in relation to actions against decisions of the SRB. It is therefore to be seen which decisions of the SRB will be regarded by the EU Courts as reviewable acts and which individuals will have an interest and *locus standi*.[576]

It can already be indicated that the SRB, being an EU agency, enjoys in principle a certain degree of discretion. Review by the EU Courts is then limited, according to settled case law, to verifying whether procedural rules and the duty to state reasons have been complied with, whether the facts have been accurately stated and whether there has been a manifest error of assessment or a misuse of powers.[577]

In addition, the resolution scheme adopted by the SRB is addressed to the national resolution authorities.[578] The bank that is put in resolution, its shareholders, creditors and counterparties are therefore considered third parties. This means that they only have the possibility to challenge the resolution scheme, if they meet the requirements of Article 263(4) TFEU, that is to say, the decision is of direct and individual concern to them as further detailed in the *Plaumann* case.[579] Schillig argues that a bank put in resolution meets the requirements of Article 263(4) TFEU in relation to a resolution scheme adopted by the SRB, since this refers to this particular bank and determines the resolution tools to be applied to this bank.[580] In addition, it could be argued that these requirements are also met in relation to shareholders, creditors or counterparties of this bank, when they are directly affected by the application of a resolution tool.[581]

576 See Tegelaar and Haentjens 2019, p. 269-277.
577 See e.g. Appeal Panel, 19 June 2018, Joined cases 44/2017 and 7/2018 (*Appelant v SRB*), par. 28, 36, 43, 50. See also Grünewald 2014, p. 98-100; Tegelaar and Haentjens 2019, p. 277-279.
578 Article 18(9) SRMR.
579 See section 3.9.2.1 for a further discussion of Article 263(4) TFEU.
580 Schillig 2016, p. 119. See also ECJ, 3 December 2019, C-414/18, ECLI:EU:C:2019:1036 (*Iccrea Banca SpA Istituto Centrale del Credito Cooperativo v Banca d'Italia*), par. 65.
581 Schillig 2016, p. 119.

Legal proceedings brought by banks
Actions have been brought by banks before the EU Courts against the SRB, mainly in relation to the payment of *ex ante* contributions to the SRF.[582] In addition, ABLV Bank brought an action against the decision of the SRB to not adopt resolution measures.[583]

Legal proceedings brought by shareholders, creditors or counterparties
The decision of the SRB as a result of which Banco Popular has been taken over by Santander for EUR 1, after equity and subordinated debt was written down and converted, as well as the Commission decision endorsing this decision have been the reason for numerous actions brought before the EU Courts. Arguments used in the cases range from that the bank was not failing or likely to fail and other private sector measures could have averted the need for resolution to infringement of right to property and the right to an effective legal remedy. In most cases the applicants request annulment of the relevant decisions. In several cases, there is an additional request for compensation of damages. Finally, a number of applicants request the annulment of provisions of the SRMR.[584]

In addition to reviewing the legality of and annulling decisions adopted by the SRB, the EU Courts also have jurisdiction to:

(i) review an action brought against the SRB for failure to act, in accordance with Article 265 TFEU by Member States, EU institutions, as well as any natural or legal person;

582 Lannoo 2019, p. 17. 15 legal actions have been brought against the SRB before the GC (SRB Annual Report 2018, p. 46). The European Banking Institute maintains a regularly updated overview of all cases pending against the SRB on its website: www.ebi-europa.eu.

583 CI, T-280/18, Action brought on 3 May 2018 (*ABLV Bank v SRB*).

584 Lannoo 2019, p. 17. 99 legal actions concerning the resolution of Banco Popular have been brought against the SRB before the GC. The GC has identified and selected six pilot cases to proceed to the second round of written procedure and oral hearing. The remaining cases have been suspended pending a final determination in the six pilot cases (SRB Annual Report 2018, p. 45-46). See also the website of the European Banking Institute for a regularly updated overview of all cases pending in relation to Banco Popular: www.ebi-europa.eu. A number of actions have been dismissed as manifestly inadmissible (GC, 24 September 2018, T-618/17, ECLI:EU:T:2018:608 (*Activa Minoristas del Popular v ECB and SRB*), GC, 27 October 2017, T-473/17, ECLI:EU:T:2017:778 (*Javier Jarabo Sancho c.s. v SRB*), ECJ, 5 July 2018, C-731/17 P, ECLI:EU:C:2018:546 (*Nap Innova Hotels v SRB*)).

(ii) give preliminary rulings on request of national judicial authorities on the validity and interpretation of acts of the SRB in accordance with Article 267 TFEU; and
(iii) determine the non-contractual liability of the SRB in accordance with Article 268 TFEU.

Request for preliminary ruling
The Italian *Tribunale Amministrativo Regionale per il Lazio* requested a preliminary ruling in the case of Iccrea Banca versus the *Banca d'Italia* in respect of the contributions that banks are required to pay to the SRF and the national resolution funds. This case has been discussed in section 4.9.1.4.

4.9.2.3 Suspected misuse of the SRF

In addition to access to the EU Courts, any person, undertaking or association whose interests may be affected by the use of the SRF shall have the right to inform the Commission of any suspected misuse of the SRF incompatible with the Commission's decision.[585]

4.10 Conclusion

The GFC showed that general corporate insolvency procedures may not always be appropriate for banks as they may not always ensure sufficient speed of intervention, the continuation of the critical functions of institutions and the preservation of financial stability.[586] This formed the justification to take away the power to determine resolution from courts and confer these on administrative authorities, the resolution authorities.

Taking into account that failure of banks is not only a national problem, solving this cannot remain in the hands of national governments alone. However, in order to successfully transfer power from the Member States to a supranational level, there must be sufficient political consensus and trust between all parties involved. The BRRD harmonized procedures for resolving banks at EU level, in order to submit resolution authorities to the same principles and to provide them with the same set of tools in order to achieve the resolution objectives. With the introduction of the SRB and the

585 Article 19(7) SRMR.
586 Recital (4) BRRD.

SRF, not only harmonisation, but also centralisation of the resolution process at supranational level took place within the European Banking Union.

Although the resolution framework has successfully been established, the devil is – as always – in the detail. The resolution framework is, mainly due to its dual structure, both on Eurozone and national level, at some points hard to read and fathom. In addition, the complexity of resolution, both in terms of involvement of the number of actors, and the procedural outline, makes that the concept of resolution is difficult to grasp, not only for the bank itself, but also for its shareholders and creditors. At the same time, resolution can have far reaching consequences. The case of Banco Popular, the first resolution case in which the SRB took the lead, shows that shareholders and subordinated debt holders can be confronted with a situation in which their shares and other capital instruments are written down without any compensation. Many of them started legal proceedings at the EU Courts. At the time of writing this dissertation, the EU Courts had not yet delivered a material judgment in these proceedings.

The resolution framework was already subject to revision, while it has barely seen its first practical applications. With the further development of its practicalities over the coming years, there will undoubtedly be many more causes for revisions of this framework. Amendments have to be carefully considered though, in light of the cohesion with other legal frameworks, such as company law, insolvency law, and State aid law.

PART 2

From State aid regime to EPFS policy:

Regulating public funding of failing banks in the EU after the introduction of the resolution framework

CHAPTER 5

THE IMPACT OF THE RESOLUTION FRAMEWORK ON THE ACCESS TO PUBLIC FUNDING FOR FAILING BANKS

> *"Even (…) enhanced resolution frameworks (…) cannot completely rule out the possibility that official financial intervention will be necessary in the future. Resolution tools aimed at resolving failing banks in an orderly and cost-efficient manner will typically require resolution financing, even if only temporarily. In a crisis, financing will often only be available from the official sector in sufficient amounts."*
>
> *Grünewald 2014, p. 29-30.*

5.1 Introduction

This chapter assesses and analyses the impact of the resolution framework on the access to public funding as a remedy for failing banks. This impact can be described as (the attempt to) restrict the access to and use of public funding by failing banks. The delicacy of this impact has already been demonstrated by the turmoil in Italy, including, *inter alia*, the bail-out of Banca Popolare di Vicenza and Veneto Banca with the help of Atlante, a private-sector backstop fund – and their subsequent liquidation – and the 'precautionary recapitalisation' of Banca Monte Dei Paschi di Siena (MPS). In these cases, Italy tried to find a way to fund banks without applying the strict resolution framework, including its bail-in requirements. In the case of Banca Popolare di Vicenza and Veneto Banca, the funds received from Atlante were not considered State aid. The subsequent liquidation of Banca Popolare di Vicenza and Veneto Banca, including the award of State aid, took place outside the scope of the resolution framework. Although the recapitalisation of MPS did involve the award of State aid, it did not trigger resolution as the recapitalisation qualified as a so-called precautionary recapitalisation. By its actions, Italy may have stretched the limits that the resolution framework sets on the access to public funding, as a result of which the resolution objective of protecting public funds may be jeopardized. But, it may also be a signal that the current resolution framework is not flexible enough, thereby jeopardizing the objective of financial stability.[1]

1 Contiguglia 2017. Donnelly and Asimakopoulos *JCMS* 2019.

Section 5.2 explains the concepts of EPFS and ELA that have been introduced in the resolution framework to regulate the access to public funding. Sections 5.3 and 5.4 subsequently discuss the access to EPFS and ELA under the resolution framework. Section 5.5 discusses the impact of the resolution framework on the access to public funding as a remedy for failing banks and identifies the hurdles in restricting this access. Section 5.6 concludes this chapter.

5.2 The concepts of EPFS and ELA

This section explains the concepts of EPFS and ELA as introduced in the resolution framework.

5.2.1 The concept of EPFS

EPFS is defined in Article 2(1)(28) BRRD as "*State aid within the meaning of Article 107(1) TFEU, or any other public financial support at supranational level, which, if provided for at national level, would constitute State aid, and that is provided in order to preserve or restore the viability, liquidity or solvency of an institution or group entity of such institution*".[2] Therefore, the term EPFS does not only include State aid, as discussed in section 3.3, but also 'other public financial support at supranational level, which, if provided for at national level, would constitute State aid' (hereinafter referred to as supranational EPFS).

> The concept of State aid has not changed with the introduction of the concept of EPFS in the resolution framework. If funding qualifies as State aid, it is subject to the compatibility assessment by the Commission under Articles 107 and 108 TFEU. If funding does not qualify as State aid, it can be granted without the Commission's approval. Notwithstanding the foregoing, supranational public funding that does not qualify as State aid (such as SRF contributions) is made subject to State aid control, as discussed below.

5.2.1.1 Supranational EPFS

With the introduction of the EPFS concept, the resolution framework not only regulates access to State aid, but also to supranational EPFS.

2 Article 2(1)(28) BRRD; Article 3(1)(29) SRMR.

> In order to even further break the link between Member States and failing banks, new public funding sources have been made available at supranational level, without the (direct) interference of Member States. An example is the SRF, which has been built up from 1 January 2016, and the direct recapitalisation instrument of the ESM (ESM DRI), available since December 2014.

The second limb of the definition of EPFS, relating to supranational EPFS, was included in the BRRD following an amendment by EP Member Lamberts.[3] The amendment included the wording "*or any other public financial support at supra-national level*". The motivation for this amendment reads: "*support provided via the ECB, EFSF, ESM or indeed third countries (for example the 'bailout' of EU banks by the US after Lehman) is also public money. A bank whose viability depends on any such support should be allowed to fail unless the cost to the taxpayer would be greater, in which case the resolution tools should be used.*"

The European Parliament subsequently further amended the definition of EPFS to its current wording, i.e. the words "*which, if provided at national level, would constitute State aid*" were added.[4] In the absence of a further explanation to this addition, it seems that these words try to express that not all supranational support constitutes EPFS. This means that the assessment whether supranational aid and national aid qualify as EPFS is based on the same criteria. That is for national aid, does the aid qualify as State aid, or for supranational aid, would it qualify as State aid, if provided at national level?

After the GFC, two forms of supranational EPFS were introduced to preserve or restore the viability, liquidity or solvency of a bank or group entity of such bank in the Eurozone: the ESM and the SRF. The definition of EPFS is, however, not restricted to these types of supranational funding; other forms of supranational public funding may fall within the definition of EPFS. Other – future – forms of supranational public funding may, for example, be support by the European Investment Bank (EIB).[5] Furthermore, EP Member Lamberts mentioned aid provided by third countries as a potential form of EPFS. This form of aid does not fall

3 Amendment 295, Philippe Lamberts, on behalf of the Verts/ALE Group, Amendments 141-383, 2012/0150(COD), p. 95.
4 Amendments by the European Parliament to the Commission proposal, p. 36.
5 Almunia and Hoyer 2014.

within the geographical scope of the EU State aid rules, as it is not granted through State resources of a Member State. It is also no form of supranational support. Thus, it is not entirely clear in the author's view how this would fit within the definition of EPFS.

Some forms of supranational EPFS *also* qualify as State aid. For example, the ESM is funded through capital contributions from the participating Member States of the SSM, and the money it raises in the financial markets. The highest decision-making body of the ESM is the ESM Board of Governors. It comprises government representatives responsible for finance from each participating Member State. The ESM Board of Governors decides on the provision of stability support and the choice of instruments and financial terms and conditions.[6] These decisions need to be taken by unanimity. The ESM can support banks through the indirect recapitalisation instrument and the direct recapitalisation instrument (the ESM DRI). In case of indirect recapitalisation by the ESM, assistance is still channelled via the Member State. As a result, the latter cannot escape the application of the State aid rules.[7] In the case of direct recapitalisation, the assistance is, however, directly granted by the ESM; the Member States do not form part of the assistance chain. The question therefore is whether any aid granted by the ESM under the application of the ESM DRI is imputable to one or more Member States. As the ESM benefits from the capital provided by the participating Member States and their finance ministers make up the ESM Board of Governors, it could be argued that is the case. The result would be that the application of the ESM DRI also falls within the scope of the State aid rules.[8]

This is different for the SRF which is funded by *ex ante* and *ex post* contributions from banks and banking groups established in the Eurozone. If contributions are not sufficient, amounts may be raised from alternative funding means, such as from Member States. The SRF is managed by the SRB. Whether or not SRF contributions qualify as State aid, is perceived differently amongst authors. Kokkoris states that the SRF may be considered State aid,[9] while Gray and De Cecco state that given the private origin of its resources and given that these resources are not managed by Member States but by an EU agency (the SRB), the use of the SRF would

6 Article 5(6)(f) ESM Treaty.
7 ESM, FAQ on the ESM, 3 February 2015, p. 13.
8 Borger 2015, p. 166-167.
9 Kokkoris 2017, p. 18.

not normally fall within the scope of the notion of State aid.[10] In the absence of any case-law from the EU Courts, the author tends to concur with Gray and De Cecco, also taking into account that the SRB has to act independently from the Member States.[11]

However, as a result of the final wording of the definition of EPFS, it actually does not matter whether supranational EPFS qualifies as State aid or not. Either way, it qualifies as EPFS, provided that it concerns a selective intervention and constitutes an economic advantage that the recipient would not have received in the normal course of its business and that has the potential to distort competition and affect trade between EU Member States.[12] In addition, the practical relevance of the qualification of supranational EPFS as State aid is also limited for the application of the State aid rules, because the supranational funding instruments are made subject to the State aid rules.[13]

> The distinction between EPFS and State aid may therefore be of a highly theoretical nature. What matters, is the public nature of the funds and the potential distortive effects that the decision to use them may have on competition.

5.2.1.2 To preserve or restore viability, liquidity or solvency

The BRRD and SRMR consider only public funding that is provided "*in order to preserve or restore the viability, liquidity or solvency*" of a bank or group entity of the bank to be EPFS. In other words, only if public funding – be it national or supranational – has a certain objective, does it fall in scope of the EPFS concept. State aid granted to a bank does not always have the objective of preserving or restoring the viability, liquidity or solvency of the bank, it can also be granted for other purposes, such as liquidation. This form of aid falls outside the scope of the definition of EPFS.

10 Gray and De Cecco 2017, p. 51. See also Iftinchi 2017, p. 76. See also Bacon 2017, p. 369.
11 Article 47(1) and (2) SRMR.
12 Bruzzone, Cassella and Micossi 2017, p. 532.
13 Article 19 SRMR. Article 1(3) ESM DRI Guideline.

> Whether or not aid qualifies as EPFS, was a question that the Commission had to answer in its assessment of a measure of indirect aid to banks granted by Cyprus.[14] The Commission assessed that the definition of EPFS does not encompass any type of aid, but only aid whose objective is "*to preserve or restore the viability, liquidity or solvency*" of a bank. The objective of the measure at hand was twofold: the aid objectively pursued the social goal of Article 107(2)(a) TFEU and the goal of addressing the social hardships particular to the vulnerabilities faced by owners of micro and small businesses under Article 107(3)(c) TFEU. The Commission assessed that in both cases, the predominantly social objective indicated that the aid scheme's objective was not to preserve or restore the viability, liquidity or solvency of a bank. It was also unlikely that it would result in any material effect on any of the financial institutions' viability, liquidity or solvency. The Commission therefore assessed that the measure did not qualify as EPFS.[15]

The definition of EPFS is not restricted to rescue or restructuring aid granted to remedy a serious disturbance in the economy of a Member State on the basis of Article 107(3)(b) TFEU. It can also involve rescue or restructuring aid granted to facilitate the development of certain economic activities or of certain economic areas on the basis of Article 107(3)(c) TFEU. This will be relevant, if the Commission decides to change the legal basis for its assessment of rescue and restructuring aid awards in the banking sector back to Article 107(3)(c) TFEU.[16]

> The objective of the ESM DRI is to preserve the financial stability of the Eurozone as a whole and of its Member States, by catering for those specific cases in which a participating Member State of the SSM experiences acute difficulties with its financial sector that cannot be remedied without significantly endangering its fiscal sustainability due to a severe risk of contagion from the financial sector to the sovereign. The use of this instrument could also be considered, if other alternatives would have the effect of endangering the

14 This question is important as the Commission cannot approve aid as compatible with the internal market if it breaches another intrinsically linked provision of Union law, including the resolution framework. See section 6.3.2.

15 EC, 3 December 2018, C(2018) 8080 final (SA.49554 – Cyprus), par. 70-77.

16 At the time of writing this dissertation, there are no indications that this will happen.

> continuous market access of a participating Member State.[17] The use of the ESM DRI is restricted to the specific purpose of recapitalizing institutions. It may not be used for winding up institutions.[18] Taking into account this objective and restrictions, the ESM DRI is per definition used to preserve or restore the viability or solvency of a bank.
>
> The SRF may only be used for the purpose of ensuring the efficient application of the resolution tools and exercise of the resolution powers.[19] The resolution objectives do not, as such, include the objective of preserving or restoring viability, liquidity or solvency of a bank of a group entity. The continuity of critical functions should be ensured and adverse effects on financial stability should be avoided. It is however not necessarily said that this should be done by preserving or restoring the viability, liquidity or solvency of a bank. The bank may also be put in liquidation while critical functions are transferred to another bank under the sale of business tool. The SRF can also be used in such a situation. It seems to be unintended that this use of the SRF falls outside the scope of EPFS. This could be clarified by supplementing the objective of EPFS with "*or to resolve the bank or its group by applying resolution tools and powers*".[20]

5.2.2 The concept of ELA

One form of public funding receives special treatment within the resolution framework. This is emergency liquidity assistance (ELA) granted by national central banks. ELA does not qualify as State aid, if certain conditions are met, and it also does not qualify as supranational EPFS.

> At the time of writing this dissertation, ELA is granted at national level through the national central banks. Although the ECB has been conferred the exclusive competence to conduct the Eurozone monetary policy,[21] the task of providing ELA to banks in the Eurozone is

17 Article 2(1) ESM DRI Guideline.
18 Article 2(2) and (3) ESM DRI Guideline.
19 Article 67(2) SRMR.
20 The same applies to the use of the national resolution funds.
21 Article 127(2) TFEU, Article 3 of the Statute of the ESCB and ECB.

not explicitly conferred on the ECB by the TFEU.[22] The Governing Council of the ECB may, however, restrict ELA operations. Some have argued that the ECB should have more competencies for the provision of ELA, at least with regard to those banks directly supervised by the ECB, and that this step would be necessary to complete the European Banking Union, not least because banking groups with significant operations outside their home country may find it difficult to get access to ELA, if required.[23] One should, however, be aware that centralisation would deviate significantly from the existing ELA practice. Given significant differences in the current national ELA arrangements, this move would surely prove highly controversial among the participating Member States. However, in the author's view, such a step would indeed be desirable, also taking into account the potential development of Eurosystem Resolution Liquidity, as further discussed in section 5.5.2.2.

The BRRD defines emergency liquidity assistance (ELA) as *"the provision by a central bank of central bank money, or any other assistance that may lead to an increase in central bank money, to a solvent financial institution, or group of solvent financial institutions, that is facing temporary liquidity problems, without such an operation being part of monetary policy'"*.[24]

This definition of ELA does not include the conditions set out in the 2013 Banking Communication under which ELA does not qualify as State aid. It is therefore not clear whether, under the resolution regime, it is intended to use the term 'ELA' only in relation to support by national central banks that does not qualify as State aid (and, therefore, EPFS). Arguments for the intention that ELA, as defined within the BRRD, does not fall within the scope of the EPFS concept can be found in (a) the fact that the BRRD includes a separate definition of ELA, besides the definition of EPFS,[25] and (b) the fact that ELA is mentioned as a separate category of funding besides EPFS, that may not be assumed in the drafting of resolution plans (as further discussed in section 5.4.5.1). It would, however,

22 Schimmelfennig *WEP* 2016, p. 493. Zilioli considers that this can however be considered to be an implied power of the competence to conduct the monetary policy of the Eurozone. According to her view, banks in the Eurozone have access to ELA through the relevant national central banks on the basis of the decentralised implementation of monetary policy (Zilioli 2015, p. 52). Grünewald mentions that the ECB at the very least has a facilitating role to play (Grünewald 2014, p. 183-189).
23 EP Financing Arrangements Briefing 2018, p. 12. Gortsos 2015, p. 65-70.
24 Article 2(1)(29) BRRD.
25 See also Hadjiemmanuil *EE* 2016, p. 107.

have been helpful, if the definition of ELA in the BRRD had clarified that ELA is meant to be central bank support that does not constitute State aid; in other words, that meets the conditions set out in the 2013 Banking Communication.

This is without prejudice to the fact that ELA can qualify as State aid if the conditions under the 2013 Banking Communication are not met. This is, for example, the case if ELA is guaranteed by a Member State. State guaranteed ELA hence qualifies as EPFS. ELA also qualifies as EPFS if it is granted in conjunction with other support measures.

> This was, for example, the case for the ELA granted to Panellinia Bank. Any cost and the risks arising from the provision of ELA were incurred by the Bank of Greece.[26] This ELA constituted State aid, because it was State guaranteed and it was granted in conjunction with other support measures. In addition, the other conditions to qualify the State-guaranteed ELA as State aid (e.g. selectivity, advantage, distortion of competition) were also met.[27]
>
> The Belgium State changed the law in order to withdraw the statutory State guarantee for ELA extended by the central bank of Belgium in order to ensure that this no longer constituted State aid. As a consequence, the central bank could extend ELA without the need either to obtain the Commission's prior approval or to apply burden-sharing measures.[28] One should, however, be aware that the shareholders of the national central banks in the Member States are (almost always) the Member States themselves. Therefore, even if there is no State guarantee, if there is a serious default under an ELA, the national budget of the Member State involved – as the shareholder of the central bank – will still be impinged. See also section 5.5.2.4.

5.2.2.1 Standard and extraordinary monetary policy operations

Provision of ELA amounts to a crisis prevention tool that falls within the remit of national central banks as part of their mandate to ensure financial stability.[29] National central banks can also provide liquidity assistance, other than ELA, through standard and extraordinary monetary policy operations.

26 EC, 16 April 2015, C(2015) 2606 final (SA.41503 – Panellinia Bank), par. 40.
27 EC, 16 April 2015, C(2015) 2606 final (SA.41503 – Panellinia Bank), par. 49-51.
28 ECB Opinion 2016.
29 EP Financing Arrangements Briefing 2018, p. 2.

The resolution framework, for example, also mentions central bank liquidity assistance provided under non-standard collateralisation, tenor and interest rate terms.[30] This is a form of an extraordinary monetary policy operation.[31]

> Article 10(3)(c) BRRD provides that the resolution plan may not assume any central bank liquidity assistance provided under non-standard collateralisation, tenor and interest rate terms to the bank. This may also not be assumed in the resolvability assessment (Article 15(1)(c) BRRD). Article 36(5) BRRD provides that Valuation 1 and 2 may not assume any central bank liquidity assistance provided under non-standard collateralisation, tenor and interest rate terms to the bank.

Standard monetary policy operations include the monetary policy tools of open market operations and standing facilities, including the marginal lending facility – in order to obtain overnight liquidity from a national central bank, against the presentation of sufficient eligible assets – and the deposit facility – in order to make overnight deposits with a national central bank.

Only banks that qualify as eligible counterparties within the meaning of Part Three of the ECB Guideline on the implementation of the Eurosystem monetary policy framework can have access to the Eurosystem monetary policy operations. The eligibility criteria include the criterion that the bank is financially sound[32] and subject to supervision by a competent authority.[33] Standard and extraordinary monetary policy operations do not qualify as State aid or EPFS.[34] They also do not qualify as ELA.

> Both the recovery and resolution plan should, where applicable, include an analysis of how and when a bank may apply, in the conditions addressed by the plan, for the use of central bank facilities, and identify those assets which would be expected to qualify as collateral.[35]

30 See e.g. Articles 10(3)(c), 15(1)(c) and 36(5) BRRD.
31 Bertsch and Molin *Sveriges Riksbank economic review* 2016, p. 105.
32 See Article 55a ECB Guideline on the implementation of the Eurosystem monetary policy framework on the assessment of the financial soundness of institutions.
33 Article 55 ECB Guideline on the implementation of the Eurosystem monetary policy framework.
34 2013 Banking Communication, point 62.
35 Article 5(4) and 10(4) BRRD; Article 8(7) SRMR.

5.3 Access to EPFS under the resolution framework

This section discusses the access to EPFS under the resolution framework. It starts with a description of the assessment framework that sets the criteria for access to EPFS. Subsequently, it discusses the restrictions set in relation to access to EPFS in and outside of resolution.

5.3.1 The assessment framework

In respect of the access to EPFS, not only the resolution framework, consisting of the BRRD and SRMR, is relevant, but also the SRF Agreement, the ESM Treaty, and the ESM DRI Guideline. Together, these law sources form the framework on the basis whereof the access to EPFS should be assessed, besides the State aid regime for the banking sector.

> The assessment framework for access to EPFS under the State aid regime for the banking sector is discussed in Chapter 6.

5.3.2 EPFS as a trigger for resolution

As set out in section 4.5.1.1, resolution authorities have to take a resolution action if the resolution conditions are met in relation to a bank. These conditions are that, (i) the bank is failing or likely to fail (FOLTF), (ii) there is no reasonable prospect that any alternative private sector measure or supervisory action would prevent the failure of the bank within a reasonable timeframe, and (iii) the resolution action is necessary in the public interest.

A bank is considered to be FOLTF, *inter alia*, where EPFS is required. As a result, resolution is triggered where EPFS is granted – provided that the other resolution conditions are also met. An exemption applies for the situation in which EPFS was provided before the introduction of the resolution framework.[36] In addition, the resolution framework provides that three specific EPFS measures do not qualify as trigger for resolution, as discussed in the next section.

36 Recital (41) BRRD. Recital (57) SRMR.

The assessment whether or not EPFS is required is made by the competent authority after consulting the resolution authority.[37] It is not clear from the resolution framework how the competent authority should determine that EPFS is 'required' by a bank. The Member States have discretion in their decision to award State aid or to request the ESM for the use of the ESM DRI. The same applies to the SRB in respect of the use of the SRF. The determination by a competent authority that a bank is FOLTF, because it requires EPFS, cannot restrict this discretion. As a consequence, the conclusion of the relevant competent authority that EPFS is required by a bank cannot create an enforceable right of that bank on the award of such EPFS.[38]

5.3.2.1 Precautionary guarantees and precautionary recapitalisation

Three aid measures do not qualify as trigger for resolution. These exempted aid measures are:

1. State guarantees to back liquidity facilities provided by central banks according to the central banks' conditions;
2. State guarantees of newly issued liabilities (the State guarantees under 1. and 2. are hereinafter together referred to as 'precautionary guarantees');
3. An injection by a Member State of own funds[39] or purchase of capital instruments (CET 1, AT 1 or Tier 2 instruments) issued by a bank, including a bank which is publicly owned (also referred to as 'precautionary recapitalisation').[40]

<u>Ad 2:</u> Member State guarantees for equity claims are prohibited.[41] The State guarantees mentioned under 2 can therefore only be provided in relation to liabilities other than equity, e.g. bonds.

37 This assessment can also be made by the resolution authority after consulting the competent authority, where such resolution authority has the necessary tools for making such determination (Article 32(1)(a) BRRD; Article 18(1), second paragraph SRMR).
38 See also ECJ, 19 July 2016, C-526/14, ECLI:EU:C:2016:570 (*Kotnik v Slovenia*), par. 61-69.
39 Own funds are defined in Article 2(1)(38) BRRD as "*own funds as defined in point (118) of Article 4(1) CRR*".
40 Article 32(4)(d) BRRD. Article 18(4)(d) SRMR.
41 Recital (41) BRRD.

Ad 3: A subgroup of the EU Financial Services Committee has argued in a report that "*If the conditions in Article 32(4) BRRD / Article 18(4) SRMR (…) are met, it seems conceivable, based on the legislative text, to provide a credit institution with aid in the form of precautionary recapitalisation so as to finance an impaired asset measure (…) i.e. the bank's NPLs would be bought by an AMC supported by the state at a transfer price which can be higher than the estimated market price but not higher than their real economic value, provided this is equivalent to a temporary injection of own funds or purchase of capital instruments.*"[42] According to this argumentation, a precautionary recapitalisation could therefore also entail an impaired asset measure, which makes the scope of EPFS that does not trigger resolution (even) broader. At the time of writing this dissertation, this has not yet happened. It is therefore still to be seen whether this argumentation resonates in practice. For completeness sake, the Italian securitization scheme (*Garanzia sulla Cartolarizzazione delle Sofferenze, 'GACS'*)[43] and the Greek Hellenic asset protection scheme (Hercules, based on the Italian securitization scheme)[44] could have been examples, because they are guarantee schemes under which a State guarantee covers the senior tranches of securitisation structures containing NPLs from banks' balance sheets. The Commission however considered that both schemes do not qualify as State aid, as a result of which they do not qualify as EPFS.[45] Article 32(4)(d) BRRD (Article 18(4)(d) SRMR) is therefore not applicable.

At the time of writing this dissertation, there were a few examples of precautionary guarantees awarded by Member States and precautionary recapitalisations conducted by Member States following the approval of the Commission under the State aid regime for the banking sector.

42 Council of the European Union, Report of the FSC Subgroup on Non-Performing Loans, 31 May 2017, ECOFIN 481, p. 100-101.

43 EC, 10 February 2016, C(2016) 873 final, (SA.43390 – Italian Securitization Scheme), paras. 79-80.

44 EC, 10 October 2019, C(2019) 7309 final (SA.53519 - Hellenic Asset Protection Scheme).

45 According to the Commission: "*under the State guarantee scheme chosen by the Italian authorities, the State will be remunerated in line with market conditions for the risk it will assume by granting a guarantee on securitised nonperforming loans. (…) If a Member State intervenes as a private investor would do and is remunerated for the risk assumed in a way a private investor would have accepted, then such interventions do not constitute State aid*." EP Bail-in Analysis 2016. EC, 10 February 2016, C(2016) 873 final (SA.43390 – Italy) and EC, 6 September 2017, C(2017) 6050 final (SA.48416 – Italy).

Examples of precautionary guarantees
In the resolution of BES, Portugal transferred State guaranteed bonds issued by BES to the value of EUR 3,750 million to the created bridge bank. These were issued under the Portuguese Guarantee Scheme approved earlier by the Commission. The liquidity provided to the bridge bank through the State Guaranteed bonds therefore constituted State aid, albeit that it was already approved and awarded prior to the resolution of BES. On 15 December 2015, Portugal extended the maturity of the bonds by one year, as well as the government guarantee. The Portuguese resolution authority considered this necessary to stabilise the liquidity situation of the bridge bank. The extension could not be done under the Portuguese Guarantee Scheme as approved earlier by the Commission because this was restricted to solvent banks with no capital shortfall. The bridge bank had a capital shortfall in the adverse scenario as revealed by the asset quality review and stress test by the ECB. The Commission considered the extension of the bonds and the government guarantee to qualify as precautionary guarantees in favour of the bridge bank.[46]

On 7 October 2016, the Commission approved that Greece granted a State guarantee on a bond to be issued by Attica Bank.[47]

On 23 December 2016, Italy submitted a request for approval of a precautionary guarantee for senior bonds issued by MPS for a maximum nominal sum of EUR 15 billion. The Commission temporarily approved the aid, conditional on, amongst other things, the submission of a restructuring plan.[48]

Banca Popolare di Vicenza asked Italy for EUR 3 billion liquidity support in the form of a State guarantee on a bond with a maturity of three years. At that time, the bank was considered a solvent institution experiencing temporary liquidity pressures. The Commission approved the liquidity support on 18 January 2017.[49] On that same date, it also approved liquidity support in the form of a State guarantee on two bonds of EUR 1.75 billion, each with a maturity of two

46 EC, 19 December 2015, C(2015) 9762 final (SA.43976 – BES), par. 24-32, 75-77, 100-102.
47 EC, 7 October 2016, C(2016) 6573 final (SA.46558 – Attica Bank).
48 EC, 29 December 2016, C(2016) 9032 final (SA.47081 – MPS). EC, 4 July 2017, C(2017) 4690 final (SA.47677 – MPS), par. 24-25.
49 EC, 18 January 2017, C(2017) 331 final (SA.47149 – Banca Popolare di Vicenza).

and three years, to Veneto Banca.[50] On 6 April 2017, the Italian State submitted an informal request for granting additional liquidity aid in the form of a State guarantee on a bond of EUR 2.2 billion to Banca Popolare di Vicenza and a State guarantee on two bonds of EUR 700 million each to Veneto Banca. The Commission also approved this additional liquidity support.[51]

On 8 January 2019, Italy's cabinet approved a decree law to provide a State guarantee for future bonds issued by Banca Carige for a nominal value of EUR 3 billion, as well as a guarantee to enhance the quality of collateral in order to access ELA (both precautionary guarantees). The Commission decided not to raise objections against the liquidity support.[52] The decree law also allows for participation in a capital increase (precautionary recapitalisation) to be activated only as a residual option.[53]

In addition, a number of guarantee schemes provide the possibility to Member States to award precautionary guarantees. Examples are the Greek State Guarantee Scheme for banks[54], the Cypriot Guarantee Scheme for banks[55], the Portuguese Guarantee Scheme[56], the Polish Bank Guarantee Scheme[57] and the Italian Bank Guarantee Scheme.[58]

Examples of precautionary recapitalisation

In 2015, the Commission approved Greece's precautionary recapitalisation of four Greek banks: Piraeus Bank, Alpha Bank, Eurobank, and National Bank of Greece. In all cases, the precautionary

50 EC, 18 January 2017, C(2017) 328 final (SA.47150 – Veneto Banca).

51 EC, 12 April 2017, C(2017) 2566 final (SA.47940 – Banca Popolare di Vicenza). EC, 12 April 2017, C(2017) 2559 final (SA.47941 – Veneto Banca).

52 EC, 18 January 2019 (SA.52917 – Banca Carige). The public version of the decision is not yet available at the time of writing this dissertation.

53 EP, Briefing – Recent measures for Banca Carige from a BRRD and State Aid perspective, February 2019, PE 624.413.

54 EC, 7 June 2018, C(2018) 3546 final (SA.51087 – Greece).

55 EC, 13 July 2015, C(2015) 4819 final, (SA.42080 – Cyprus).

56 EC, 7 November 2017, C(2017) 7306 final (SA.48550 – Portugal).

57 EC, 7 December 2017, C(2017) 8163 final (SA.49404 – Poland)

58 EC, 29 December 2016, C(2016) 9031 final (SA.47082 – Italy).

recapitalisation consisted of the commitment of the Hellenic Financial Stability Fund to act as a backstop for the required capital increase.[59]

On 4 July 2017, the Commission approved Italy's plan to support a precautionary recapitalisation of the Italian bank MPS for the sum of EUR 5.4 billion.[60] This approval followed the confirmation by the ECB in its supervisory capacity that MPS was solvent and met capital requirements, and on Italy obtaining a formal confirmation from private investors that they would purchase the non-performing loan portfolio. MPS first attempted to raise private capital on the markets, but in December 2016 it announced that this private capital raise had failed. The Italian authorities then decided to apply for State aid in the form of a precautionary recapitalisation. The recapitalisation took place by the subscription of the Italian State of EUR 3.9 billion newly issued shares. To further address the shortfall, MPS's shareholders and junior bondholders contributed to the costs of restructuring of the bank for an amount of EUR 4.3 billion, that is from the conversion of junior bonds into shares and the dilution of existing shareholders. The Italian State compensated retail junior bondholders who were mis-sold by converting their bonds into shares and buying those shares from them, for a total amount of EUR 1.5 billion. In return, the retail junior bondholders received more secure senior instruments.[61]

On 18 December 2017, the Commission approved Lithuania's plan to support the precautionary recapitalisation of the Lithuanian Central Credit Union (LCCU) amounting to EUR 8.9 million under the State aid regime for the banking sector. Under the Lithuanian Central Bank's stress test and asset quality review, the LCUU had no capital shortfall under the baseline scenario and a capital shortfall of around EUR 8.9 million under the adverse scenario. Lithuania's planned precautionary recapitalisation only addressed the shortfall

59 EC, 26 November 2015, C(2015) 8488 final (SA.43366 – Alpha Bank), par. 18-20. EC, 4 December 2015, C(2015) 8930 final (SA.43365 – National Bank of Greece), par. 18-21. EC, 10 May 2019, C(2019) 3445 final (SA.43365 – National Bank of Greece), par. 3-6. EC, 26 November 2015, C(2015) 8486 final (SA.43363 – Eurobank), par. 18-20. EC, 7 February 2019, C(2019) 885 final (SA.53123 – Eurobank). EC, 29 November 2015, C(2015) 8626 final (SA.43364 – Piraeus bank), par. 18-21.

60 EC, 4 July 2017, C(2017) 4690 final (SA.47677 – MPS).

61 EC, Statement on Agreement in principle between Commissioner Vestager and Italian authorities on Monte dei Paschi di Siena (MPS), 1 June 2017, STATEMENT/17/1502.

> in this adverse scenario. The Commission therefore concluded that the proposed restructuring aid ensured that the LCUU continued to be viable in the long-term while distortions of competition were minimised, in particular given the small size of the beneficiary, its small market share and the aid amount.[62]

5.3.2.2 Access criteria

Precautionary guarantees and precautionary recapitalisation can only take place without triggering the FOLTF determination, provided certain criteria are met. The remainder of this dissertation refers to these criteria as 'access criteria', because fulfilment of these criteria leads to the situation that a bank has access to precautionary guarantees or precautionary recapitalisation. In case of precautionary guarantees or precautionary recapitalisation, access is available *outside* resolution only.

> Access criteria should be distinguished from 'assessment criteria'. These are the criteria that the Commission applies in its assessment of compatibility of State aid with the internal market under the State aid regime for the banking sector. The assessment by the Commission under the State aid regime for the banking sector is further discussed in Chapter 6.

The following access criteria apply to the instruments of precautionary guarantees and precautionary recapitalisation.

<u>Access criterion 1: Precautionary and temporary nature</u>
First, the instruments must be of a precautionary and temporary nature. The BRRD and the SRMR do not contain a definition of 'precautionary nature'. The term 'precautionary' suggests that the aid will result in the creation of prudential buffers in the bank.[63] In a fact sheet published on 25 June 2017, the Commission explains precaution as "*to prepare for possible capital needs of a bank that would materialise if economic conditions were to worsen significantly*".[64] In the same fact sheet, the Commission explains that the relevant Member State should be able to recover the aid in the short to medium term.

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62 EC, Daily News, 19 December 2017, MEX/17/5369. EC, 18 December 2017, C(2017) 8848 final (SA.48920 – Lithuanian Central Credit Union). Contrary to all other credit unions in Lithuania, the LCUU is the only central credit union subject to CRD IV/CRR. It is therefore also in scope of the resolution regime.

63 Iftinchi 2017, p. 81. EC, 4 July 2017, C(2017) 4690 final (SA.47677 – MPS), par. 131.

64 EC Factsheet 2017.

> In case of precautionary guarantees, the precautionary nature is established by the Commission based on the condition that the guarantees only cover newly issued liabilities.[65] In the case of CCB, the Commission assessed that recapitalisation by the national resolution fund was not of a precautionary nature, as it aimed at covering a capital shortfall which stemmed from additional loan loss provisioning.[66]
>
> The temporary nature of precautionary guarantees is established on the basis of the maturity of the guarantees.[67] In case of a precautionary recapitalisation, the temporary nature can be realized by making use of a hybrid instrument with a predetermined maturity date or by taking a binding commitment that the shares will be sold at a certain point in time.[68]

Access criterion 2: Solvency
Precautionary guarantees and precautionary recapitalisation must be confined to solvent banks. The BRRD and the SRMR do not contain a definition of 'solvency'.

In the Single Rulebook Q&A published on the EBA website, it is stated that within the context of Article 32(4)(d) BRRD, the notion of solvent institution should be interpreted as referring to a bank which does not fall within Article 32(4)(a), (b), (c) BRRD. As regards Article 32(4)(a), the concept of solvency does not refer to meeting conditions for authorisation that would relate to non-financial resources, such as systems and controls.[69]

> This interpretation has been prepared by the Directorate General Financial Stability, Financial Services and Capital Markets Union (DG FISMA) of the Commission and is an unofficial opinion of that Directorate General, which the EBA has published on its behalf. The interpretation is not binding on the Commission as an institution, and it may change.

65 See e.g. EC, 7 October 2016, C(2016) 6573 final (SA.46558 – Attica Bank), par. 46. See also section 3.5.4.1.
66 EC, 18 December 2015, C92015) 9681 final (SA.43367 – Cooperative Central Bank), par. 126.
67 See e.g. EC, 7 October 2016, C(2016) 6573 final (SA.46558 – Attica Bank), par. 46.
68 Iftinchi 2017, p. 81. EC, 4 July 2017, C(2017) 4690 final (SA.47677 – MPS), par. 131.
69 EBA, Single Rulebook Q&A, Question ID 2015_1777.

In addition to the EBA, the ECB had published on its website that the ECB, as the competent authority, is informed and asked to confirm in the case of a precautionary recapitalisation, that the bank is solvent i.e. it fulfils the minimum capital requirements (i.e. Pillar 1 requirements).[70] This interpretation of solvency has, however, been deleted in an update of the publication on 2 May 2018, without any further explanation. The reason could be that this explanation differed from the interpretation given by the DG FISMA.

> The Commission (DG COMP) applied the interpretation of the DG FISMA in the case of the precautionary recapitalisation of LCCU, further to the assessment that regulatory capital requirements were met. [71] In the case of MPS, the Commission, however, seemed to interpret 'solvent' as fulfilling the CET 1 and Total Capital Ratio requirement established in Article 92 CRR,[72] while in the case of BES, it considered that, as long as the baseline scenario was not breached, the bridge bank to which the precautionary guarantees were granted was considered solvent.[73] The Commission therefore still seems to be searching for the correct interpretation of the solvency condition. In its review of the resolution framework, it mentions the issue that there is no definition of solvency, and that it is not specified which authority should confirm that the bank is solvent.[74]

In relation to precautionary recapitalisation the following additional requirements should be met:[75]

a) the indicators that a bank is FOLTF - as set out in Article 32(4) sub (a) to (c) BRRD – are not met (this means that the bank is solvent, according to the definition of solvency as published by the EBA);[76]

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70 ECB, What is a precautionary recapitalisation and how does it work?, 27 December 2016, available on the website of the ECB: www.bankingsupervision.europa.eu.

71 EC, 18 December 2017, C(2017) 8848 final (SA.48920 – Lithuanian Central Credit Union), par. 53.

72 EC, 4 July 2017, C(2017) 4690 final (SA.47677 – MPS), par. 128. See also e.g. EC, 12 April 2017, C(2017) 2559 final (SA.47941 – Veneto Banca), par. 51 and EC, 12 April 2017, C(2017) 2566 final (SA.47940 – Banca Popolare di Vicenza), par. 51.

73 EC, 19 December 2015, C(2015) 9762 final (SA.43976 – BES), par. 102.

74 EC Report on application and review resolution framework 2019, p. 5. See also De Serière and Milione *JIBLR* 2019, p. 76, 80.

75 Article 32(4)(d) under (iii) BRRD.

76 That is, the bank does not infringe – or is likely to infringe – the requirements for continuing authorisation at the time the public support is granted, the assets of the bank are not less than its liabilities at the time the public support is granted, and the bank is able to pay its debts or other liabilities as they fall due at the time the public support is granted.

b) the circumstances under which resolution authorities should exercise the PONV conversion power are not fulfilled (that is, the conditions for resolution are not met, the bank or its group is still viable and no EPFS is required, other than precautionary recapitalisation).

The condition mentioned under (b), i.e. that no EPFS is required, includes precautionary guarantees. It seems however that the use of precautionary guarantees is not considered to be a hurdle for a precautionary recapitalisation. For example, in the case of MPS, precautionary guarantees preceded the precautionary recapitalisation of MPS.

Access criterion 3: No capital shortfall under the baseline scenario

Precautionary guarantees and precautionary recapitalisation may not be used to offset losses that a bank has incurred or is likely to incur in the near future.[77] In practice this means that losses stemming from an asset quality review or from the baseline scenario of a stress test must be covered by private funds.[78] The bank may hence not have a capital shortfall under the baseline scenario.[79]

A precautionary recapitalisation should, in addition, be necessary to address a capital shortfall established under the adverse scenario in national, EU or SSM-wide stress tests, asset quality reviews or equivalent exercises conducted by the ECB, EBA or national authorities, where applicable, confirmed by the competent authority.[80] The capital injection is hence capped at the capital shortfall under the adverse scenario. No similar requirement applies for precautionary guarantees.

In the case of MPS, the ECB considered MPS solvent. In the 2016 stress test carried out by the EBA and ECB, MPS's capital ratios were deemed sufficiently high under the so-called ‘baseline scenario’, i.e. where the economy and financial situation would evolve as expected. However, the bank had a capital shortfall in the ‘adverse case scenario’, i.e. should economic conditions worsen. The ECB

77 Article 32(4), first and second paragraph BRRD. Article 18(4)(d) SRMR. Recital (41) BRRD. Recital (57) SRMR.

78 EP, Briefing – Precautionary recapitalisations under the Bank Recovery and Resolution Directive: conditionality and case practice, 5 July 2017, PE 602.084.

79 Recital (41) BRRD. Recital (57) SRMR.

80 Article 32(4)(d) BRRD. Article 18(4)(d) SRMR. See also EBA Guidelines on types of tests, reviews or exercises.

considered that under the adverse scenario, EUR 6.3 billion was needed to realign the CET1 ratio to the 8% threshold and an additional EUR 2.5 billion was needed to reach the total capital ratio (TCR) threshold of 11.5%. Of those EUR 8.8 billion, about EUR 4.2 billion would be covered by the burden-sharing on subordinated bonds, while EUR 4.6 billion would be funded by the State. As to the 8% threshold used by the ECB to determine the capital requirements, it is similar to the threshold used in Greece in 2015 in the aftermath of the capital controls, but differs from the threshold used in 2014 and 2015 for other Eurozone banks (5.5% under the adverse scenario).[81]

Access criterion 4: Remedy a serious disturbance in the economy of a Member State and preserve financial stability

Precautionary guarantees and precautionary recapitalisation can only be used, when this is required in order to remedy a serious disturbance in the economy of a Member State and to preserve financial stability, in particular in the case of a systemic liquidity shortage,[82] and is proportionate to remedy the consequences of the serious disturbance.

It is the author's understanding that this criterion ties into access criterion 7 (precautionary guarantees and precautionary recapitalisation are conditional on final approval by the Commission under the Union State aid framework[83]), taking into account that the current legal basis for the assessment of the Commission under the Union State aid framework is Article 107(3)(b) TFEU. The addition that the precautionary guarantees should be *proportionate* to that goal is already an inherent part of the assessment made by the Commission under the State aid regime for the banking sector.

81 EP, Briefing – The precautionary recapitalisation of Monte dei Paschi di Siena, 6 July 2017, PE 587.392.

82 Recital (41) BRRD.

83 The Union State aid framework is a term that is introduced in the BRRD and refers to '*the framework established by Article 107, 108 and 109 TFEU and regulations and all Union acts, including guidelines, communications and notices, made or adopted pursuant to Article 108(4) or Article 109 TFEU*' (Article 2(1)(53) BRRD). It is the author's understanding that this term should be read as a reference to the State aid regime for the banking sector as described in Chapter 3.

The Commission's decisions show that it considers this access criterion to be fulfilled when established in the compatibility assessment under Article 107(3)(b) TFEU.[84] Imposing this access criterion may therefore have as a consequence that precautionary recapitalisation and precautionary guarantees are no longer available should the Commission decide that Article 107(3)(b) TFEU is no longer available as the legal basis for its assessment of State aid awards in the banking sector.[85] Whether the Commission will ever take such a decision is still unclear at the time of writing this dissertation. It should be noted that the Commission has assessed in certain State aid decisions that aid can also be compatible with Article 107(3)(b) TFEU when it is necessary to *avoid* (instead of remedy) a serious disturbance in a Member State.[86] It also made this assessment in relation to the precautionary recapitalisation of LCCU.[87] Moreover, several language versions of the BRRD use the wording 'to *avoid* a serious disturbance' in the translation of Article 32(4)(d) BRRD.[88] This interpretation may lead to Article 107(3)(b) TFEU being used as a more permanent basis for the compatibility assessment of State aid awards in the banking sector, as it can then also be applied if a serious disturbance may be caused, if no aid is granted. In other words, aid may be compatible with the internal market, not because it remedies an *existing* serious disturbance, but rather because it avoids a *future* serious disturbance. It also provides greater flexibility, as the public funding can be granted in a situation where the market is still able to share the burden, making the intervention less onerous for the State and possibly more effective for the preservation of financial stability.[89]

Access criterion 5: No advantage

From the BRRD and SRMR recitals can be derived that precautionary guarantees should be sufficiently remunerated by the bank.[90] The BRRD and SRMR do not further explain what is meant by 'sufficiently remunerated'. The State aid regime for the banking sector includes the requirement that

84 See e.g. EC, 4 July 2017, C(2017) 4690 final (SA.47677 – MPS), par. 126; EC, 26 November 2015, C(2015) 8488 final (SA.43366 – Alpha Bank), par. 130-131.
85 Iftinchi 2017, p. 80.
86 See e.g. EC, 28 June 2011, C(2011) 4648 final (SA.33001 – Denmark), par. 18.
87 EC, 18 December 2017, C(2017) 8848 final (SA.48920 – LCCU), par. 26.
88 Such as the Italian, French, Spanish and Portuguese versions of the BRRD text.
89 Olivares-Caminal and Russo 2017, p. 11.
90 Recital (41) BRRD. Recital (57) SRMR.

funding guarantees should be adequately remunerated. This implies that the minimum remuneration level of funding guarantees must be in line with the formula set out in the 2011 Prolongation Communication.

> It can be derived from the Commission's decisions in cases that concern precautionary guarantees, that the Commission assesses compliance with the 2011 Prolongation Communication in order to assess compliance with this access criterion.[91]

In addition, the injection or purchase by the State within the framework of a precautionary recapitalisation should be at prices and on terms that do not confer an advantage on the bank. According to Véron, this condition is widely open to interpretation.[92] The author argues that interpretation can take place on the basis of a similar condition included in the State aid regime for the assessment of a rescue recapitalisation. The starting point for rescue recapitalisations is that closeness of pricing to market prices is the best guarantee to limit competition distortions.

> In the first decision from the Commission on the use of precautionary recapitalisation (the case of Alpha Bank), the wording used by the Commission refers to "*undue advantage*", that is, "*an advantage incompatible with the internal market under State aid rules*". In order to avoid that such an undue advantage is conferred on the bank, the level of remuneration and the depth of the restructuring should be in line with the State aid regime.[93]

<u>Access criterion 6: Not be part of a larger aid package</u>
From the BRRD recitals can be derived that precautionary guarantees should not be part of a larger aid package.[94] This requirement is not restated in Article 32(4)(d) BRRD or Article 18(4)(d) SRMR. The requirement seems, however, to be implied in the legal construction that the award of precautionary guarantees forms an exemption to the premise that the award of EPFS triggers resolution, besides precautionary recapitalisation.

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91 See e.g. EC, 4 July 2017, C(2017) 4690 final (SA.47677 – MPS), par. 132.
92 Véron *Bruegel Policy Contribution* 2017, p. 6.
93 EC, 26 November 2015, C(2015) 8488 final (SA.43366 – Alpha Bank), par. 131.
94 Recital (41) BRRD.

Access criterion 7: Final approval under the State aid regime

The instruments of precautionary guarantees and precautionary recapitalisation may only be used after receiving *final* approval under the Union State aid framework.[95] By requiring final approval, it seems that precautionary guarantees cannot be temporarily approved by the Commission as rescue aid. The State aid regime for the banking sector, however, provides that guarantees are temporarily approved by the Commission as rescue aid under the commitment to submit a restructuring or a wind up plan within two months, unless the aid is reimbursed within those two months. Only after assessment of the restructuring or wind up plan, can the aid be authorized on a final basis. If it is not possible for the Commission to approve precautionary guarantees as rescue aid – and therefore on a temporary basis – the use thereof in practice is severely obstructed. It can be derived from the Commission's decisions in relation to the precautionary guarantees that it temporarily approves such as rescue aid.[96] This is the correct approach in the author's view.

> The State aid regime for the banking sector provides that precautionary recapitalisation can also take place in the form of rescue aid, i.e. a rescue recapitalisation. See section 3.5.4.2. At the time of writing this dissertation, there were no examples thereof.

5.3.2.3 Relevance of precautionary guarantees and recapitalisation

If the access criteria for precautionary guarantees or precautionary recapitalisation are met, public support can be granted by Member States to banks without triggering the FOLTF determination. This means that Member States can grant these forms of public support without triggering resolution. This means that the powers of the resolution authorities are not triggered, including the power to apply the bail-in tool. Moreover, no mandatory bail-in of 8% of the total liabilities including own funds of the bank in resolution has to take place as a precondition for the Member State support.[97] In relation to precautionary guarantees, there is one exception to the rule that the resolution framework is not triggered. This relates to the exercise of the PONV conversion power, as will be discussed in section 5.3.3.

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95 This assessment is discussed in more detail in section 6.5.1.

96 See e.g. EC, State aid: Commission authorises precautionary Recapitalisation of Italian bank Monte dei Paschi di Siena, 4 July 2017, IP/17/1905.

97 It will be seen in section 5.3.5 that this is generally a requirement for the award of State aid, once resolution is triggered.

The BRRD and the SRMR provide for the requirement for the Commission to review, by 31 December 2015, whether there is a continuing need for allowing precautionary recapitalisation and the conditions that need to be met in that case.[98] At the time of writing this dissertation, the review has not taken place. According to Véron, including the possibility of precautionary recapitalisation seems to be motivated by a need for transitional arrangements in order to prepare the Member States and the banks for the new bail-in requirements.[99] The question is whether there will not always be a need (or desire) for precautionary recapitalisation to be allowed.[100] In July 2017, Hellwig reported that precautionary recapitalisation may be advantageous for banks active in multiple jurisdictions, as long as there are no binding agreements on single-point-of-entry resolution.[101] In that case, resolution may lead to resolution procedures in multiple jurisdictions, each taking control of legally independent units. As a result, certain integrated operations may no longer be viable. In that case, precautionary recapitalisation may solve the financial difficulties of the bank before it comes to resolution. He however notes that maintenance of payment systems and lending does not necessarily warrant precautionary recapitalisation, as long as the resolution authorities have sufficient funding available to continue these activities in resolution. In addition, concerns about the impact on bank lenders/investors do not necessarily warrant precautionary recapitalisation, since the resolution authority can choose to exempt certain liabilities from a bail-in. Hellwig therefore recommends restricting the domain of precautionary recapitalisation to those cases where a pre-emption of resolution makes a difference to financial stability or the maintenance of bank lending.[102] In the author's view, it would be recommendable to include precautionary guarantees and precautionary recapitalisation in the resolution process itself. This means that precautionary guarantees and precautionary recapitalisation will no longer be excluded as trigger for resolution and the resolution authority will be involved in the decision-making process, including the implementation of the guarantees or recapitalisation. In order to achieve this, the resolution framework should provide for more flexibility in respect of the bail-in requirements that apply when EPFS is granted; see also section 8.6.5.

98 Article 32(4), last paragraph, BRRD. See also Article 18(4), last paragraph, SRMR.
99 Véron *Bruegel Policy Contributions* 2017, p. 4.
100 See Olivares-Caminal and Russo 2017, p . 16.
101 See section 4.6.1 for an explanation of single-point-of-entry resolution.
102 Hellwig 2017, p. 5-6.

5.3.3 *EPFS as a trigger for the exercise of the PONV conversion power?*

Resolution authorities must exercise the PONV conversion power before EPFS, including precautionary guarantees, can be awarded to a bank.[103] The PONV conversion power must therefore not only be exercised when EPFS is awarded in resolution, but also in the case of precautionary guarantees – which takes place outside of resolution.[104] This outcome seems to be illogical, taking into account that the burden-sharing principle under the State aid regime for the banking sector only applies in relation to restructuring aid, which normally takes the form of recapitalisation or impaired asset measures. Precautionary guarantees are normally granted as temporary rescue aid, addressing liquidity issues rather than insolvency issues.

> A justification for the exercise of the PONV conversion power in relation to precautionary guarantees could be that this contributes to the guarantees not being used to offset losses the bank has incurred or is likely to incur in the near future. This is, however, also an access criterion for precautionary recapitalisation, in which case the exercise of the PONV conversion power is not triggered.

In the event of precautionary recapitalisation, the resolution authorities are not required to exercise the PONV conversion power under the resolution framework. However, as will be discussed in section 6.5.1, the burden-sharing requirements as set out in the State aid regime for the banking sector still apply.

> In the case of the precautionary recapitalisation of MPS, the Commission, for example, considered that all AT 1 and Tier 2 instruments held by MPS were subject to conversion into ordinary shares and would fully contribute to covering capital needs of MPS before State aid was injected.[105]

103 Article 59(3)(e) BRRD; Article 21(1)(e) SRMR.
104 It is not specified in the resolution framework, whether this only is the case when the guarantees are called or already on putting the guarantees in place.
105 EC, 4 July 2017, C(2017) 4690 final (SA.47677 – MPS), par. 136.

5.3.4 EPFS as a trigger for recovery?

As set out in section 5.3.2, the award of EPFS triggers resolution, provided that the other conditions for resolution are also met, with the exception of precautionary guarantees and precautionary recapitalisation. Although these do not trigger resolution, they may still trigger the recovery of a bank. In fact, that is what they are designed to do.

Banks and banking groups are required to draw up and maintain recovery plans providing for the measures to be taken by the bank or the group to restore their financial position following a significant deterioration of their financial situation.[106] These recovery plans may not assume any access to or receipt of EPFS, or expose taxpayers to the risk of loss.[107]

In relation to recovery, no triggers are defined in the resolution framework. Each recovery plan has to include a framework of indicators established by the bank or group which identifies the points at which recovery actions may be taken. These indicators have to be agreed by the competent authority. The EBA has explained that, although precautionary guarantees and precautionary recapitalisation are no trigger for resolution, they may be a trigger for recovery.[108] The use of precautionary guarantees and/or precautionary recapitalisation may therefore be identified as a trigger in the recovery plan of a bank for the execution of recovery actions by the bank in question.

The intervention by deposit guarantee schemes beyond their statutory pay-out function deserves special attention. In accordance with Article 11(3) DGS Directive, Member States may allow deposit guarantee schemes to use available financial means for 'alternative measures' in order to prevent the failure of a bank, provided that, *inter alia*, the resolution authority has not taken any resolution action.[109] However, in case a deposit guarantee scheme intervenes beyond its statutory pay-out function, which is the case when the deposit guarantee scheme takes alternative measures, this may qualify as State aid as this may fulfil a public policy

106 Articles 5 and 7 BRRD.
107 Article 5(3) BRRD. Recital (31) BRRD. The SRMR does not contain any provisions in relation to the contents of recovery plans.
108 EBA Guidelines on types of tests, reviews or exercises, p. 11.
109 Article 11(3) DGS Directive.

mandate at the discretion of the Member States involved.[110] In that case, the alternative measures qualify as EPFS, since they prevent the failure of the bank.

> In the case of the rescue of Banca Tercas, the Italian Interbank Deposit Protection Fund (IDFF) intervened by taking alternative measures. The GC, however, assessed that these measures did not qualify as State aid as they were not funded by State resources and were not imputable to Italy. It should be taken into account that the IDFF is a private law inter-bank consortium of which the management – formed by the representatives of the IDFF member banks– can take autonomous decisions in respect of adopting alternative measures. In addition, the contributions by the banks to the IDFF for taking the alternative measures are not mandatory on the basis of the law, but on the basis of the articles of association.[111]

When a deposit guarantee scheme takes alternative measures that qualify as State aid, the resolution of the bank is triggered, provided that the other conditions for resolution are also met. This outcome does create the – undesirable – situation that alternative measures from deposit guarantee schemes that qualify as State aid are, in practice, not available as they trigger resolution, while they can only be taken when the resolution authority has not taken any resolution action. This outcome seems to be unintended. This would only be different if the alternative measures taken by deposit guarantee schemes in accordance with Article 11(3) DGS Directive never qualify as an FOLTF indicator, similar to precautionary guarantees and precautionary recapitalisation. This would require amendment of the BRRD and SRMR.

> In addition, deposit guarantee schemes cannot apply alternative measures where the conditions for early intervention measures are met.[112] As a result, the alternative measures would only be available in the recovery phase as long as no early intervention measures are taken by the competent authority.

110 Recital (3) and (16) DGS Directive. Hancher, Ottervanger and Slot 2016, p. 521.
111 GC, 19 March 2019, T-98/16, T-196/16 and T-198/16, ECLI:EU:T:2019:167 (*Italy, Banca Popolare di Bari and Fondo interbancario di tutela dei depositi v Commission*), par. 83-132.
112 Article 11(4) DGS Directive.

5.3.5 *Access to EPFS in resolution*

The previous section discussed in which circumstances the award of EPFS triggers the resolution of a bank. This section discusses the access to EPFS, once a bank is put in resolution.

5.3.5.1 No assumption of EPFS in the resolution plan

The resolvability assessment of a bank should lead to the situation that it is feasible and credible for the resolution authorities to either wind up a bank (and its group entities) in normal insolvency proceedings, or to resolve the bank (or its group) by applying resolution tools and powers *without* the assumption of EPFS, besides the use of the national resolution funds or SRF.[113] If the resolvability assessment reveals that winding up the bank in normal insolvency proceedings or putting the bank in resolution likely involves the use of EPFS – other than national resolution funds or the SRF –, this should lead to the outcome that there are substantive impediments to the resolvability of the bank or group involved. In that case, measures should be taken to improve the resolvability of the bank or group involved before the resolution plan can be adopted or updated. The resolution plan has to identify how resolution actions could be financed without assuming EPFS.[114] Only contributions by the national resolution funds or SRF may be assumed as an available funding means, once the resources from shareholders and creditors are exhausted.[115]

Against that background, it can be concluded that, if liquidation or resolution of a bank *does* in fact involve the use of EPFS (other than the national resolution funds or SRF); this was not foreseen. [116] Of the ten resolution cases notified by the SRB and the national resolution authorities to the EBA at the time of writing this dissertation, seven involve a decision by the Commission on the compatibility of State aid granted to the bank in resolution, albeit that this is often granted through the national resolution funds. The overview in Table 6 only covers aid measures granted *in resolution*. In many cases, this aid was preceded by other aid measures, such

113 Article 15(1) BRRD. Article 10(1) SRMR.
114 Article 10(7)(i) BRRD. Article 8(9)(i) SRMR.
115 Article 101(2) BRRD. Article 76(3) BRRD.
116 National resolution authorities have to inform the competent ministry and, unless otherwise laid down in national law, have its approval before implementing decisions that have a direct fiscal impact or systemic implications (Article 3(6) BRRD). Such decisions may, for example, include the use of national resolution funds. Kleftouri *ERA Forum* 2017, p. 267-269.

as State guaranteed ELA support, recapitalisation by a Member State or Member State guarantees, that were awarded prior to the introduction of the resolution framework.

Table 6: Overview of State aid measures in resolution cases

Bank	**Resolution measure**	**Member State support**	**National resolution fund contribution**	**Deposit guarantee scheme contributions**
Heta Asset Resolution AG (HETA)	Bail-in tool[117] (preceded by asset separation and sale of business tool prior to introduction of resolution framework)	Guarantee granted by Austria for bonds issued by the Carinthian settlement payment fund under a settlement agreement with creditors of HETA that held senior and junior debt guaranteed by the Land of Carinthia (the guarantee was considered by the Commission to be covered by the existing aid that was approved by the Commission prior to the resolution, i.e. the guarantee by the Land of Carinthia)[118]		

117 The application of the bail-in tool was however controversial, as discussed in section 4.4.3.4.

118 EC, 1 September 2016, C(2016) 5646 final (SA.45940 – Heta Asset Resolution AG), par. 11-17, 22-63.

Jadranska Banka d.d. Sibenik (Jadranska Banka)	Asset separation tool / sale of business tool / bail-in tool		Subscription by the national resolution fund of new shares in the capital of Jadranska Banka[119]	Subscription by the deposit guarantee scheme fund of new shares in the capital of Jadranska Banka[120]
Panellinia Bank S.A. (Panellinia Bank)	Sale of business tool		Contribution by the national resolution fund covering the funding gap related to the transfer of activities of Panellinia Bank to Piraeus Bank[121]	
MKB Bank Zrt. (MKB Bank)	Sale of business tool / asset separation tool		Financial assistance granted by the national resolution fund as a result of which the transfer of problematic assets of MKB Bank to an asset management company could take place at a price that exceeded the market value of those assets[122]	

119 Jadranska Banka d.d. Sibenik, Financial Statements for 2016, p. 20. The State aid was granted on the basis of the resolution scheme for small credit institutions with total assets below EUR 1.5 billion adopted by Croatia and approved by the Commission. There is, therefore, no ad hoc decision from the Commission in relation to the State aid award to Jadranska Banka. See EC, 23 June 2017, C(2017) 4384 final (SA.48287 – Croatia), par. 6.

120 Jadranska Banka d.d. Sibenik, Financial Statements for 2016, p. 20. See also EC, 23 June 2017, C(2017) 4384 final (SA.48287 – Croatia), par. 6.

121 EC, 16 April 2015, C(2015) 2606 final (SA.41503 – Panellinia Bank), par. 21-35, 52-57.

122 EC, 16 December 2015, C(2015) 9349 final (SA.40441 – MKB Bank), par. 81-88.

Banca delle Marche, Banca Popolare dell'Etruria e del Lazio, Cassa di Risparmio di Ferrara, Cassa di Risparmio della Provincia di Chieti (Banca Marche, Banca Etruria, Carife, Carichieti)	Bridge bank tool / asset separation tool		Capital injections from the national resolution fund in the bridge banks, financial assistance from the national resolution fund as a result of which the transfer of assets from the bridge banks to asset management vehicles could take place above market prices, guarantees from the national resolution fund for the benefit of the buyer of the bridge banks[123]	
Banco Espirito Santo (BES)	Bridge bank tool	Extension of the maturity of government guaranteed bank bonds transferred to the bridge bank and provision of capital backstop if the total capital ratio of the bridge bank falls below the SREP total capital requirements[124]	Capital injection from the national resolution fund in the bridge bank, underwriting of tier 2 instruments issued by the bridge bank, guarantee from the national resolution fund for the benefit of the buyer of the bridge bank[125]	

123 EC, 22 December 2015, C(2015) 8373 final (SA.43547 – Carichieti), par. 20-30, 44-81; EC, 22 December 2015, C(2015) 8372 final (SA.41925 – Carife), par. 22-32, 46-80; EC, 22 December 2015, C(2015) 8371 final (SA.39543 – Marche), par. 27-37, 51-85; EC, 22 December 2015, C(2015) 8374 final (SA.41134 – Etruria), par. 22-32, 46-80; EC, 30 April 2017, C(2017) 3000 final (SA.39543, SA.41134, SA.43547 – Marche, Etruria and Carichieti), par. 68-89; EC, 29 June 2017, C(2017) 4564 final (SA.41925 – Carife), par. 69-90.

124 EC, 11 October 2017, C(2017) 6896 final (SA.49275 – BES), par. 63, 81-83.

125 EC, 11 October 2017, C(2017) 6896 final (SA.49275 – BES), par. 65-80.

Banco Internacional do Funchal, S.A. (BANIF)	Sale of business tool / asset separation tool	Capital injection and subscription of CoCos issued by BANIF (granted prior to the resolution and re-notified and requalified as liquidation aid in the context of the resolution) Direct contribution by Portugal covering the funding gap related to the transfer of a set of assets, rights and liabilities of BANIF to a private sector purchaser[126]	Contribution by the national resolution fund covering the funding gap related to the transfer of activities of assets, rights and liabilities of BANIF to a private sector purchaser Financial assistance granted by the national resolution fund as a result of which the transfer of problematic assets of BANIF to an asset management company could take place at a price that exceeded the market value of those assets[127]	

At the time of writing this dissertation, there were no examples of State aid measures granted in resolution that were not approved by the Commission.

5.3.5.2 Access to contributions from national resolution funds or the SRF

The national resolution funds and the SRF are new means of public funding introduced under the resolution framework. Although they are a form of public funding, they are both funded by contributions from the banking sector. The resolution framework enables access to these forms of public funding for banks that are put in resolution. The SRF can only be used in relation to the resolution of banks and banking groups within the scope of the SRM. National resolution funds can only be used in relation to the resolution of banks and banking groups outside the scope of the SRM.

126 EC, 21 December 2015, C(2015) 9763 final (SA.43977 – BANIF), par. 92-102.
127 EC, 21 December 2015, C(2015) 9763 final (SA.43977 – BANIF), par. 97-114.

The resolution framework provides for certain access criteria in respect of the national resolution funds and the SRF.

Access criterion 1: Specified use
The national resolution authorities may use the national resolution funds only to the extent necessary to ensure the effective application of the resolution tools, for the following purposes: to guarantee the assets or the liabilities of the bank under resolution, its subsidiaries, a bridge bank or an asset management vehicle, to make loans to these entities, to purchase assets from the bank under resolution, to make contributions to a bridge bank or asset management vehicle, to pay compensation to shareholders or creditors, or to make a contribution to a bank under resolution where the bail-in tool is applied and the resolution authority decides to exclude certain creditors from the scope of bail-in.[128] The national resolution funds may also be used with respect to the purchaser in the context of the sale of business tool.[129]

> As set out in section 5.3.5.1, national resolution funds have already been used as a funding tool in resolution cases.

The SRB may use the SRF under the same conditions as the national resolution authorities use the national resolution funds.[130]

Access criterion 2: Bail-in and cap when used for loss absorption or recapitalisation
The national resolution funds and the SRF may not be used directly to absorb the losses of a bank in resolution or to recapitalise such a bank. An exemption applies in case the resolution authorities have decided to fully or partially exclude eligible liabilities from bail-in in accordance with Article 44(3) BRRD (Article 27(5) SRMR) and the losses that would have been borne by those liabilities have not been passed on fully to other creditors. In such a case, the national resolution funds or the SRF may make a contribution to cover any losses that have not been absorbed, or purchase shares or other instruments in the bank in resolution for recapitalisation purposes, but only where:

128 Article 101(1) BRRD. The national resolution funds can also be used to lend to other national resolution funds.
129 Article 101, last paragraph BRRD.
130 Article 76(1) and (2) SRMR.

(a) A contribution equal to an amount not less than 8% of the total liabilities and own funds of the bank in resolution has been made by the shareholders and creditors of the bank; and
(b) The contribution of the national resolution fund or the SRF does not exceed 5% of the total liabilities and own funds of the bank in resolution.[131]

Ad a: In case of small banks (banks with assets below EUR 900 billion on a consolidated basis) a derogation from sub (a) can be applied, entailing that the national resolution fund may also make a contribution where (i) a contribution equal to an amount not less than 20% of the TREA of the bank in resolution has been made by the shareholders and creditors of the bank, and (ii) the national resolution fund has at its disposal, by way of *ex ante* contributions, an amount which is at least equal to 3% of covered deposits of all banks authorised in the territory of the relevant Member State.[132] This derogation does not apply in relation to contributions by the SRF.[133]

Ad b: In extraordinary circumstances, the national resolution fund or the SRF may make a further contribution than 5% of the total liabilities and own funds of the bank, but only where all unsecured, non-preferred liabilities, other than eligible deposits, have been written down or converted in full.[134] A contribution may be made in that case from resources of the national resolution fund or the SRF which have been raised through *ex ante* contributions and which have not yet been used.[135]

The conditions set out above under (a) and (b) also apply in the event that the use of national resolution funds or the SRF *indirectly* results in part of the losses being passed on to them.[136]

Access criterion 3: Approval by the Commission

Where the exclusion of certain liabilities requires a contribution by the national resolution fund or the SRF, the Commission may, within 24 hours of receipt of such a notification, or a longer period with the agreement of the resolution authority, prohibit or require amendments to the proposed exclusion, if the requirements under the resolution framework are not met,

131 Article 44(5) BRRD. Article 27(6) SRMR.
132 Article 44(8) BRRD.
133 Article 27(11) SRMR.
134 Article 44(7) BRRD. Article 27(9) SRMR.
135 Article 44(7) BRRD. Article 27(10) SRMR.
136 Article 101(2) BRRD. Article 76(3) BRRD.

in order to protect the integrity of the internal market. This is without prejudice to the application by the Commission of the State aid regime for the banking sector.[137]

5.3.5.3 Access to resolution financing by deposit guarantee schemes

Deposit guarantee schemes are required to make a contribution - not greater than the amount of losses that they would have had to bear if the bank had been wound up in normal insolvency proceedings – when a resolution action ensures that depositors continue to have access to their deposits.[138] The deposit guarantee scheme is liable for (a) when the bail-in tool is applied, the amount by which covered deposits would have been written down in order to absorb the losses in the bank, had covered deposits been included within the scope of bail-in and been written down to the same extent as creditors with the same level of priority under the national law governing normal insolvency proceedings, or (b) when one or more resolution tools other than the bail-in tool is applied, the amount of losses that covered depositors would have suffered, had covered depositors suffered losses in proportion to the losses suffered by creditors with the same level of priority under the national law governing normal insolvency proceedings.[139]

> Deposits covered by a deposit guarantee scheme (covered deposits) are excluded from the application of the bail-in tool.[140] If a bank is put in resolution, holders of deposits (retail or corporate) covered by a deposit guarantee scheme will therefore not lose their deposits. This only applies up to an amount of EUR 100,000 for the aggregate deposits of each depositor.[141] Because deposits covered by a deposit guarantee scheme are excluded from the scope of bail-in, deposit guarantee schemes contribute to funding the resolution process by absorbing losses to the extent of the net losses that they would have had to suffer after compensating depositors in normal insolvency proceedings.[142]

137 Article 44(12) BRRD. Article 27(7), last paragraph SRMR.
138 Article 109(1) BRRD. Article 79(1) SRMR. Article 109(5), last paragraph BRRD. Article 79(5) SRMR.
139 Article 109(1) BRRD. See also Gortsos 2019.
140 Article 44(2)(a) BRRD. Article 27(3)(a) SRMR.
141 Article 5 and 6 and Annex I DGS Directive.
142 Article 11(2) DGS Directive. Article 109 BRRD. Article 79 SRMR.

Resolution financing by the deposit guarantee scheme is triggered by the discretionary decision of the resolution authority, in contrast to the pay-out of covered deposits by the deposit guarantee scheme in case of liquidation of a bank, which is mandatory under the DGS Directive. Resolution financing by deposit guarantee schemes therefore qualifies as EPFS.[143]

5.3.5.4 Access to GFST under the BRRD

The BRRD introduces the peculiar concept of government financial stabilisation tools (GFST). The GFST do not constitute resolution tools, but set conditions for Member States under which they can award public funding to banks in resolution. It is up to the discretion of the Member States to implement the GFST in national law.[144]

The GFST include the 'public equity tool' and the 'temporary public ownership tool'.[145] Under the application of the public equity tool, Member States may, while complying with national company law, participate in the recapitalisation of a bank or group by providing capital to the latter in exchange for CET 1, AT 1 or Tier 2 instruments.[146] Under the application of the temporary public ownership tool, Member States may take a bank or group into temporary public ownership (in other words, the bank is nationalised). For that purpose, a Member State may make one or more share transfer orders in which the transferee is a nominee of the Member State or a company wholly owned by the Member State.[147]

> Nationalisation itself does not constitute a form of State aid, since the TFEU is neutral with regard to the form of ownership. However, any capital injections or other aid measures that take place in relation thereto may indeed form State aid.[148]

The GFST can be applied for the purpose of participating in the resolution of a bank or group, including by intervening directly, in order to avoid its winding up, with a view to meeting the resolution objectives in relation to

143 See e.g. EC, 5 October 2016, C(2016) 6417 final (SA.46066 – Croatia), par. 45-51.
144 See IMF Country Report 2018, p. 44 for an overview that shows which Member States have implemented the GFST.
145 Article 56(5) BRRD.
146 Article 57 BRRD.
147 Article 58 BRRD.
148 Athanasaki *EPL* 2017, p. 623.

the relevant Member State or the EU as a whole.[149] The provision of EPFS through the GFST has to take place under the leadership of the competent ministry or the government of the relevant Member State in close cooperation with the relevant resolution authority. In order to give effect to the GFST, the competent ministries or governments should have the relevant resolution powers specified in Articles 63 to 72 BRRD in accordance with Articles 66, 68, 83 and 117 BRRD.[150] It is up to the discretion of the relevant Member State to use the GFST; it cannot be forced by the resolution authority in that respect.[151]

> At the time of writing this dissertation, the GFST have not yet been applied by a Member State.

The resolution authority may only seek funding from a Member State through the use of the GFST, if the following 'access criteria' are met.[152]

<u>Access criterion 1: Systemic crisis</u>
There should be the very extraordinary situation of a systemic crisis. A systemic crisis is defined in Article 2(1), point (30) BRRD as "*a disruption in the financial system with the potential to have serious negative consequences for the internal market and the real economy. All types of financial intermediaries, markets and infrastructure may be potentially systemically important to some degree*".

<u>Access criterion 2: Last resort</u>
The GFST should be used as a last resort after having assessed and exploited the resolution tools to the maximum extent practicable whilst maintaining financial stability.[153] The GFST can only be applied, when one of the following conditions is met:

a) the competent ministry or government and the resolution authority, after consulting the central bank and the competent authority, have determined that the application of the resolution tools would not suffice to avoid a significant adverse effect on the financial system; or

149 Article 56(1) BRRD.
150 Article 56(1) and (2) BRRD.
151 This would otherwise be in direct violation of the budget sovereignty of Member States. See section 5.5.2.5.
152 The concept of 'access criteria' has been introduced in section 5.3.2.2. The assessment of the access criteria by the Commission is further discussed in Chapter 6.
153 Article 56(3) BRRD.

b) the competent ministry or government and the resolution authority have determined that the application of the resolution tools would not suffice to protect the public interest, where ELA has previously been given to the bank; or

c) in respect of the temporary public ownership tool, the competent ministry or government, after consulting the competent authority and the resolution authority, has determined that the application of the resolution tools would not suffice to protect the public interest, where public equity support through the public equity tool has previously been given to the bank.[154]

Access criterion 3: Bail-in

The GFST may only be used provided that a contribution to loss absorption and recapitalisation equal to an amount not less than 8% of total liabilities, including own funds of the bank in resolution, measured at the time of resolution action, has been made by the shareholders and the holders of other instruments of ownership, the holders of relevant capital instruments and other eligible liabilities through write down, conversion, or otherwise.[155]

> It is not entirely clear whether in addition to this access criterion the conditions set out in Article 44(7) BRRD, as further discussed in section 5.3.5.6, should also be met. Pursuant to this article, in extraordinary circumstances, the resolution authority may seek further funding from alternative financing sources after, (a) a contribution of the resolution financing arrangement of 5% of the total liabilities including own funds of the institution under resolution, measured at the time of resolution action, has been made, and (b) all unsecured, non-preferred liabilities other than eligible deposits, have been written down or converted in full. Gardella seems to take the stance that these conditions do not apply to the GFST.[156] In the author's view, it can however not be excluded that Article 44(7) BRRD should also be applied in case of the use of the GFST, taking into account that the GFST are considered alternative financing sources, as can be derived from Article 37(10) BRRD. As will be seen in section 5.3.5.7, the ESM DRI is also only available, if the conditions set out in Article 27(9) SRMR, which are the same as the conditions set

154 Article 56(4) BRRD.
155 Article 37(10)(a) BRRD.
156 Gardella 2015, p. 211.

out in Article 44(7) BRRD, are met. If one assumes that the GFST are not available as a funding means within the SRM, as further discussed in section 5.3.5.5, it seems to be arbitrary that the access conditions to the GFST are less strict than those to the ESM DRI, taking into account that both instruments have the same purpose: recapitalisation of the bank in resolution.

On the other hand, the GFST may only be applied in the very extraordinary situation of a systemic crisis (access criterion 1). It is precisely in such a situation that the application of strict bail-in requirements may be difficult, for example, if the investors to be bailed-in are also in a financially difficult position and bail-in may cause their financial position to significantly deteriorate. Depending on the type of investor, this may further contribute to the situation of the systemic crisis that the GFST is trying to remedy.[157] There may, therefore, be reason to introduce some type of flexibility in the bail-in requirement. For example, an option could be that the national resolution funds are allowed to contribute to part of the required bail-in of 8%. Or an exception to the bail-in requirement could be introduced when implementing these measures would endanger financial stability or lead to disproportionate results, similar to the exemption to the burden-sharing requirements under the State aid regime for the banking sector.[158] This however requires further amendment of the BRRD.

Access criterion 4: Temporary solution
Member States have to ensure that the shareholding in the bank will be transferred to the private sector as soon as commercial and financial circumstances allow.[159]

Access criterion 5: The bank will be maintained as a going concern
Only when the resolution of a bank is aimed at maintaining it as a going concern, can the GFST be applied.[160] This makes sense, because the purpose of the GFST is to recapitalise a bank. The GFST can therefore be used when the resolution entails the application of the bail-in tool to recapitalise the failing bank.[161] Use of the GFST is however incompatible with the transfer

157 See also Bodellini *EBOLR* 2018, p. 377, 385.
158 2013 Banking Communication, point 45.
159 Article 57(2) and (3), Article 58(3) BRRD.
160 Recital (8) BRRD. Iftinchi 2017, p. 76. Hadjiemmanuil *EE* 2016, p. 105.
161 Gortsos 2016, p. 10.

of the bank's operations to a new entity under a transfer tool, since this would lead to the old entity's dissolution. However, if the transfer tool is used to transfer the bank's ownership to a new owner, including a bridge bank, it is the author's view that this should be seen as a 'going concern' solution, in which case it could be argued that the GFST could also be used in such a situation. Lastly, one could potentially argue that the GFST should also be available to fund a bridge bank, since a bridge bank itself should be operated as a viable going concern.[162]

Access criterion 6: Management on commercial and professional basis
Member States have to ensure – to the extent that the shareholding in a bank or group so permits – that the bank or group that is subject to the application of the GFST is managed on a commercial and professional basis.

Access criterion 7: Approval under the State aid regime
The GFST may only be used after receiving final approval under the Union State aid framework.[163]

5.3.5.5 Access to GFST within the SRM?

The SRMR does not provide for a legal basis for the SRB – or the national resolution authorities – to seek funding through the use of the GFST.[164] It is logical that the SRB, being a supranational agency, cannot seek funding from Member States, also taking into account the level playing field that the SRMR intends to achieve.[165] It is understood that the SRB, as an EU agency, cannot interfere with the sovereignty of the Member States when, at the national level, the government takes the decision to support the bank by applying the GFST.[166] Although the SRB may not actively seek funding through the use of the GFST, it can thus can also not prevent a Member State from using the GFST if a bank is put in resolution under the SRM and as long as there is no violation of the resolution framework. There will be no violation of the framework as long as the GFST are used in line with the requirements set out in the BRRD and – potentially – Article 27(9) SRMR. The only authority who could then still oppose to this use is the Commission, if the use of the GFST is in violation of the State aid rules.

162 Recital (65) BRRD.
163 Article 37(10)(b) BRRD.
164 See also Busch, Van Rijn and Louisse *EBLR* 2019, p. 589, 597.
165 Article 6(6) SRMR. See also Gardella 2015, p. 212.
166 EC, Eurostat guidance note on statistical implications of new resolution legislation, 31 March 2016, p. 17.

It is explicitly stated in a briefing from the European Parliament that the GFST have not been included in the SRMR.[167] Although this seems to be implied, the briefing does however not explicate whether the GFST are available under the SRMR. Binder notes that neither the availability of EPFS as such nor the procedural framework for the provision of EPFS within the institutional setting of the SRM have been adequately addressed in the SRMR.[168] The author concurs with this conclusion. This status quo may be partly motivated by the fact that a Fiscal Union is still undebatable within the EU, as discussed in section 5.5.2.4. As long as Member States have the sovereignty to decide on the award of State aid within the boundaries set by the State aid regime for the banking sector aid the resolution framework, it will be difficult to fully achieve and resolution objective of protecting public funds by minimising reliance on EPFS.

5.3.5.6 Access to other Member State support than GFST (alternative financing sources)

The resolution framework does not exclude the possibilities for Member States to support banks in resolution.[169] As discussed in sections 5.3.5.4 and 5.3.5.5, the GFST provide Member States with the option to recapitalise a bank or to take a bank in ownership if the GFST have been implemented by the relevant Member State. Member States can however also provide other forms of support, such as funding guarantees, liquidity support, or impaired asset measures. The question is whether there still is access to these types of measures within resolution and, if so, whether any access restrictions apply.

An argument that there should still be access to Member State support in resolution is, that the ESM DRI, as discussed in the next section, could never be applied, if this access were not available, since application of this instrument requires a contribution by the participating Member State requesting for the application of the ESM DRI. The ESM DRI would then be an empty shell.

In accordance with Article 44(7) BRRD and Article 27(9) SRMR, in extraordinary circumstances, the resolution authority may seek further funding

167 EP Financing Arrangements Briefing 2018, p. 6.
168 Binder *EBOR* 2017, p. 415.
169 Recital (55) BRRD.

from 'alternative financing sources'. Alternative financing sources include in any event the GFST, based on the text of Article 37(10) BRRD, and the ESM DRI, based on the text of Article 30(6) SRMR. Article 44(7) BRRD and Article 27(9) SRM are, however, not restricted to alternative financing sources in the form of GFST and the ESM DRI. It therefore seems that other support measures from Member States would also be available in resolution, as long as the following access criteria are met.[170]

> An interesting question is whether Member States could still recapitalise a bank in accordance with Article 44(7) BRRD or Article 27(9) SRMR, without qualifying this as the use of the GFST. It is the author's understanding that this would be in violation of the resolution framework. See also section 5.5.2.5.

Access criterion 1: Bail-in
In accordance with Article 44(7) BRRD and Article 27(9) SRMR, in extraordinary circumstances, the resolution authority may seek further funding from 'alternative financing sources' after the national resolution funds or SRF have contributed up to 5% of total liabilities, and all unsecured, non-preferred liabilities, other than eligible deposits, have been written down or converted in full.[171]

Access criterion 2: Assessment by Commission in case of exclusion of liabilities
Where the contribution by alternative financing sources is required because of exclusion of certain liabilities in accordance with Article 44(3) BRRD (Article 27(5) SRMR), the Commission may, within 24 hours of receipt of such a notification, or a longer period with the agreement of the resolution authority, prohibit or require amendments to the proposed exclusion if the requirements under the resolution framework are not met, in order to protect the integrity of the internal market. This is without prejudice to the application by the Commission of the State aid regime for the banking sector.[172]

170 See however EP Liquidation In-Depth Analysis 2019, p. 12. See also Schillig 2018, p. 56.
171 This may therefore be more far-reaching than compliance with the requirement to bail-in 8% of total liabilities, including own funds of the bank in resolution. This bail-in requirement applies when the national resolution funds or the SRF are used to cover any losses or to recapitalise the bank. After the resolution authorities have decided to exclude eligible liabilities from bail-in.
172 Article 44(12) BRRD. Article 18(7), last paragraph SRMR.

> An interesting question is whether alternative *financing sources* also include alternative *funding means* as meant in Article 105 BRRD.[173] These are 'borrowings or other forms of support from institutions, financial institutions or other third parties' in the event that the amounts raised by a national resolution fund or the SRF are not immediately accessible or sufficient. The BRRD seems to use both terms randomly. It could, however, also be that there is a difference between alternative *financing sources* and alternative *funding means*; the SRMR seems to point in that direction.[174] In the author's view, it would be logical to make a distinction between alternative financing sources and alternative funding means, since the latter are clearly meant as a backstop to the national resolution funds and the SRF, while the former could also be used for a different purpose, if one takes into account the text of Article 44(7) BRRD and Article 27(9) SRM.

5.3.5.7 Access to the ESM DRI within the SRM

Even if the GFST are not available within the SRM, this would not mean that recapitalisation of a bank in resolution cannot take place with the use of EPFS. From 8 December 2014, the ESM can apply the ESM DRI to systemic banks that are put in resolution, if these are found in need of additional recapitalisation funds. The ESM only provides for direct bank recapitalisation for banks established in the participating Member States of the SSM and that are therefore in scope of the SRM. The ESM Board of Governors decides on the application of the ESM DRI.[175] Decisions of the ESM Board of Governors in that respect should be taken by unanimity.[176]

> It has been argued that the instrument of direct recapitalisation would no longer be needed once the SRF is fully established, as in that case the ESM will provide a back-up directly to the SRF.[177] It is currently foreseen as part of the ESM reform that the ESM DRI will

173 See Article 44(6)(c) BRRD.
174 See Article 27(8)(b) BRRD that uses the term alternative *funding means*, while Article 27(9) SRMR uses the term alternative *financing sources*.
175 Article 4(3) ESM DRI Guideline.
176 Article 5(6)(f) ESM Treaty. Some authors have argued that the procedure for direct recapitalisation should be simplified so that it can actually be deployed when needed. See e.g. Sapir and Schoenmaker *Bruegel Policy Brief* 2017, p. 5. See also critically – but with a positive note – Lo Schiavo, p. 171-172.
177 EP, At a Glance – An evolutionary path for a European Monetary Fund?, 31 August 2017, PE 602.102.

> no longer be available for recapitalisation of a bank.[178] This is an interesting development, because the ESM DRI is available on request of a participating Member State and approval from the Board of Governors, while the SRF is available depending on a decision by the SRB, which acts independently from the Member States and in the general interest.[179] Replacing the ESM DRI by the backstop to the SRF will therefore have the impact that participating Member States will be more dependent on the SRB for the funding of a bank in resolution, unless Member States are given a say in the use of the backstop.

As a general rule, the ESM will acquire common shares (CET 1) in the bank through the application of the ESM DRI.[180] The ESM Board of Governors may however also decide to authorise the acquisition of other capital instruments, the issuance of guarantees or, in exceptional circumstances, to provide financial assistance to any bridge institution or asset management vehicle.[181]

The ESM Board of Directors may only apply the ESM DRI, if the following 'access criteria' are met as set out in the ESM DRI Guideline.

<u>Access criterion 1: Breach of capital requirements</u>
The bank is, or is likely to be in the near future, in breach of the capital requirements established by the ECB in its capacity as supervisor, it is unable to attract sufficient capital from private sector sources to resolve its capital problems and the bail-in conducted in accordance with Article 8 of the ESM DRI Guideline (see access criterion 6) is not expected to fully address the capital shortfall. Private sector sources include tapping new market investors or existing shareholders. [182]

> The ESM DRI is thus not available for precautionary recapitalisation. Some authors have argued that the ESM should be allowed to participate in precautionary recapitalisations.[183] It seems, however, that this is not intended to be part of the ESM Treaty amendment in relation to the common backstop function.

178 Term sheet on the ESM reform, 4 December 2018.
179 Article 47(1) and (2) SRMR.
180 Article 10(1) ESM DRI Guideline.
181 Article 10(2) ESM DRI Guideline.
182 Article 3(1)(a) ESM DRI Guideline.
183 Sapir and Schoenmaker *Bruegel Policy Brief* 2017, p. 5. Véron *Bruegel Policy Contribution* 2017, p. 10.

Access criterion 2: Systemic relevance

The bank concerned should have a systemic relevance or pose a serious threat to the financial stability of the Eurozone as a whole or of the requesting participating Member State. In establishing the systemic relevance of a bank, the systemic dimension of the bank will be assessed, taking primarily, its size, interconnectedness, complexity, and substitutability into account.[184]

> Systemic relevance can refer to: (i) systemically important institutions that fall into the main criteria enclosed in the ESM DRI Guideline (size, interconnectedness, complexity, and substitutability); or (ii) other institutions, not necessarily cross-border, whose insolvency could have a significant negative impact on the financial system because of adverse market circumstances or financial stress. [185]

Access criterion 3: Direct supervision by the ECB

The bank should be directly supervised by the ECB.[186] It can be expected that this will normally be the case when taking the access criterion of systemic relevance into account. However, if the bank is not directly supervised by the ECB, the ESM Board of Governors will request the ECB to take over its direct supervision.

Access criterion 4: Use of ESM DRI is indispensable to safeguard financial stability

The use of the ESM DRI should be indispensable to safeguard the financial stability of the Eurozone as a whole or of its Member States. [187]

Access criterion 5: Member State is unable to provide financial assistance in full itself

The requesting participating Member State of the SSM should be unable to provide financial assistance to the bank *in full* without very adverse effects on its own fiscal sustainability, including via the instrument of indirect recapitalisation. The use of the ESM DRI can also be considered if it is established that other alternatives would have the effect of endangering the continuous market access of the requesting participating Member State and consequently require the financing of its sovereign needs via the ESM. [188]

184 Article 3(1)(b) ESM DRI Guideline.
185 Footnote 2 ESM DRI Guideline.
186 Article 4(2) ESM DRI Guideline.
187 Article 3(2)(b) ESM DRI Guideline.
188 Article 3(2)(a) ESM DRI Guideline.

Access criterion 6: Contribution by the Member State

Although the requesting participating Member State should not be able to provide the financial assistance in full by itself, it should contribute a level of capital alongside the ESM. The exact contribution depends on the bank's equity level. If a participating Member State is unable to fully provide its contribution, the Board of Governors may decide to partially or fully suspend the contribution.[189]

> If the beneficiary bank has insufficient equity to reach the legal minimum CET 1 of 4.5%, the requesting participating Member State will be required to make a capital injection to reach this level. Only then will the ESM participate in the recapitalisation. If the beneficiary bank already meets the capital ratio mentioned above, the requesting participating Member State will be obliged to make a capital contribution alongside the ESM. This contribution will be equivalent to 20% of the total amount of public contribution in the first two years after the ESM DRI is applied.

Access criterion 7: Bail-in

The ESM DRI may only be used provided that, (a) a contribution to loss absorption and recapitalisation equal to an amount not less than 8% of the total liabilities including own funds of the bank in resolution, measured at the time of resolution action, has been made by shareholders, the holders of relevant capital instruments, and other eligible liabilities through write down, conversion or otherwise, (b) a contribution by the SRF of 5% of the total liabilities including own funds of the bank in resolution, measured at the time of resolution action has been made, and (c) all unsecured, non-preferred liabilities, other than eligible deposits, have been written down or converted in full. [190]

> The conditions set out under (b) and (c) concur with the conditions set out in Article 27(9) SRMR that provides that, in extraordinary circumstances, further funding may be sought from alternative financing sources. It can be derived from Article 30(6) SRMR that such

189 Article 9 ESM DRI Guideline.

190 Article 8 ESM DRI Guideline.

> alternative financing sources specifically include the ESM DRI, as this article states that the SRB will cooperate closely with any public financial assistance facility, including the ESM, in particular in the extraordinary circumstances referred to in Article 27(9) SRMR.

Access criterion 8: Approval under the State aid regime
The ESM DRI may only be used after receiving final approval under the Union State aid framework.[191]

5.3.6 *Access to EPFS in insolvency?*

Public funding only qualifies as EPFS insofar it is provided in order to preserve or restore the viability, liquidity or solvency of a bank or group entity of such a bank. Public funding granted to allow for the exit process to take place in an orderly manner so as to preserve financial stability does therefore not qualify as EPFS. This section discusses the access to public funding in situations in which a bank is wound up in normal insolvency proceedings, because resolution action is not necessary in the public interest, or because resolution involves part of the bank to be wound up in normal insolvency proceedings.

5.3.6.1 Resolution action is not necessary in the public interest

If a bank is FOLTF, but a resolution action is not necessary in the public interest, it should be wound up in normal insolvency proceedings. Winding up a bank through normal insolvency proceedings should be the starting point. The extra safety net of resolution is only available to the few, according to Ms König, Chair of the SRB.[192]

> While this stance is reiterated extensively throughout publications of the European institutions, it is in the author's view problematic for two reasons. The first is the lack of harmonization of national insolvency proceedings in the EU.[193] Secondly, it should be taken into account that winding up a bank through normal insolvency proceedings can only take place if the conditions set out in national law for entering such proceedings are fulfilled. The administrative or judicial authorities of the home Member State of the bank which

191 Article 4(4) ESM DRI Guideline.
192 Merler *Bruegel Policy Contribution* 2018, p. 2.
193 See e.g. Gortsos 2015, p. 67.

are responsible for winding up are alone empowered to decide on the opening of winding up proceedings concerning a bank.[194] The SRB or the national resolution authorities can therefore not subject a bank to normal insolvency proceedings following the assessment that resolution is not necessary in the public interest.

This became clear in the case of ABLV Bank Luxembourg. On 23 February 2018, the ECB determined that ABLV Bank Luxembourg was FOLTF.[195] The SRB subsequently determined that resolution action was not necessary in the public interest, and that winding up should take place under the law of Luxembourg.[196] The Luxembourg court however rejected a request from the competent authority (the *Commission de Surveillance du Secteur Financier*) to liquidate ABLV Bank Luxembourg. The court assessed that ABLV Bank Luxembourg had a strong financial standing and could look for new investors.[197] This outcome directly contradicted the determination by the ECB. It is therefore unsurprising that ABLV Bank brought an action before the CI to annul the decision of the ECB that ABLV Bank and ABLV Bank Luxembourg are FOLTF. In an order of 6 May 2019, the CI decided that the action of ABLV Bank was inadmissible.[198] In that respect, it is interesting that BRRD II introduces a new Article 32b which requires Member States to ensure that a bank in relation to which the resolution authority considers that the resolution conditions, besides the public interest condition, are met, should be wound up in an orderly manner in accordance with the applicable insolvency law.

It is up to the discretion of the Member States whether or not to grant liquidation aid to failing banks that are not put in resolution.[199] The resolution framework does not set any restrictions in that respect.

194 Article 9 Reorganisation and Winding Up Directive.
195 ECB, ECB determined ABLV Bank was failing or likely to fail, 24 February 2018.
196 SRB, The Single Resolution Board does not take resolution action in relation to ABLV Bank, AS and its subsidiary ABLV Bank Luxembourg S.A., 24 February 2018.
197 Reuters, Court rules Latvian bank ABLV may keep Luxembourg branch, 10 March 2018.
198 GC, 6 May 2019, T-281/18, ECLI:EU:T:2019:296 (*ABLV Bank v ECB*). See also section 4.4.1.1.
199 EC Factsheet 2017. Bacon 2017, p. 375. Such liquidation aid cannot qualify as EPFS, taken into account the definition of EPFS (see section 5.2.1.2).

Banca Popolare di Vicenza and Veneto Banca

An example of the award of liquidation aid to failing banks that were not put in resolution, is the award of liquidation aid to Banca Popolare di Vicenza and Veneto Banca. After the ECB had established that the banks were FOLTF, the SRB considered that there was no public interest in resolution.[200] Rather than initiating a liquidation procedure under general insolvency law, the Italian government, on the basis of an emergency decree enacted directly after the SRB's decisions, prepared the ground for a breakup of the two institutions, the sale of parts of their business to a competitor (Intesa Sanpaolo), the transfer of the unviable parts to a 'bad bank', and a compensation for those private investors who had purchased subordinated debt instruments issued by both banks. In particular, the Italian State granted the following measures: cash injections of about EUR 4.785 billion and State guarantees of a maximum of about EUR 12 billion, notably on Intesa's financing of the liquidation mass. Both guarantees and cash injections were backed by the Italian State's senior claims on the assets in the liquidation mass. The Commission found these measures to be in line with the State aid regime for the banking sector. A potential transfer of non-performing loans from Banco Popolare di Vicenza and Veneto Banca to an AMC was deemed by the Commission not to constitute State aid, since the transfer would occur at a value less or equal to the net book value.[201]

Banca Romagna

On 29 June 2015, Italy notified the Commission the forthcoming liquidation of Banca Romagna. Italy first tried to sell Banca Romagna as a going concern, but when that failed, it decided to resolve Banca Romagna as a gone concern under national insolvency law by selling only parts of assets and liabilities out of liquidation. Non-performing loans, deferred tax assets, and subordinated debt would remain in the entity to be liquidated. Banca Sviluppo was selected as the buyer of the offered assets and liabilities of Banca Romagna.

200 SRB, Decision concerning the assessment of the conditions for resolution in respect of Veneto Banca S.p.A (SRB/EES/2017/11); SRB, Decision concerning the assessment of the conditions for resolution in respect of Banca Popolare di Vicenza S.p.A (SRB/EES/2017/12). EC, 25 June 2017, C(2017) 4501 final (SA.45664 – Banca Popolare di Vicenza and Veneto Banca), par. 36-46, 59-85.

201 EC, 25 June 2017, C(2017) 4501 final (SA.45664 – Banca Popolare di Vicenza and Veneto Banca), par. 36-46, 59-85.

> The Italian deposit guarantee scheme contributed the negative difference between the acquired assets and liabilities in cash, and in turn became the only senior creditor of the entity in liquidation. This was considered by the Commission to be State aid compatible with the internal market pursuant to Article 107(3)(b) TFEU.[202]

5.3.6.2 Resolution is combined with normal insolvency proceedings

Once the resolution authority has taken the decision to put a bank in resolution, normal insolvency proceedings should be excluded, unless they need to be combined with the use of the resolution tools and at the initiative of the resolution authority.[203] For example, in the event of a partial transfer of assets of a bank in resolution to a private purchaser or to a bridge bank, the residual part of the bank in resolution should be wound up in normal insolvency proceedings.[204] In such a case, a Member State may be willing – following the request from the bank in resolution – to provide liquidation aid to the bank.[205]

> In the case of BANIF, Portugal re-notified the rescue recapitalisation aid that was granted to BANIF as liquidation aid, because BANIF would exit the market as a result of the resolution strategy. The Commission considered this aid award to be compatible with the internal market on the basis of Article 107(3)(b) TFEU.[206]

5.4 Access to ELA under the resolution framework

A special case involves emergency liquidity assistance (ELA). National central banks can award ELA to banks in and outside the Eurozone. As discussed in section 3.3.1.3, this ELA does not constitute State aid if it is granted in accordance with the conditions set out in the 2013 Banking Communication. As a result of the outcome that ELA does not qualify as EPFS because it is no State aid and also no supranational EPFS, the description of the access to EFPS under the resolution framework set out in the previous section does not apply for ELA. This section discusses the

202 EC, 2 July 2015, C(2015) 4599 final (SA.41924 – Banca Romagna), par. 33-56.
203 Recital (44) BRRD.
204 Recital (50) BRRD.
205 Again, such liquidation aid cannot qualify as EPFS, taken into account the definition of EPFS (see section 5.2.1.2).
206 EC, 21 December 2015, C(2015) 9763 final (SA.43977 – BANIF), par. 92-95, 188.

access to ELA for failing banks. It starts with a description of the assessment framework that sets the criteria for access to ELA. Subsequently, it discusses the restrictions that are set in relation to access to ELA in and outside of resolution.

5.4.1 *The assessment framework*

The resolution framework does not provide for an assessment framework in respect of ELA, as long as this does not qualify as EPFS. The criteria for access to ELA are the result of the prohibition on monetary financing set out in Article 123 TFEU, in combination with the requirement of financial independence set out in Article 130 TFEU and the criteria set out in the State aid regime for the banking sector. Within the Eurozone, the ELA Agreement also forms part of the assessment framework. This section discusses the criteria for access to ELA set out in this assessment framework.

5.4.1.1 Solvency

In accordance with guidance from the ECB, ELA can only be granted to solvent banks. The rationale behind this is that by financing an insolvent bank, a national central bank would be assuming a government task in violation of the monetary financing prohibition set out in Article 123 TFEU. Article 123 TFEU provides that overdraft facilities or any other type of credit facility with the ECB or with the national central banks of the Member States in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States, will be prohibited, as will the purchase directly from them by the ECB or national central banks of debt instruments. The ECB has developed guidance on the basis of which it may decide whether a task conferred on a national central bank is to be considered a central banking task or a government task for the purposes of the monetary financing prohibition set out in Article 123 TFEU. The ECB considers that, while, for purposes of the monetary financing prohibition solvency support is a government task, liquidity-related tasks, the ultimate objective of which are to finance the economy, are central banking tasks.[207]

In the ELA Agreement it is set out that a bank is considered to be solvent, if:

1. its CET 1, Tier 1 and Total Capital Ratio as reported under CRR on an individual (if applicable) and consolidated (if applicable) basis comply with the harmonised minimum regulatory capital levels (namely 4.5%, 6% or 8%, respectively); or
2. there is a credible prospect of recapitalisation - in case condition 1. is not met, i.e. the CET 1, Tier 1 and Total Capital Ratio, on an individual and/or consolidated basis, do not comply with the harmonised minimum regulatory capital levels (namely 4.5%, 6% or 8%, respectively) - by which harmonised minimum regulatory capital levels would be restored within 24 weeks after the end of the reference quarter of the data that showed that the bank does not comply with harmonised regulatory minimum standards; in duly justified, exceptional cases the Governing Council of the ECB may decide to prolong the grace period of 24 weeks.[208]

As a result of this broad definition of solvency, also including the "*credible prospect of recapitalisation*", ELA could potentially also be granted in resolution as long as the bank put in resolution has a credible prospect of recapitalisation. This is further discussed in section 5.4.5.

> Mr Mersch, Member of the Executive Board of the ECB, has indicated that the ECB will probably change these indicators in the future in order to take account of forward-looking elements, in line with the evolution of supervisory practices, so as to have a more accurate picture about the solvency of the bank and the appropriateness of continuing to provide ELA, and in view of the fact that FOLTF means a handover to resolution authorities.[209] See also section 5.5.2.2.

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207 Sinn 2014, p. 169-175. See also e.g. the opinion of the ECB of 3 February 2017 on liquidity support measures, a precautionary recapitalisation and other urgent provisions for the banking sector, CON/2017/01, footnote 40. ECB, Opinion of 1 February 2016 on the recovery and resolution of credit institutions and investment firms, CON/2016/5, par 2.5.2. ECB, Opinion of 1 July 2015 on recovery and resolution in the financial market, CON/2015/222, par. 2. ECB, Convergence Report May 2012, p. 29-30.

208 Section 4 ELA Agreement.

209 Mersch 2018.

Article 123 TFEU does not prevent a State guarantee from being provided for ELA. The ECB has, however, set a number of criteria that must be met in that case:

1. It must be ensured that the credit provided is as short term as possible;
2. There must be systemic stability aspects at stake;
3. There must be no doubt as to the legal validity and enforceability of the State guarantee under the applicable national law; and
4. There must be no doubt as to the economic adequacy of the State guarantee, which should cover both principal and interest on the loans, thus fully preserving the central bank's financial independence.[210]

> If a State guarantee is provided, the ELA qualifies as State aid and can only be awarded after approval from the Commission under the State aid regime for the banking sector. See also section 3.3.1.3 and section 5.2.2.

5.4.1.2 Central bank independence

Article 130 TFEU forms the legal basis for central bank independence. This entails that neither national central banks nor the ECB, will seek or take instructions from Union institutions, bodies, offices or agencies, from any government of a Member State, or from any other body. This does not only apply in the conduct of monetary policy, but also in relation to the provision of ELA.

> This means that central banks cannot be instructed to provide liquidity – the provision of liquidity must be their free and independent decision.[211]

Such independence also implies that national central banks are required to have sufficient financial resources not only to perform their ESCB-related tasks but also their national tasks, including the provision of ELA. Losses incurred by a national central bank in the exercise of its national tasks could negatively impact on the exercise of ESCB-related tasks. For all these reasons, financial independence under the EU Treaties implies that a national central bank should always be sufficiently capitalised. Therefore, the event of a national central bank's net equity becoming less than its statutory

210 ECB Opinion 2017, par. 3.3.
211 Mersch 2018.

capital or even negative would require that the respective Member State provides the national central bank with an appropriate amount of capital at least up to the level of the statutory capital within a reasonable period of time so as to comply with the principle of financial independence.[212]

5.4.1.3 No interference with the single monetary policy of the Eurosystem

In order to ensure that ELA operations do not interfere with the single monetary policy of the Eurosystem, the ECB has to be informed, regardless of the size or nature of the ELA operations, of the details of any ELA operation, at the latest, within two business days after the operation was carried out. After the initial notification, further relevant information should be provided on an ongoing basis until the ELA is repaid. In addition, the bank receiving ELA must provide a funding plan within two months following the first provision of ELA. For as long as the bank is receiving ELA, it must update the funding plan on a quarterly basis. On a monthly basis, the bank must also provide up-to-date information on the precise level of regulatory capital ratios as well as the leverage ratio. Any bank in breach of the own funds requirements under the CRR must submit a recapitalisation plan to the ECB. Lastly, where ELA is provided for a period longer than six months, the governor(s) of the national central bank(s) involved must address a letter to the President of the ECB outlining the intended exit strategy.[213]

Where the size of ELA operations envisaged by one or more national central banks for a bank or banking group exceeds a threshold of EUR 500 million, the national central bank(s) involved should inform the Executive Board of the ECB at the earliest possible time prior to the extension of assistance[214].

Where the size of ELA operations envisaged by one or more national central banks for a bank or banking group exceeds a threshold of EUR 2 billion, the Executive Board of the ECB has to timely decide whether the issue needs to be addressed by the Governing Council of the ECB. If the Executive Board comes to the conclusion that there is a risk that the respective ELA interferes with the single monetary policy of the Eurosystem, it will ask the Governing Council to take a position on this issue at short notice. The national central

212 ECB Opinion 2016, par. 2.5.
213 Section 3.2(a) ELA Agreement.
214 Section 3.2(b) ELA Agreement.

bank(s) is (are) free to undertake the planned ELA operations unless the Governing Council decides to prohibit the execution of the operations, on the grounds that they interfere with the Eurosystem's single monetary policy, within 24 hours of the notification by the national central bank(s).[215]

In addition, the Governing Council has the following powers under the ELA Agreement:

1. It may prohibit ELA, if it finds that the provision of ELA interferes with the objectives and tasks of the ESCB. This may be the case, if Article 123 TFEU is violated;
2. The provision of ELA may only exceed 12 months following a non-objection by the Governing Council.[216]

5.4.1.4 Compatibility with the State aid regime

As set out in section 3.3.1.3, ELA constitutes State aid unless the cumulative conditions set out in point 62 of the 2013 Banking Communication are met. If these cumulative conditions are not met, ELA qualifies as State aid. In that case, the award thereof can only take place if the Commission considers this to be compatible with the internal market. For example, ELA granted under a counter-guarantee of a Member State qualifies as State aid.

5.4.2 ELA as a trigger for resolution?

As set out in section 5.2.2, it is the author's understanding that it is intended that ELA as defined in the BRRD, does not qualify as State aid and is therefore not covered by the EPFS definition. Moreover, the recitals to the BRRD and SRMR mention that resort to ELA does not demonstrate *per se* that a bank is or, in the near future, will be unable to pay its liabilities as they fall due.[217] Based on that premise, ELA granted by a national central bank does not trigger resolution as such.

> When ELA is provided under a State guarantee, this leads to the qualification of ELA as State aid, and therefore EPFS, as a result of which one could argue that the award of ELA would trigger resolution. Hadjiemmanuil, however, mentions that the fact that the use of

215 Section 3.3 ELA Agreement.
216 Sections 5 and 6 ELA Agreement.
217 Recital (41) BRRD. Recital (57) SRMR.

State guarantees in support of ELA does not trigger resolution (because these qualify as precautionary guarantees) may contribute to the conclusion that the use of ELA in that case also does not trigger resolution.[218] This seems to be a logical interpretation, although the text of the BRRD and SRMR leaves room for debate.

5.4.3 *ELA as a trigger for the exercise of the PONV conversion power?*

ELA granted by a national central bank does not trigger the exercise of the PONV conversion power as such. If State guarantees are used in support of ELA (i.e. precautionary guarantees), the PONV conversion power must however be exercised, as set out in section 5.3.3.

Taking into account the definition of solvency discussed in section 5.4.1.1, a bank could still be eligible for ELA after it has reached the PONV when there is a credible prospect of recapitalisation during the 6 months following this determination and the bank has sufficient collateral to pledge.[219]

5.4.4 *ELA as a trigger for recovery?*

Article 5 BRRD does not prohibit recovery plans to assume access to ELA and other central bank support. Moreover, access to central bank funding is considered a recovery option, for example to address the risks of adverse fluctuations in market prices or potential changes in a central bank tender process. Recovery plans should therefore provide that banks have the required amount of collateral in custody with the relevant central bank, or facilitate availability of central bank eligible collateral.[220]

5.4.5 *Access to ELA in resolution*

This section discusses the access to ELA in resolution.

5.4.5.1 No assumption of ELA in the resolution plan

The resolvability assessment of a bank should lead to the situation that it is feasible and credible for the resolution authorities to either wind up a bank (and its group entities) in normal insolvency proceedings or to resolve the

218 Hadjiemmanuil *EE* 2016, p. 107.
219 Fernandez de Lis and Garcia 2018, p. 6.
220 EBA Comparative Report on Recovery Options 2017, p. 34, 41.

bank (or its group) by applying resolution tools and powers *without* the assumption of ELA or any central bank liquidity assistance provided under non-standard collateralisation, tenor and interest rate terms.[221] The resolution plan has to identify how resolution actions could be financed without assuming such public funding.[222]

5.4.5.2 The award of ELA in resolution

Although it may not be assumed in the resolution plan, when a bank is put in resolution it may still have access to ELA if it is considered solvent and has sufficient clearly identified eligible collateral. Whether a bank still has access to ELA when it is put in resolution depends on whether it can still be considered solvent as defined by the ECB. The application of the resolution tools may lead to the bank becoming financially sound again. For example, in the case of resolution through application of the asset separation tool, liquidity can be provided to the solvent part of the bank that is participating in monetary policy transmission and not in order to finance the separation itself. Its restored solvency will first have to be confirmed by the competent authority, before it can have access to ELA (and Eurosystem monetary policy liquidity) again. A bridge bank may also have access to such liquidity once it has obtained a license as a bank and complies with the relevant capital, liquidity, and leverage ratios.[223] Wind up entities, whose main purpose is the gradual divestment of their assets and the cessation of their business (such as asset management vehicles), have been excluded from access to monetary policy credit operations. As regards their access to ELA, the relevant central bank assesses the situation of each entity according to that central bank's national framework. However, in most cases, these entities are unlikely to obtain access to ELA, if there are doubts as to their solvency, or if this would raise monetary financing concerns.

5.4.6 Access to ELA in insolvency

If a bank is put into insolvency or liquidation proceedings, no liquidity can be provided by a central bank, be it under the monetary policy framework or ELA, because this would violate the prohibition of monetary financing.[224]

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221 Article 15(1) BRRD. Article 10(1) SRMR.
222 Article 10(7)(i) BRRD. Article 8(9)(i) SRMR.
223 Mersch 2018.
224 Mersch 2018. Section 5.3 ELA Agreement.

5.5 Access to public funding after the introduction of the resolution framework

This section discusses the impact of the resolution framework on the access to public funding for failing banks. It also discusses the hurdles that can be identified in restricting such access.

5.5.1 Impact of the resolution framework on the access to public funding for failing banks

As a result of the resolution framework, the access to public funding for failing banks has been restricted. Which restrictions apply depend on whether it concerns the availability of public funding in or outside of resolution.

5.5.1.1 Access restriction

The previous sections have shown that the access to public funding as a remedy for failing banks has been restricted by the resolution framework. Firstly, the terms EPFS and ELA have been introduced within the resolution framework to regulate the access to public funding. Only, if public funding falls within scope of one of these concepts, is the access thereto regulated by the resolution framework. This means, for example, that public funding in the form of liquidation aid and interventions by Member States on market terms, are not impacted by the resolution framework.

Secondly, if public funding qualifies as EPFS or ELA, access thereto is restricted in several ways under the resolution framework, as discussed in sections 5.3 and 5.4.

> It can be derived from sections 5.3 and 5.4 that the resolution framework restricts the access to EPFS and ELA in the following ways:
>
> <u>Resolvability assessment</u>
> If the resolvability assessment reveals that the winding up in normal insolvency proceedings or the resolution likely involves the use of EPFS – other than national resolution funds or the SRF –, ELA or any central bank liquidity assistance provided under non-standard collateralisation, this should lead to the outcome that there are substantive impediments to the resolvability of the bank or group involved.

In that case, measures should be taken to improve the resolvability. As a result, resolvability cannot be established when EPFS or ELA (or any central bank liquidity assistance provided under non-standard collateralisation) is required in the resolution or winding up of a bank in normal insolvency proceedings. In that case, restructuring measures can be imposed on the bank that need to ensure that this is not required.[225] An exemption is made for the use of national resolution funds or the SRF. The use of these means of EPFS does not impede resolvability.

Recovery and resolution plan

Recovery plans may not assume access to EPFS, but they may assume access to ELA and other central bank support. Resolution plans have to identify how resolution actions could be financed without assuming EPFS – other than national resolution funds or the SRF –, ELA or any central bank liquidity assistance provided under non-standard collateralisation.

Exercise of PONV power

The exercise of the PONV conversion power is triggered when EPFS is used, except in the situation of a precautionary recapitalisation. This means that, prior to access to EPFS, the resolution authority has to reduce CET 1 items in proportion to the losses and to the extent of their capacity, after which the principal amount of AT 1 instruments has to be written down or converted in CET 1 instruments or both, and/or the principal amount of Tier 2 instruments has to be written down or converted into CET 1 instruments or both.[226] ELA does not trigger the exercise of the PONV conversion power.

FOLTF assessment

A bank is considered to be FOLTF, *inter alia*, where EPFS is required, unless it concerns precautionary guarantees or precautionary recapitalisation. As a result, resolution is triggered where EPFS is granted, provided that the other resolution conditions are also met. Resolution authorities have no discretion in that respect. When a bank is put in resolution, a mandatory bail-in of shareholders and creditors applies should the bank want to access EPFS, with the exception of precautionary recapitalisation and precautionary

225 See section 7.2.1.3.
226 Article 60(1) BRRD.

guarantees.[227] ELA granted by a national central bank does not trigger resolution as such.

Access criteria
The resolution framework has introduced criteria that have to be fulfilled in order to get access to EPFS (access criteria). These access criteria set strict boundaries for the award of EPFS outside of resolution, as a result of which the award of EPFS outside of resolution is only possible in the form of precautionary guarantees and precautionary recapitalisation. In addition, when using EPFS in resolution,[228] the access criteria include the mandatory application of a bail-in to effectuate a contribution from shareholders and creditors to cover the losses of a bank, as further discussed in section 7.4.3.2. Moreover, the access criteria ensure that the use of GFST and the ESM DRI is only possible as an *ultimum remedium*.[229]

The resolution framework does not provide for any access criteria in respect of ELA, as long as this does not qualify as EPFS. As discussed in section 5.4.1, the criteria for access to ELA are the result of the prohibition on monetary financing set out in Article 123 TFEU in combination with the State aid prohibition set out in Articles 107 and the requirement of financial independence set out in Article 130 TFEU. Within the Eurozone, the ELA Agreement also forms part of the assessment framework; this has not changed as a result of the resolution framework.[230]

The access restrictions included in the resolution framework do not all restrict the access to public funding in the same way. Some of the access restrictions contribute to minimising the total amount of public funds necessary to assist failing banks (*absolute restriction*).

227 Section 7.4.3.2 shows that an exemption to the bail-in requirement applies when national resolution funds or the SRF are used other than for loss absorption or recapitalisation.
228 With the exception of contributions by national resolution funds or the SRF, other than when used for loss absorption or recapitalisation.
229 Whether or not the access criteria are fit for purpose is a topic of debate in literature. Some authors argue that the access criteria for precautionary recapitalisation or the ESM DRI are too strict (Sapir and Schoenmaker *Bruegel Policy Brief* 2017. Véron *Bruegel Policy Contribution* 2017). In the author's view, this intertwines with the lack of flexibility in the burden-sharing requirements when a bank is put in resolution. See section 8.6.8.
230 See in respect of the specific rules for ELA in combination with the State aid rules also Laprévote and Coupé 2017, p. 118.

> For example, the introduction of the award of EPFS as a trigger for resolution creates an absolute restriction to the access of public funding. When a bank is put in resolution, a mandatory bail-in of shareholders and creditors applies should the bank want to access EPFS, with the exception of precautionary recapitalisation and precautionary guarantees (albeit, that the PONV conversion power should be exercised in respect of precautionary guarantees).[231] It can be read in the BRRD recitals that this exception should be appreciated against the objective of preserving financial stability.[232]

Other access restrictions are directed more towards introducing a certain 'public funding cascade' in which taxpayers' money (that is, Member State resources) is used in the last instance (*relative restriction*).

> For example, the use of national resolution funds and the SRF do not impede resolvability. In addition, ELA, contributions from the national resolution funds and contributions from the SRF are all public funding means that are available without triggering burden-sharing (unless – in the case of the national resolution funds and the SRF – they are used to cover losses or recapitalise a failing bank). In the author's view, it is remarkable that the bail-in requirement applies when national resolution funds or the SRF cover losses or recapitalise a failing bank, as this may cause hesitation to use these public funding means; this seems to be contrary to the purpose of the resolution framework to favour the use of these means (which are funded by the banking sector itself) over Member State support. This may however be justified by reasons of limiting moral hazard.
>
> In addition, the very strict requirements for the use of the ESM DRI, similar to the requirements that apply for the use of the GFST, are quite remarkable, as this instrument is not an actual taxpayers' liability.[233] Véron argues that it should even be allowed to use the ESM DRI for precautionary recapitalisation. According to him, currently, only individual Member States can engage in precautionary recapitalisations, a situation that prevents the fulfilment of the European Banking Union's aim "*to break the vicious circle between banks and*

231 Section 7.4.3.2 shows that an exemption to the bail-in requirement applies when national resolution funds or the SRF are used other than for loss absorption or recapitalisation.
232 Recital (41) BRRD.
233 It is however a taxpayers' contingent liability. See also section 5.5.2.4.

> *sovereigns*". Allowing the ESM to participate in a precautionary recapitalisation either alone or alongside Member States would help to fulfil that promise.[234] The relevance of this discussion is, however, limited, because the ESM DRI is intended to develop into the SRF backstop.

5.5.1.2 Access differentiation

The access restrictions that apply under the resolution framework differ depending on whether it concerns the availability of public funding in or outside of resolution. The resolution framework therefore not only provides for access restriction, but also for access differentiation.

> The insolvency phase is not covered by the resolution framework. As a result, the resolution framework does not control the access to public funding sources in this phase.

The access differentiation created by the resolution framework can be explained by the different purposes that public funding may have. Public funding can be geared more towards addressing liquidity issues (liquidity support) or solvency issues (solvency (or capital) support). While liquidity support addresses temporary cash flow problems caused by a lack of liquid assets, solvency support aims to absorb losses (in other words, to ensure that the net asset value is equal to zero) and to restore the capital position of a bank (in other words, to restore the regulatory capital ratios).

> Liquidity can come from direct cash holdings in currency or on account at a national central bank. More commonly, it comes from holding securities that can be sold quickly with minimal loss. Banks can increase their liquidity in multiple ways, e.g. shorten asset maturities, improve the average liquidity of assets, lengthen liability maturities, issue more equity, reduce contingent commitments, or obtain liquidity protection (e.g. from another bank or the national central bank). All else being equal, the higher the capital levels at banks, the less need there is likely to be for high levels of liquidity. Higher capital levels decrease the likelihood of a loss of confidence by funders and increase the ability of the central bank to perform

234 Véron *Bruegel Policy Contribution* 2017, p. 10.

its lender of last resort function, as it becomes clearer that banks are solvent. Conversely, the lower the level of liquidity, the greater the need for capital to protect a bank from a confidence shock.[235]

Table 7 shows the public funding sources currently available for banks, divided in liquidity support and solvency support. It shows that public funding sources are more geared towards solvency support in resolution. Liquidity support may, however, also be beneficial for the solvency of a bank and *vice versa*. Illiquidity and insolvency are linked and closely interdependent, and will often be indistinguishable, in particular in a crisis scenario.[236] The distinction is therefore not as clear as may be expected on the basis of the table.

Table 7: Qualification of public funding as liquidity or solvency support

Source of public funding	**Liquidity support**	**Solvency support**
Outside resolution (and normal insolvency proceedings)		
Precautionary guarantees	x	
Precautionary recapitalisation		x (future solvency as result of the failure of the adverse scenario stress test)[237]
ELA	x	
DGS (alternative measures)	x (primary focus)[238]	
Inside resolution		
NRF / SRF	x	x (but only in case the resolution authorities have decided to fully or partially exclude eligible liabilities from bail-in)
DGS (resolution financing)	x (not exceeding the costs of fulfilling the statutory or contractual mandate of the DGS)	x (not exceeding the costs of fulfilling the statutory or contractual mandate of the DGS)

235 Elliot 2014, p. 2, 4, 19. De Groen 2018, p. 5.
236 Schillig 2018, p. 9. See also Grünewald *JBR* 2010, p. 73-74.
237 Olivares-Caminal and Russo 2017, p. 7.
238 EC, Deposit Guarantee Schemes – Frequently Asked Questions, 12 July 2010, MEMO/10/318, p. 3. It is however not excluded that such alternative measures take the form of recapitalisation or an impaired assets measure (Hancher, Ottervanger and Slot 2016, p. 521).

GFST		x
ESM DRI		x
Member State support other than GFST (alternative financing sources)	x (e.g. loans and guarantees)	x (e.g. impaired assets measures)

As a result, a further distinction can be made between public funding available in the recovery phase, the resolution phase, and the insolvency phase. This distinction differs depending on whether the public funding is available for banks and banking groups in the Eurozone (in scope of the SRMR) or banks and banking groups outside the Eurozone (in scope of the BRRD). Table 8 provides a summary of findings in relation to the access to public funding in the different phases, while making a distinction between the public funding sources available under the SRMR and the BRRD.

Table 8: Summary of findings in relation to access to public funding

	ELA	**DGS support**	**NRF**	**SRF**	**ESM DRI**	**Member State support**
SRMR						
Recovery phase	Yes	Yes (alternative measures)	No	No	No	Yes, precautionary guarantees / precautionary recapitalisation
Resolution phase	No (unless the bank is considered solvent)	Yes (resolution financing)	No	Yes	Yes	Yes, (GFST and) alternative financing sources
Insolvency phase	No	Yes (pay-out function and other use)	No	No	No	Yes, liquidation aid
BRRD						
Recovery phase	This depends on national legislation	Yes (alternative measures)	No	No	No	Yes, precautionary guarantees / precautionary recapitalisation

Resolution phase	This depends on national legislation	Yes (resolution financing)	Yes	No	No	Yes, GFST and alternative financing sources
Insolvency phase	No	Yes (pay-out function and other use)	No	No	No	Yes, liquidation aid

5.5.2 *Hurdles in restricting the access to public funds*

The previous sections have shown that the access to public funds is restricted under the resolution framework depending on in which phase (recovery, resolution or insolvency) and under which legal instrument (BRRD or SRMR) the public funds are used. The following sections show that there are further hurdles in restricting such access.

5.5.2.1 Concepts of EPFS and ELA need further refinement

The concepts of EPFS and ELA as introduced in the resolution framework need further refinement. Firstly, the definition of EPFS makes the concept of 'State aid' an integral part of the fabric of the resolution framework.[239] As a result, when public funding qualifies as State aid, it qualifies as EPFS provided that it is granted to preserve or restore the viability, liquidity, or solvency of a bank. One should be aware that the notion of State aid is a technical term with a defined legal meaning.[240] Regardless of whether a failing bank is resolved through the resolution framework or under national standard insolvency law, any mobilisation of financial resources that meets the definition of State aid will be subject to the State aid regime for the banking sector.[241] An example where this interlinkage of definitions seems to cause unintended consequences, are alternative measures taken by deposit guarantee schemes. As discussed in section 5.3.4, these alternative measures may qualify as State aid and therefore as EPFS, in which case they trigger resolution, while, at the same time, they can only be granted outside of resolution.

Secondly, as a result of the restriction of the definition of EPFS to aid provided to preserve or restore the viability, liquidity, or solvency of a bank, it is not clear whether the use of the SRF and the national resolution funds

239 Schillig 2018, p. 64.
240 Schillig 2018, p. 11.
241 Schillig 2018, p. 6.

always qualify as EPFS, as they may also be used to assist in winding up the bank in an orderly manner, e.g. through the use of a transfer tool. It seems to be the intention that the use of the SRF and the national resolution funds always qualify as EPFS, but strictly speaking, the definition of EPFS would have to be amended to include all possible uses of the SRF and the national resolution funds.

Thirdly, it is not clear whether ELA qualifies as EPFS or not. It seems that ELA is excluded from the definition of EPFS as long as this meets the conditions set out in the 2013 Banking Communication, as a result of which it does not qualify as State aid. It would however be helpful if the definition of ELA in the resolution framework refers to the conditions set out in the 2013 Banking Communication.

5.5.2.2 Lack of access to liquidity support in resolution

Section 5.5.1.2 showed that in resolution, public funding sources are more geared towards solvency support. A bank in resolution may however also be in need of liquidity support. Liquidity support may be needed, if resolution takes place at a point when a bank is still solvent.

> In the case of Banco Popular, a rapid evaporation of liquidity followed media coverage on doubts about asset quality and the bank's poor earnings position coupled with questionable management. This prompted the resolution decision by the ECB.[242]

Liquidity support may also be needed after the capital position has been restored (through bail-in or bail-out).[243] In the EU, the resolution framework has been qualified by Ms König, Chair of the SRB, as "*being geared towards addressing solvency issues more than liquidity*". She sees a need for central banks to step in and to provide liquidity in resolution.[244]

> Given the extent of the potential liquidity needs in resolution, the resources of the SRF, even when supplemented by a backstop of the same or similar size, may not be sufficient to adequately address these needs.[245]

242 Lehmann 2018, p. 6.
243 Bodellini *EBOLR* 2018, p. 376. Haentjens and Wessels 2014, ch. 8, par. 4.
244 EP Financing Arrangements Briefing 2018, p. 9. See also FSB Report 2018, p. 3.
245 EC Report on application and review resolution framework 2019, p. 7. De Groen 2018, p. 5.

The additional liquidity facility could be provided by the ECB in the form of 'Eurosystem Resolution Liquidity' (ERL).[246] That instrument should be construed as a monetary policy tool as the ESCB may not take financing actions that should be undertaken by public authorities. In addition, it would require a public-sector guarantee, for example, provided by the SRF with a potential backstop provided by the ESM, in order to meet the collateral demand.[247] In this way, the ECB would not finance any government deficits, no taxpayer money would be involved, and thus no monetary financing would take place. ERL would also not be considered State aid, although this should ideally be covered by the State aid regime for the banking sector through a special section, provided that i) the bank is not considered insolvent at the moment it receives the funds because a recapitalisation plan is applied in the short term; ii) while collateral for ELA purposes might be depleted, there will be a guarantee from the SRF, considered as appropriate collateral for funding in resolution purposes, which is backed by funds raised *ex ante* and if needed *ex post* by the industry so neither taxpayers money nor moral hazard issues would be involved, and iii) there is no counter-guarantee from a State.[248] The debate on ERL is closely linked to the unsettled issue on whether the function of ELA should be centralized at the level of the ECB.[249] See section 5.2.2.

> With the introduction of ERL as a source of liquidity support in resolution the definition of 'solvency' as applied by the ECB in relation to ELA may become stricter as it will then no longer be necessary to rely on ELA for liquidity purposes within resolution. See section 5.4.1.1.

5.5.2.3 Financial stability as the overriding goal

Within the resolution framework, several indications can be found that (one of) its objectives is to protect public funds. Firstly, the BRRD and SRMR recitals contain several references to the objective of minimising the costs for 'taxpayers'.[250] Secondly, one of the resolution objectives is to

246 Such introduction of ERL provided by the ECB should hence also be accompanied by centralizing ELA provision at the level of the ECB in order to better coordinate the provision of liquidity (EP Financing Arrangements Briefing 2018, p. 12).
247 EP Financing Arrangements Briefing 2018, p. 10-11. Fernandez de Lis and Garcia 2018, p. 6. De Groen 2018, p. 11.
248 Fernandez de Lis and Garcia 2018, p. 9. De Groen 2018, p. 12. See differently Avgouleas and Goodhart 2019, p. 17.
249 Gortsos 2019-1, p. 275.
250 Recitals (1), (5), (31) BRRD, Recital (73) SRMR. See also Recitals (1) and (5) BRRD II (Recitals (1) and (5) SRMR II).

protect 'public funds' by minimising reliance on EPFS (by failing banks).[251] In other words, one of the reasons to put a bank in resolution is to restrict the use of public funds for bank failures. Even if this is not the reason for putting the bank in resolution, public funds are still protected through the resolution condition that there is no reasonable prospect that any alternative private sector measures, including measures by an IPS or supervisory action taken in respect of the entity, including early intervention measures or the write-down or conversion of relevant capital instruments in accordance with the PONV conversion power, would prevent its failure within a reasonable timeframe. This resolution condition should always be met before a bank can be put in resolution.[252] While protecting public funds is one of the objectives of the resolution framework, another is to avoid a significant adverse effect on the financial system (according to the wording in the BRRD) or the financial stability (according to the wording in the SRMR).[253]

> For example, precautionary recapitalisation and precautionary guarantees have been exempted as a trigger for resolution in order to preserve financial stability. See section 5.5.1.1.

According to Tuominen, the Member States came up with the concept of financial stability in order to justify the bail-out of Greece and the subsequent creation of the ESM. The underlying rationale was that the GFC threatened not just the individual Member States, but also the future of the euro as a currency and therefore the whole EU. With this political rationale, financial stability became a legally legitimizing factor for bail-outs.[254] There is however a tipping point, when bail-outs have a destabilizing impact on public finances and sovereign debt.[255] During the GFC, certain Member States faced this tipping point, as a result of which it became clear that strict limits should be set for bail-outs. Both the State aid regime and the resolution framework, however, prioritise maintaining financial stability above protecting public funds in a last resort situation.[256] The underlying assumption justifying the use of public funds in a last resort situation is that the financial position of the bank could quickly deteriorate and then

251 Article 31(2)(c) BRRD. Article 14(2)(c) SRMR.
252 See section 4.4.1.2.
253 See also, *inter alia*, Recitals (11), (18), (24), (29), (40), (41), (45), (49), (132) BRRD, Recitals (10), (19), (39), (46), (61), (73) SRMR.
254 Tuominen *CML Rev.* 2017, p. 1378.
255 Avgouleas and Goodhart *EE* 2016, p. 76. See also Lo Schiavo 2018, p. 170-171.
256 Olivares-Caminal and Russo 2017, p. 15. Lastra, Russo and Bodellini 2019, p. 13-14.

generate financial instability.[257] This means that sometimes taxpayers have to contribute to the losses of banks in order to avoid any further – potentially catastrophic – losses and to ensure financial stability.

There could therefore be situations where the use of public money instead of – or accompanying – the resolution tools can be more appropriate and effective in light of the public interest. Public funds may be needed if imposing extensive losses on private stakeholders would unleash large spillovers. In these exceptional cases, the moral hazard and fiscal costs of bail-outs would be preferable to the disruptive effects that spillovers associated with bail-ins could have on financial stability and the economy at large.[258] In other words, financial instability can have a meaningful cost to taxpayers even if it is not visible in the very short term.[259]

> Besides financial stability considerations, there may also be financial considerations for using public money. Cases could occur in which Member States' intervention can be less costly and more beneficial for the public than the application of the bail-in tool both in a going-concern and in a gone-concern scenario.[260] In a letter from Mr Draghi to Mr Almunia of 30 July 2013, Mr Draghi reminds Mr Almunia that there have been several recent examples where viable banks have been recapitalised with public money as a means of enhancing confidence and stability and where the funds involved were paid back in a timely manner, with the State making a non-negligible return.[261]

5.5.2.4 Member States are still the ultimate backstop

The standing of a banking system depends on the strength and credibility of the backstop of the available resources, especially in the case of a full-blown systemic crisis.[262] As long as this backstop is provided by the Member States, it will still be the Member States that ultimately carry the burden of failing banks. While the BRRD has introduced additional public funding resources in the form of national resolution funds, funding

257 Bodellini *Cambridge Yearbook of European Legal Studies* 2017, p. 155.
258 IMF Staff Discussion Note 2018, p. 7.
259 Constâncio 2014.
260 Bodellini *Cambridge Yearbook of European Legal Studies* 2017, p. 161.
261 Letter from Mr Draghi to Mr Almunia, 30 July 2013, L/MD/13/474. See also Fernandez de Lis and Garcia 2018, p. 13 for an overview of the cost of government interventions to support financial institutions.
262 Schoenmaker *IF* 2018, p. 41.

through these funds is capped at certain maxima. If the amount of aid available within these limits is not sufficient, the Member States will still act as the ultimate backstop. The same applies to the use of deposit guarantee schemes.

In addition, while the introduction of the SRF and ESM DRI may have lifted the decision to use these forms of EPFS to the Eurozone level, thereby breaking the direct link between Member States and banks, this is still suboptimal, because both funding resources are capped at 55 billion and 60 billion, respectively.

Should aid be required from the SRF that exceeds the threshold of EUR 55 billion, the Member States will still have to act as the capital backstop. They provide a national individual credit line to the SRB to back their national compartments in the SRF in case of possible funding shortfalls following resolution cases of banks in the Eurozone.

> As discussed, the ESM Treaty will be amended to provide the ESM with the new task to act as a common backstop to the SRF.

In case of the ESM DRI, any losses arising will be charged on, firstly, the reserve fund,[263] secondly, against the paid-in capital and thirdly, through a capital call. The paid-in capital is provided by the participating Member States and the callable capital is committed by the same Member States. Although the Member States are ultimately the backstop, this is a contingent liability. The Member States share the burden of bank failure in their jurisdictions.[264] Although the backstop to the ESM DRI is a contingent liability of the Member States, the ESM DRI may only be applied, if the Member State in which the failing bank is established also contributes to the funding gap of the failing bank. As a result, there still is a link between the failing bank and the Member State in which it is established when the ESM DRI is used.

Table 9 shows the different sources of public funding available in resolution, other than direct Member State support, their target level, resources and ultimate backstop.

263 The reserve fund is formed by the net income generated by the ESM operations and the proceeds of the financial sanctions received from the ESM Members under the multilateral surveillance procedure, the excessive deficit procedure and the macro-economic imbalances procedure established under the TFEU (Article 24 ESM Treaty).

264 It has therefore become a taxpayers' contingent liability. See also Grünewald 2014, p. 242. This was made conditional on the establishment of the SSM.(Teixeira *EBOLR* 2017, p. 546).

Table 9: Resources and backstop of public funding in resolution

Source of public funding in resolution, other than Member State support	**Target level**	**Resources**	**Ultimate backstop**
DGS support	At least 0.8% of covered deposits by 2024 (in specific cases the adjusted target level may be 0.5%).[265]	The deposit guarantee schemes are funded by their members, which are the banks in the respective Member States.[266]	Deposit guarantee schemes should have adequate alternative funding arrangements in place to enable them to obtain short-term funding to meet claims against them.[267] These arrangements could involve support from Member States.
NRF	1% of covered deposits by 2024.[268]	Contributions from the banking sector outside the Eurozone, BRRD investment firms and Union branches	Alternative funding means (including Member State support) raised in accordance with Article 105 BRRD[269]

265 Article 10 DGS Directive.
266 Article 10 DGS Directive.
267 Article 10(9) DGS Directive.
268 Article 102 BRRD. Part of the national resolution funds of participating Member States will be transferred to the SRF. The final target level of the national resolution funds of participating Member States will hence be lower, because only BRRD investment firms and Union branches will contribute to such national resolution funds.
269 Article 44(6)(c) BRRD. In Article 105 BRRD it is specified that national resolution funds are enabled to contract borrowings or other forms of support from institutions, financial institutions or other third parties in case the *ex ante* and *ex post* contributions to the national resolution funds are insufficient to cover the losses, costs or other expenses incurred by the use of the single resolution fund. Such alternative financing sources can also include funding by Member States. For example, In the resolution of BANIF, selected assets and liabilities were transferred to a private sector purchaser (Banco Santander Totta). The gap between the price offered by the buyer for the assets and liabilities amounted to EUR 2,225 billion. The funding gap was filled by a contribution of EUR 489 million by the Portuguese resolution fund and EUR 1,766 million by the Portuguese State (EC, 21 December 2015, C(2015) 9763 final (SA.43977 – BANIF), par. 65).

SRF	1% of covered deposits by 2024.[270]	Contributions from the banking sector within the Eurozone	Alternative funding means raised in accordance with Articles 73 and 74 SRMR.[271] As of 2016, all participating Member States have entered into a harmonised Loan Facility Agreement for a maximum aggregate amount of EUR 55 billion with the SRB, providing a national individual credit line to the SRB to back their national compartments in the SRF in case of possible funding shortfalls following resolution cases of banks in the Eurozone. The banking sector of the Member State concerned will be liable for repayment of the amounts drawn under the credit line.[272]

270 Article 69 SRMR. This is estimated to be EUR 55 billion. See also Busch *EBLR* 2017, p. 464.

271 Article 27(8)(b) SRMR. In Article 73 SRMR it is stated that the SRB may contract for the SRF borrowings or other forms of support from those institutions, financial institutions or other third parties, which offer better financial terms at the most appropriate time so as to optimise the cost of funding and preserve its reputation in the event that the amounts raised in the banking sector are not immediately accessible or do not cover the expenses incurred by the use of the SRF in relation to resolution actions. Pursuant to Article 74 SRMR, the SRB has to contract for the SRF financial arrangements, including, where possible, public financial arrangements, regarding the immediate availability of additional financial means to be used where the contributions from the banking sector are not sufficient to meet the SRF's obligations.

272 Council, Statement on Banking Union and bridge financing arrangements for the Single Resolution Fund, 8 December 2015. See also Teixeira *EBOLR* 2017, p. 555.

ESM DRI	EUR 60 billion	The ESM raises money it needs in financial markets by issuing bills and bonds and through other funding tools[273]	Losses arising in the ESM operations shall be charged on, firstly, the reserve fund, secondly, against the paid-in capital and thirdly, through a capital call.[274] The ESM has a total capital of nearly EUR 705 billion. This consists of over EUR 80 billion in paid-in capital provided by the participating Member States and approximately EUR 624 billion in committed callable capital.[275]

Although central bank support is, at the time of writing this dissertation, not (yet) available in resolution – unless the bank can be considered solvent –, it is also interesting to look at the resources of central banks. The main liabilities of central banks are issued banknotes and commercial bank reserves as a result of their monetary operations. Central banks also carry capital on their balance sheet. This capital comes from the Member States for most central banks, but it can also come from the public.[276] The Bank of Greece is, for example, listed on the Athens Exchange.[277]

> According to Schoenmaker, a central bank can provide unlimited liquidity by expanding its balance sheet, but its capacity to bear losses is limited to its capital which is normally provided by the Member States.[278] He also notes that, taking into account that the national

273 FAQ on the ESM, 28 July 2014, Question A9 and Section C. Article 21 ESM Treaty.
274 Article 25(1) ESM Treaty.
275 ESM, FAQ on the ESM, 28 July 2014, Question A9. Articles 8 and 9 ESM Treaty.
276 Rule 2015, p. 8-15,
277 Article 8 Statute of Bank of Greece, tenth edition, 2016.
278 Schoenmaker 2015, p. 46.

central banks of all Member States are the shareholders of the ECB,[279] any losses of the ECB, are transferred to these national central banks. This makes the Member States the ultimate backstop of the ECB.[280]

5.5.2.5 Fiscal sovereignty of Member States

According to Mr Constâncio in his role as vice-president of the ECB, participant countries in the European Banking Union are shedding considerable sovereign power. In accepting the transfer of supervision and resolution of banks to the European level, Eurozone countries are committing to a remarkable sharing of sovereignty which could be a positive sign of their willingness to deepen European integration in general.[281] While the fiscal sovereignty of Member States is restricted by State aid control and by the agreements set out in the Fiscal Compact Treaty,[282] it is, however, still the prerogative of Member States to decide whether or not to grant State aid to a bank.[283] The SRB and national resolution authorities cannot prevent a Member State from providing State aid to a failing bank. Only the Commission can order the repayment of unlawful aid in accordance with Article 108(2) TFEU.

This is different in respect of the GFST. According to Gortsos, the GFST enable a Member State to provide funding to a bank in resolution through State resources.[284] In the author's view, the GFST do not enable a Member State to provide funding to a bank in resolution, as they could already provide public funding prior to the introduction of the resolution framework. The resolution framework, however, introduces conditions that the Member States should comply with when providing public funding through the GFST. If they do not comply with these conditions when recapitalising or taking a bank in ownership, they would be violating the resolution framework. This is interesting, as under the State aid regime for the banking sector it is possible for Member States to notify aid measures which they consider compatible with Article 107(3)(b) TFEU to the Commission *without* meeting the conditions set out in the State aid regime

279 The national central banks of the non-Eurozone Member States are only required to contribute to the operational costs incurred by the ECB. They therefore only pay up a small percentage of their share in the ECB's subscribed capital.
280 Schoenmaker 2015, p. 49. See also Grünewald 2014, p. 182-183.
281 Constâncio 2014.
282 See section 1.4.4.
283 See also Grünewald 2014, p. 221.
284 Gortsos 2016, p. 12.

for the banking sector and the Commission may authorise the proposed aid in exceptional circumstances.[285] The GFST therefore seem to restrict the prerogative of Member States to choose for recapitalisation or nationalisation of a bank. Member States can still choose to do so, but they need to comply with the resolution framework. The same is true for precautionary recapitalisation and guarantees.

> As discussed in section 5.3.5.6, it is the author's understanding that Member States may also still award other forms of public funding in resolution, as long as they meet the access conditions set for alternative financing sources, in addition to the conditions that apply under the State aid regime for the banking sector.

5.6 Conclusion

This chapter discussed the access to public funding for failing banks after the introduction of the resolution framework. The resolution framework introduced the terms EPFS and ELA to regulate access to public funding. Only, if public funding falls within scope of one of these concepts, is the access thereto regulated by the resolution framework. This means, for example, that public funding in the form of liquidation aid and interventions by Member States on market terms are not impacted by the resolution framework.

If public funding qualifies as EPFS or ELA, access thereto is restricted in several ways under the resolution framework: (a) through the resolvability assessment, (b) in the recovery and resolution plans, (c) by making EPFS a trigger for the exercise of the PONV conversion power, (d) by making EPFS a trigger for resolution, and (e) by making the access to EPFS subject to compliance with certain access criteria, including the application of a mandatory threshold for bail-in in respect of – certain forms of – EPFS granted in resolution. In respect of ELA, a separate assessment framework applies that provides for access criteria.

285 ECJ, 19 July 2016, C-526/14, ECLI:EU:C:2016:570 (*Kotnik v Slovenia*), par. 43. ECB, Opinion of the European Central Bank of 6 November 2013 on a proposal for a Regulation of the European Parliament and of the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Bank Resolution Fund and amending Regulation (EU) No 1093/2010 of the European Parliament and of the Council, CON/2013/76, par. 2.8.

The access restrictions included in the resolution framework do not all restrict access to public funding in the same way. Some contribute to minimising the total amount of public funds necessary to assist failing banks (*absolute restriction*), such as the mandatory bail-in of shareholders and creditors that apply in respect of – certain forms of – EPFS granted in resolution. Others are more directed towards introducing a certain 'funding cascade' in which taxpayers' money (that is, Member State resources) is used in the last instance (*relative restriction*). For example, the use of national resolution funds and the SRF do not impede resolvability.

The access restrictions that apply under the resolution framework differ depending on whether it concerns the availability of public funding in or outside of resolution. The resolution framework therefore not only provides for access restriction, but also for access differentiation. The access differentiation created by the resolution framework can be explained by the different purposes that public funding may have. Public funding can be geared more towards addressing liquidity issues (liquidity support) or solvency issues (solvency – or capital – support). As a result, a distinction can be made between public funding available in the recovery phase, the resolution phase and the insolvency phase. This distinction differs depending on whether the public funding is available for banks and banking groups in the Eurozone (in scope of the SRMR) or banks and banking groups outside the Eurozone (in scope of the BRRD).

This chapter recognised that there are still some hurdles in restricting access to public funding. The concepts of EPFS and ELA need further refinement in order to limit uncertainty and mitigate unintended consequences. In addition, currently, public funding sources in resolution are more geared towards solvency support. A bank in resolution may however also be in need of liquidity support. At the time of writing this dissertation, whether the ECB could provide an additional liquidity facility in resolution – without such qualifying as State aid – is a subject of discussion. Furthermore, although the resolution framework aims to protect public funds, financial stability is the overriding goal. As a result, bail-outs are sometimes preferable to bail-in due to financial stability (or financial) considerations. Other hurdles are the lack of backstops to public funding resources that are *not* provided by the Member States, and that it is the prerogative of Member States to decide whether or not to grant State aid to a failing bank. Abolition of the hurdles identified in this chapter may further contribute to restricting the access to public funds. In the author's view, it is, however, more important to find the right balance between financial stability and the protection of public funds than restricting the access to public funding against all costs.

CHAPTER 6

THE IMPACT OF THE RESOLUTION FRAMEWORK ON THE EXERCISE OF STATE AID CONTROL BY THE COMMISSION

> "*As the rules of the Banking Union start to have their effect, there should be much less need for state aid in the future. But the state aid rules have made a big difference to helping to build a healthy banking sector in Europe, with fair competition.*"
>
> *Vestager 2018*

6.1 Introduction

The State aid regime for the banking sector, as described in Chapter 3, has not changed as a result of the introduction of the resolution framework. The Commission still assesses State aid awards to failing banks on the basis of the 2013 Banking Communication. Although Ms König, the Chair of the SRB, believes that the 2013 Banking Communication is, in effect, out of date as the EU has taken further steps since the introduction of the 2013 Banking Communication to make sure failed banks can be wound up without sparking a broader crisis, the Commission has not – yet – changed the State aid regime for the banking sector.[1] This does not, however, mean that the resolution framework has not had an impact on the exercise of State aid control by the Commission. Since the introduction of the resolution framework, the Commission has to assess State aid granted in the banking sector, not only on compatibility with the internal market, but also on compatibility with the resolution framework (procedural impact). In addition, it has acquired the new role of co-resolution authority since the introduction of the resolution framework (institutional impact).

This chapter first assesses the institutional impact by discussing the different roles of the Commission as a result of the introduction of the resolution framework in section 6.2. It subsequently assesses the procedural impact. Section 6.3 introduces the term 'resolution aid' for State aid that is granted in relation to the resolution of banks and discusses what is meant by compliance with 'intrinsically linked provisions' of the resolution

1 FT, Tighter EU curbs urged on winding down banks, 8 August 2017.

framework. Section 6.4 discusses the assessment by the Commission of this resolution aid. Section 6.5 discusses the assessment of State aid outside resolution. Section 6.6 further analyses the impact that the resolution framework has on State aid control by the Commission and identifies any challenges in the exercise thereof after the introduction of the resolution framework. Section 6.7 concludes this chapter.

> This chapter is based to a large extent on the State aid decisions taken by the Commission following the introduction of the resolution framework. It should be noted that the number of State aid decisions taken by the Commission since the introduction of the resolution framework is still modest at the time of writing this dissertation. In addition, as set out in section 3.5.2, the Commission is not bound by its earlier decisional practice in the application of Article 107(3) TFEU.[2] It is against that background, that the following sections assess the Commission's decisions in order to shed light on the impact of the resolution framework on the exercise of State aid control by the Commission.

6.2 The different roles of the Commission

Since the introduction of the resolution framework, the Commission basically has two roles. It still acts as State aid authority, but, in addition, it also acts as co-resolution authority within the SRM. Lastly, a possible third role can be distinguished, as will be further discussed in the sections below.

6.2.1 The Commission in its role as State aid authority

The resolution framework has not changed the fact that the Commission has the exclusive competence to assess State aid awards on their compliance with the internal market under Articles 107 and 108 TFEU. In addition, it has not changed the State aid regime for the banking sector or the concept of State aid. The resolution framework does, however, have an impact on the role of the Commission as State aid authority, as further discussed below.

2 According to Lannoo, these decisions are however certainly taken into consideration by the EU Courts in exercising their judicial review function (Lannoo 2010, p. 31). See also GC, 1 March 2017, T-454/13, ECLI:EU:T:2017:134 (SNCM v Commission), par. 99.

6.2.1.1 References to State aid (regime) in the resolution framework

The resolution framework contains several references to 'State aid' and the 'Union State aid framework', the latter being defined as "*the framework established by Articles 107, 108 and 109 TFEU and regulations and all Union acts, including guidelines, communications and notices, made or adopted pursuant to Article 108(4) or Article 109 TFEU*".[3] These references can be distinguished in four categories:

a) References that are – from a legal perspective – unnecessary and did not have to be included in the resolution framework;
b) References that streamline the restructuring obligations of a bank under the resolution framework and the State aid regime for the banking sector;
c) References that ensure that the resolution framework does not violate the State aid regime for the banking sector; and
d) References that regulate the relation between the SRB and the Commission.

<u>Ad a: Unnecessary references</u>
Certain references in the resolution framework are – from a legal perspective – unnecessary, because they are already covered by Articles 107 and 108 TFEU. These are, for example, references to aid measures, such as precautionary guarantees, precautionary recapitalisation and GFST, being conditional on final approval under the Union State aid framework[4], and Member States needing to comply with the Union State aid framework when applying the resolution tools and exercising the resolution powers.[5] Even if these references were not included in the resolution framework, the same would apply on the basis of Articles 107 and 108 TFEU. In other words, the resolution framework cannot in any way restrict the exclusive competence of the Commission to assess State aid awards on their compliance with the internal market under Articles 107 and 108 TFEU.[6] Hence, the legal basis for the Commission to assess, for example, the compatibility of precautionary guarantees with the internal market is not the resolution framework, but Articles 107 and 108 TFEU.

3 Article 2(1)(53) BRRD.
4 Article 32(4)(d) BRRD. Article 18(4)(d) SRMR. Recital (41) BRRD. Recital (57) SRMR. Article 37(10)(b) BRRD. Article 56(1) BRRD.
5 Article 34(3) BRRD. Recital (47) BRRD. Article 38(2) BRRD. Article 39(2) BRRD. Article 41(1)(g) BRRD. Article 41(4) BRRD. Other examples can be found in Article 36(5) BRRD, Article 20(6) SRMR, Article 44(12) BRRD, Recital (41) BRRD and Recital (57) SRMR.
6 Botta *JEI* 2016, p. 265.

While the resolution framework cannot restrict the competence of the Commission to assess State aid awards on their compliance with the internal market, an interesting question is whether the resolution framework can expand this. In the author's view, this is only possible insofar this expansion is not, on its own merit, included in the competence under Articles 107 and 108 TFEU. One could, for example, think of the assessment of SRF contributions as these do not qualify as State aid, but are made subject to the State aid rules by means of Article 19 SRMR.[7]

> Although – from a legal perspective – it may be preferable to delete the references to the Union State aid framework as set out above, there may be a practical advantage of including these references. The financial regulatory framework and the State aid regime for the banking sector are two different domains, governed by different institutions and experts. The references may serve the purpose of ensuring that both domains are aware of each other's existence and impact.

Ad b: Streamline restructuring obligations

The resolution framework explicates that, where the Union State aid framework is applicable, a business reorganisation plan should be compatible with the restructuring plan that a bank is required to submit to the Commission under the State aid regime for the banking sector.[8] This compatibility requirement would not apply if not set out in the resolution framework. Moreover, the resolution framework sets out that where the business reorganisation plan is required to be notified within the Union State aid framework, the resolution authority may extend the period in which this has to be submitted to the resolution authority.[9] These references streamline the restructuring obligations of a bank put in resolution with the assistance of State aid. The impact of the resolution framework on the restructuring process of a bank is discussed in more detail in Chapter 7.

Ad c: No violation of the State aid regime for the banking sector

The resolution framework clarifies that the exemption for national resolution authorities to comply with any procedural requirements to notify any person prior to the exercise of resolution powers does not apply to any

7 See also Teixeira *EBOLR* 2017, p. 555.
8 Article 52(1) BRRD. Recital (69) BRRD. Recital (75) SRMR.
9 Article 52(3) BRRD.

notification requirements under the Union State aid framework.[10] Without this, the resolution framework might have given the impression that the notification obligation would not apply, which would be in violation with Articles 107 and 108 TFEU.

> National resolution authorities are public administrative authorities entrusted with public administrative powers, e.g. national central banks, competent ministries or other public administrative authorities, or authorities entrusted with public administrative powers.[11] As such they are bound by Article 107 and 108 TFEU.[12]

Ad d: Regulation of the relationship between the SRB and the Commission
Lastly, the resolution framework includes provisions that describe the relationship between the Commission and the SRB.

First, it introduces a *notification obligation* for the SRB. If the SRB considers that resolution action could constitute State aid, it has to invite the Member State(s) concerned to immediately notify the envisaged measure to the Commission. In addition, the SRB has to notify the Commission of any such case.[13]

Secondly, the resolution framework introduces a *stand-still obligation* for the SRB. Where resolution action involves the granting of State aid, the adoption of the resolution scheme shall not take place until such time as the Commission has adopted a positive or conditional decision concerning the compatibility of the use of this aid with the internal market.[14]

> Articles 107 and 108 TFEU are directed towards the Member States, but not the SRB.[15] Hence, the SRB would not be bound to the State aid provisions set out therein, including the stand-still obligation, if this was not catered for by the SRMR.[16] As stated above, this is different for national resolution authorities.

10 Article 63(2) BRRD.
11 Article 3(1)(2) and (3) BRRD.
12 Sciskalová and Münster *SBS* 2014, p. 224.
13 Article 19(2) SRMR.
14 Article 19(1) SRMR. Recital (30) SRMR.
15 Nicolaides 2016, p. 2.
16 Despite the fact that Article 44 SRMR contains a general obligation for the SRB to comply with Union law.

Thirdly, a *compliance obligation* is introduced. The resolution scheme adopted by the SRB has to establish, in accordance with any decision on State aid, the details of the resolution tools to be applied.[17] Furthermore, where State aid is present, the SRB has to act in conformity with a decision on that aid taken by the Commission.[18]

6.2.1.2 Introduction of supranational EPFS

With the introduction of the resolution framework, the SRF was also introduced: a form of supranational EPFS, similar to the ESM DRI. Both supranational funding instruments have been made subject to the State aid rules independent of their qualification as State aid. For SRF contributions, this is laid down in Article 19 SRMR. For the ESM DRI, this is laid down in Article 1(3) of the ESM DRI Guideline. As a result, the Commission is also authorized to assess the use of the SRF and the ESM DRI.

If the SRF contributions and ESM DRI were not covered by Article 107(1) TFEU, this would have led to unequal treatment of participating and non- participating Member States, since the SRF contributions and ESM DRI are only available for banks within participating Member States. These forms of supranational support within the Eurozone would then not be subject to Article 107(1) TFEU, while national financial support during resolution is covered by Article 107(1) TFEU.[19]

The new role that the Commission has gained as a result of the applicability of the State aid regime for the banking sector on supranational EPFS comes along with the interaction of different actors. This is the SRB in respect of the SRF, as discussed in section 6.2.1.1, and the ESM in respect of the ESM DRI. This may change the dynamics of the State aid procedure. In any event, as a result of the fact that both the SRF and the ESM DRI have been made subject to the State aid regime for the banking sector, there is no discussion as to whether these instruments qualify as State aid.

17 Article 23 SRMR.
18 Article 18(9) SRMR.
19 Hancher, Ottervanger and Slot 2016, p. 524.

6.2.2 The Commission in its role as co-resolution authority within the SRM

Within the SRM, the Commission (DG FISMA) considers itself to exercise the function of the ultimate authority in the context of bank resolution. As such, it ensures that any bank resolution takes place in a way that does not jeopardise financial stability while preserving market discipline via the bail-in rules which are aimed at minimising the use of public funds for a bank resolution.[20] This role of the Commission – and also the Council – is extensively discussed in the recitals of the SRMR.[21] The involvement of the Commission and the Council in the resolution decision-making process is deemed necessary, since only institutions of the Union may establish the resolution policy of the Union and since a margin of discretion remains in the adoption of each specific resolution scheme.

> While the Commission and Council are institutions which may exercise implementing powers in accordance with Article 291 TFEU, the SRB is an agency established under Article 114 TFEU. Delegating more autonomous powers to the SRB to ensure a more efficient SRM would require a Treaty change.[22]

The foregoing is sparked by the principle of delegation of powers to agencies as interpreted by the EU Courts. The TFEU itself still does not provide for an indication of when and in what form a delegation to an agency is justified and legitimate, and which form and scope legally binding acts adopted by agencies must have (in addition to the system established under Articles 290/291 TFEU).[23]

> In its judgment in the case *Meroni v High Authority*, the ECJ held that the consequences resulting from a delegation of powers are very different depending on whether it involves clearly defined executive powers the exercise of which can, therefore, be subject to strict review in the light of objective criteria determined by the delegating authority, or whether it involves a discretionary power, implying a wide margin of discretion which may, according to the use which is made of it, make possible the execution of actual economic policy. A delegation of the first kind cannot appreciably alter the consequences involved in the exercise of the powers concerned, whereas a

20 DG FISMA, Strategic Plan 2016-2020, p. 4.
21 Recitals (24) and (26) SRMR.
22 Lintner *EBOR* 2017, p. 603.
23 Lintner *EBOR* 2017, p. 605.

delegation of the second kind, since it replaces the choices of the delegator by the choices of the delegate, brings about an actual transfer of responsibility. To delegate a discretionary power by entrusting it to bodies other than those which the Treaty has established to effect and supervise the exercise of this power, each within the limits of its own authority, would render the balance of powers which is characteristic of the institutional structure of the EU ineffective.[24]

In its judgment in the *Short Selling* case, the ECJ further developed the doctrine that it had established in *Meroni v High Authority* in relation to the powers that Article 28 Short Selling Regulation[25] confers on the ESMA. It considered that it should be observed that the bodies in question in *Meroni v High Authority* were entities governed by private law, whereas the ESMA is a European Union entity, created by the EU legislature. It subsequently assessed that, unlike *Meroni v High Authority*, the exercise of the powers by the ESMA under Article 28 Short Selling Regulation is circumscribed by various conditions and criteria which limit the ESMA's discretion. In addition, the Commission is empowered to adopt delegated acts, specifying criteria and factors to be taken into account by the ESMA. The ECJ concludes that it follows from these and other considerations that the powers available to the ESMA under Article 28 Short Selling Regulation are precisely delineated and amenable to judicial review in the light of the objectives established by the delegating authority. Accordingly, those powers comply with the requirements laid down in *Meroni v High Authority*. The powers that the ESMA is vested with are therefore not incompatible with the TFEU.[26] The ECJ also assessed in this case, whether the requirement for the ESMA to adopt measures of general application under Article 28 Short Selling Regulation is at odds with the principle established in the *Romano* case.[27] The ECJ recalls, in that respect, that the institutional framework established by the TFEU, in particular the first section of Article 263 TFEU and Article 277 TFEU, expressly permits Union bodies, offices and agencies to adopt acts of general application. Accordingly, the ECJ holds that it cannot be inferred from

24 ECJ, 13 June 1958, C-9/56, ECLI:EU:C:1958:7 (*Meroni v High Authority*), p. 152.
25 Regulation (EU) No 236/2012.
26 ECJ, 22 January 2014, C-270/12, ECLI:EU:C:2014:18 (*United Kingdom v European Parliament and Council*), par. 41-54.
27 ECJ, 14 May 1981, C-98/80, ECLI:EU:C:1981:104 (*Giuseppe Romano v Institut national d'assurance maladie-invalidité*), par. 20.

> *Romano* that the delegation of powers to a body, such as the ESMA, is governed by conditions other than those set out in *Meroni v High Authority*.[28]

In order to act in compliance with the principle of delegation of powers to agencies, as interpreted by the EU Courts in the case-law set out above, the assessment of the discretionary aspects of the resolution decisions taken by the SRB is exercised by the Commission. In addition, the Commission has been empowered to adopt delegated acts to specify further criteria or conditions to be taken into account by the SRB in the exercise of its different powers. Lastly, on an ongoing basis, the Commission checks, as an observer to the meetings of the SRB, that the resolution scheme adopted by the SRB complies fully with the SRMR, balances appropriately the different objectives and interests at stake, respects the public interest, and that the integrity of the internal market is preserved.[29] Although the Commission can take part in the discussions, it does not have a vote.[30]

In addition, given the considerable impact of the resolution decisions on the financial stability of Member States and on the Union as such, as well as on the fiscal sovereignty of Member States, the implementing power to take certain decisions relating to resolution is conferred on the Council. This concerns the decisions to exercise effective control on the assessment by the SRB of the existence of a public interest and to assess any material change to the amount of the SRF to be used in a specific resolution action. The Commission also still has a role in that respect, because the decisions by the Council are taken on the proposal of the Commission. This has been discussed in section 4.5.1.1.

> Whether or not the decision-making process developed within the SRM complies with the principle of delegation of powers to agencies as interpreted by the ECJ, is appreciated differently amongst authors.[31] A major concern flagged in that respect is the stringent timeframe set out for resolution decisions.[32] Lo Schiavo questions

28 ECJ, 22 January 2014, C-270/12, ECLI:EU:C:2014:18 (*United Kingdom v European Parliament and Council*), par. 63-67. Despite the judgment of the ECJ, certain legal questions relating to the principle of delegation of powers to agencies are still unresolved. See e.g. Chamon *ERA Forum* 2018.

29 Recitals (24) and (26) SRMR.

30 Article 43 SRMR.

31 Recker 2018, p. 47-49. Lintner *EBOR* 2017, p. 610.

32 Beros *J.Com.Mar.St*. 2018, p. 653.

whether there should be a reconsideration of the principle of delegation of powers to agencies in order to ensure real effectiveness in resolution-making.[33]

6.2.3 *Another role for the Commission in the resolution process?*

When a resolution authority (the SRB or the national resolution authority) decides to (partially) exclude certain liabilities from the application of the bail-in tool, it has to notify the Commission.[34] If this requires a contribution by the SRF, national resolution fund, or an alternative financing source, the Commission may prohibit or require amendments to the proposed exclusion in order to protect the integrity of the internal market.[35] Under the SRMR, it is specified that such a decision by the Commission has to set out adequate reasons based on an infringement of the requirements laid down in Article 27 SRMR and in the delegated act adopted by the Commission on the basis of Article 44(11) BRRD.[36] This is without prejudice to the assessment by the Commission under the State aid regime.[37]

This assessment is hence not part of the State aid assessment conducted by the Commission in its role as State aid authority. It however seems that this assessment is also not made by the Commission in its role as co-resolution authority, since the BRRD also provides for the Commission to conduct this assessment.[38] One could argue that this assessment should be seen as an assessment on compliance with intrinsically linked provisions of the resolution framework, as this relates to aid measures granted by Member States or the SRF, in relation to which the Commission exercises an analogue form of State aid control, as further discussed in section 6.4.6.1. It seems however to be a more far-reaching power, since the Commission may also prohibit or require amendments to the exclusion proposed by the resolution authority.

33 Lo Schiavo 2017, p. 254.
34 Article 18(7), last paragraph SRMR. Article 44(12) BRRD. Article 18(7), last paragraph SRMR does not explicitly requires a notification to the Commission. However, it is the author's understanding that such notification will have to take place in order to enable the Commission to make its assessment.
35 But only, if the requirements of Article 44 BBRD – or Article 27 SRMR – and the delegated act adopted by the Commission on the basis of Article 44(11) BRRD are not met (Article 44(12) BRRD).
36 Article 18(7) SRMR. Article 44(12) BRRD also refers to Article 44 BRRD and the delegated act. It does however not require the Commission to set out adequate reasons.
37 Article 44(12) BRRD.
38 The Commission is no co-resolution authority under the BRRD.

6.3 Changes in the State aid assessment procedure

This section discusses how the resolution framework caused the introduction of the term 'resolution aid' and the assessment by the Commission on compliance with 'intrinsically linked provisions of the BRRD and SRMR'.

6.3.1 The introduction of the term 'resolution aid'

With the introduction of the resolution framework, the term 'resolution aid' was also introduced by the Commission in its State aid decisions. This term is not included in the 2013 Banking Communication.

> The concept of resolution aid was actually already mentioned by the Commission prior to the introduction of the resolution framework, namely in relation to the assessment of aid involved in the application of national resolution regimes. For example, T Bank and Proton Bank received 'resolution aid' when put in resolution on the basis of the Greek resolution regime.[39]

The Commission does not explain in its State aid decisions when an aid measure qualifies as resolution aid. Its decisions however show that:

- the concept of resolution aid covers all aid provided in relation to the application of a resolution tool (i.e. the sale of business tool, bridge bank tool, asset separation tool, or bail-in tool);
- the beneficiary of resolution aid can be the bank in resolution, but, for example, also the bridge bank created;
- resolution aid can be granted by Member States directly, but also by deposit guarantee schemes or the national resolution funds; and resolution aid can be granted in different forms, e.g. in the form of capital injections, impaired asset measures, guarantees, or liquidity.

It is not clear how the concept of resolution aid fits within the concepts of rescue, restructuring and liquidation aid. It seems, based on the decisions from the Commission, that resolution aid can have the form of all three types of aid, as will be seen in section 6.4.4.

39 EC, 29 April 2014, C(2014) 2933 final (SA.34825, SA.34825, SA.36006, SA.34488 and SA.31155 – Eurobank Group).

> It may benefit the transparency of the State aid regime for the banking sector, if resolution aid is distinguished as a separate type of State aid with its own assessment framework. See also section 8.6.3.

Supranational EPFS can also be a form of resolution aid, if it qualifies as State aid. As discussed in section 5.2.1.1, the qualification of supranational EPFS as State aid is however of less relevance, since the specific frameworks set out in the SRMR and the ESM DRI Guideline subject the use of the SRF and the ESM DRI to the State aid rules. It seems logical that the Commission assesses the use of the SRF and the ESM DRI along the same lines as set out for resolution aid in the next section, taking into account that the SRF and ESM DRI can only be used in resolution.

6.3.2 Compliance with intrinsically linked provisions of the resolution framework

With the introduction of the resolution framework, the Commission started to assess in its State aid decisions whether aid measures granted to the banking sector violate 'intrinsically linked provisions of the BRRD and SRMR'. It is not indicated in the resolution framework which provisions qualify as 'intrinsically linked'.[40] In its decisions in relation to aid measures awarded to banks after the introduction of the resolution regime, the Commission considers that to ascertain whether a violation of a provision of Union law is indissolubly linked to the object of the aid, a relation of necessity has to be established. It means that the State aid measure has to be connected with a national measure in a way that necessarily breaches a specific provision of Union law which is relevant for the compatibility analysis under paragraphs 2 and 3 of Article 107 TFEU.[41]

> Before the introduction of the resolution regime, the interaction between State aid rules and the resolution framework was already highlighted by the Commission's assessment of the compatibility of State aid with the BRRD.[42] For example, in the case of Panellinia Bank, the Commission assessed the compliance of measures with intrinsically linked provisions of the BRRD, although Greece had not yet transposed the BRRD into national law at that time.[43]

40 With the exception of Recital (57) BRRD, as further discussed in section 6.4.7.
41 See e.g. EC, 22 November 2015, C(2015) 8373 final (SA.43547 – Carichieti), par. 136.
42 Gray and De Cecco 2017, p. 50.
43 EC, 16 April 2015, C(2015) 2606 final (SA.41503 – Panellinia Bank), par. 111.

The obligation of the Commission to assess whether an aid measure violates intrinsically linked provisions of the resolution framework is in line with the jurisprudence of the EU Courts.

In a judgment of 15 June 1993 in the case of *Matra v Commission*[44] the ECJ held that:

"*41. It must be noted in this respect that while the procedure provided for in Articles 92 and 93 leaves a wide discretion to the Commission, and under certain conditions to the Council, in coming to a decision on the compatibility of a system of State aid with the requirements of the common market, it is clear from the general scheme of the Treaty that that procedure must never produce a result which is contrary to the specific provisions of the Treaty (judgment in Case 73/79 Commission v Italy [1980] ECR 1533, paragraph 11). The Court has also held that those aspects of aid which contravene specific provisions of the Treaty other than Articles 92 and 93 may be so indissolubly linked to the object of the aid that it is impossible to evaluate them separately (judgment in Case 74/76 Iannelli v Meroni [1977] ECR 557).*

42. That obligation on the part of the Commission to ensure that Articles 92 and 93 are applied consistently with other provisions of the Treaty is all the more necessary where those other provisions also pursue, as in the present case, the objective of undistorted competition in the common market."

In a judgment of 12 February 2008, the GC considered in relation to this obligation of the Commission that:

"[…] *while that obligation is the expression of a general principle that every application of Community law must be made in conformity with the higher rules of law, it does not mean that the Commission is required, in a procedure relating to aid, to apply the rules specially laid down for review of the application of other provisions of the Treaty or to adopt one or more decisions producing combined legal effects. Under that obligation, the Commission is required to make an assessment by reference to the relevant provisions which are not, strictly speaking, covered by the law on aid only where certain aspects of the aid in issue are so closely linked to its object that any failure on their part to comply with those provisions would necessarily affect the compatibility of the aid with the common market.*"[45]

44 ECJ, 15 June 1993, C-225/81, ECLI:EU:C:1993:239 (*Matra v Commission*).
45 GC, 12 February 2008, T-289/03, ECLI:EU:T:2008:29 (*BUPA and others v Commission*), par. 314.

In a judgment of 12 November 1992[46], the ECJ had to answer the question from a national court whether a decision by the Commission authorizing State aid could also authorize the Greek State to maintain in force provision of a law contrary to the Second Company Law Directive. The ECJ held that the discretion conferred on the Commission by Article 93 of the Treaty (Article 107 TFEU) in the field of State aid does not permit the Commission to authorize Member States to derogate from provisions of Community law (Union law) other than those relating to the application of Article 92(1) of the Treaty (Article 107(1) TFEU). [47]

In a judgment of 2 May 2019, the ECJ had to assess, further to a request for a preliminary ruling from a Dutch court of appeal, whether a German investment company could request for a refund of dividend tax withheld at the source in the Netherlands. The investment company argued that refusing this refund was an infringement of free movement of capital. However, granting the refund would constitute illegal State aid. The ECJ assessed:[48]

"By contrast, the arrangements of an aid may be so indissolubly linked to the object of the aid that it is impossible to evaluate them separately so that their effect on the compatibility or incompatibility of the aid viewed as a whole must therefore of necessity be determined in the light of the procedure prescribed in Article 108 TFEU.

(…)

It does not therefore appear to be possible to separate such a condition, which is necessary for the attainment of the objective and functioning of that aid scheme, without adversely affecting the division of competences between the Commission and the national courts in the matter of State aid.

Consequently, it must be held that EU law precludes a national court from assessing whether a residence condition, such as that at issue in the main proceedings, complies with the free movement of capital, where the scheme for the refund of dividend tax concerned constitutes an aid scheme."

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46 ECJ, 12 November 1992, C-134/91 and C-135/91, ECLI:EU:C:1992:434 (*Kerafina and Vioktimatiki v Hellenic Republic*), par. 20.

47 See also GC, 27 September 2000, T-184/97, ECLI:EU:T:2000:217 (*BP Chemicals v Commission*), par. 55.

48 ECJ, 2 May 2019, C-598/17, ECLI:EU:C:2019:352 (*A-Fonds v Inspecteur van de Belastingdienst*), par. 48-52.

The following elements can be derived from the case-law of the EU Courts:

a) the Commission's assessment of State aid awards may never produce a result which is contrary to the specific provisions of the EU Treaties;
b) those aspects of aid which contravene specific provisions of the EU Treaties, other than Article 107 and 108 TFEU, may be so indissolubly linked to the object of the aid that it is impossible to evaluate them separately;
c) the obligation of the Commission to ensure that Articles 107 and 108 TFEU are applied consistently with other provisions of the EU Treaties, is all the more necessary where those other provisions also pursue the objective of undistorted competition in the internal market;
d) this does however not mean that the Commission is required, in a procedure relating to aid, to apply the rules specially laid down for review of the application of other provisions of the Treaty or to adopt one or more decisions producing combined legal effects.[49] The Commission is required to make an assessment by reference to the relevant provisions which are not, strictly speaking, covered by the law on aid, only where certain aspects of the aid in issue are so closely linked to its object that any failure on their part to comply with those provisions would necessarily affect the compatibility of the aid with the internal market; and
e) the discretion conferred on the Commission by Article 107 TFEU in the field of State aid does, in any event, not permit the Commission to authorise Member States to derogate from provisions of Union law.

The assessment on compatibility with intrinsically linked provisions of the resolution framework in relation to aid granted in and outside of resolution is further discussed in the next sections.

49 In its decisions, the Commission explicitly states that the conclusion of the Commission that aid measures do not violate intrinsically linked provisions of the resolution framework in the context of the State aid rules is without prejudice to the prerogative of the Commission to initiate infringement procedures against a Member State for breach of Union law, including breach of the provisions of the resolution framework. See e.g. EC, 22 November 2015, C(2015) 8372 final (SA.41925 – Carife), par. 145.

6.4 The assessment of resolution aid

As a result of the fact that the 2013 Banking Communication does not include the concept of resolution aid, it is also not clear which framework applies to the assessment by the Commission of this aid. This section discusses the criteria that can be established based on the Commission's decision practice in respect of the assessment by the Commission of resolution aid when notified by a Member State that it intends to grant resolution aid, both on an *ad hoc* basis and under a resolution aid scheme. The assessment of State aid awards outside of resolution is discussed in the next section.

6.4.1 The procedural outline of the assessment of resolution aid

When the resolution of banks involves the granting of resolution aid, this should be notified by the relevant Member State(s) involved to the Commission and be – conditionally – approved by the Commission before any such aid can be granted. The two-stage procedure of preliminary examination and formal investigation as set out in section 3.5.1 applies.

A new feature within the SRM is that the SRB plays a role in that respect. On receiving a communication or on its own initiative, if the SRB considers that resolution actions could constitute State aid pursuant to Article 107(1) TFEU, it shall invite the Member State(s) concerned to immediately notify the envisaged measures to the Commission under Article 108(3) TFEU. The SRB shall notify the Commission of any case in which it invites one or more Member States to make a notification under Article 108(3) TFEU.[50]

As discussed in section 6.2.1.1, where State aid is present in resolution within the SRM, the SRB can only adopt a resolution decision after the Commission has adopted a positive or conditional decision concerning the compatibility of the use of this aid with the internal market.[51] The SRB has to act in conformity with a decision on that aid taken by the Commission.[52] The adoption of any resolution scheme following the resolution decision is also conditional on the Commission adopting a positive or conditional decision on the granting of the State aid.[53] It can be derived from the Commission's decisions that the decision of national resolution authorities to adopt a resolution

50 Article 19(2) SRMR.
51 Article 19(1) and Recital (30) SRMR.
52 Article 19(9) SRMR.
53 Article 19(1) SRMR.

decision also more or less coincides with the Commission taking a decision on the compatibility of the State aid involved.[54]

The procedural outline for the assessment of the use of the SRF and ESM DRI is discussed separately in section 6.4.6, taking into account that specific criteria apply for these types of supranational EPFS, in addition to the State aid regime for the banking sector, based on the SRMR and the ESM DRI Guideline.

6.4.2 *The legal basis for the assessment of resolution aid*

It can be derived from its decisions, that the Commission applies Article 107(3)(b) TFEU as the legal basis for the assessment of resolution aid. The State aid assessment on the basis of Article 107(3)(b) TFEU is covered in section 3.5.2.

6.4.3 *The principles governing the assessment of resolution aid*

As the Commission applies Article 107(3)(b) TFEU as the legal basis for its assessment of resolution aid, it assesses the aid on compliance with the general principles of appropriateness, necessity, and proportionality for compatibility under Article 107(3)(b) TFEU.[55] These principles have been discussed in section 3.5.3.

6.4.4 *The assessment criteria for resolution aid*

This section discusses the assessment criteria the Commission has applied in relation to resolution aid. As said, the 2013 Banking Communication does not contain a specific assessment framework for resolution aid. The following sections therefore discuss the application of the assessment

54 In the case of the resolution of BES, the State aid decision was taken on the same date as Portugal notified the Commission of the resolution (EC, 3 August 2014, C(2014) 5682 final (SA.39250 – BES), par. 4). In the case of the resolution of Carichieti, the State aid decision was taken two days after Italy notified the Commission of the resolution (EC, 22 December 2015, C(2015) 8373 final (SA.43547 – Carichieti), par. 5).

55 EC, 3 August 2014, C(2014) 5682 final (SA.39250 – BES), par. 73.

criteria in the resolution cases in which the Commission had taken a State aid decision at the time of writing this dissertation.[56]

6.4.4.1 Example 1: The capital injection from a resolution fund to a bridge bank

In a number of resolution cases, national resolution funds provided capital injections to bridge banks in order to cover negative equity of the bridge bank and/or to recapitalise the bridge bank.[57] It can be derived from the Commission's decisions that the Commission assessed the capital injections by reference to the 2013 Banking Communication, and more specifically Section 6 thereof on liquidation aid, because the resolution measures were aimed at ensuring winding up the bank in an orderly manner.[58]

> Carichieti was put in resolution by the Italian resolution authority through the application of the bridge bank tool and the asset separation tool. The Italian resolution authority had decided to transfer all assets and liabilities (apart from equity and subordinated debt that remained in the residual entity) from the bank to a bridge bank and subsequently to transfer non-performing loans (NPL) from the bridge bank to an AMC. Both the bridge bank and the AMC were owned by the resolution fund and controlled by the resolution authority. The bridge bank received assets and liabilities resulting in a negative net equity value of EUR 26 million. This negative equity value was compensated in cash by the resolution fund. In return for making up the negative net value, the resolution fund received a senior claim of EUR 26 million in the residual entity. In addition, a further 141 million was injected by the resolution fund in the bridge

56 The State aid to Jadranska Banka was granted on the basis of the resolution scheme for small credit institutions with total assets below EUR 1.5 billion adopted by Croatia and approved by the Commission. There is, therefore, no ad hoc decision from the Commission in relation to the State aid award to Jadranska Banka. This case is therefore left out of scope in this section. See EC, 23 June 2017, C(2017) 4384 final (SA.48287 – Croatia), par. 6.

57 In the case of Andelskassen, a bridge bank was established to contribute new capital to Andelskassen and take over ownership of the institution, after full bail-in by owners and creditors. New capital of DKK 37.5 million was injected into Andelskassen after bail-in of all the relevant creditors was conducted and the balance between assets and liabilities was reestablished. The injection of new capital was based on funds from the resolution fund (World Bank Report 2016, p. 26, 27). It seems that this did not qualify as State aid, since there is no decision from the Commission in that respect.

58 EC, 22 December 2015, C(2015) 8373 final (SA.43547 – Carichieti), par. 86.

bank in cash in order to enable a CET1 value of around 9%. The Commission considered the capital injections by the resolution fund to constitute State aid. It identified the bridge bank as the beneficiary of the aid.[59] The same assessment was made in relation to the resolution of Carife[60], Banca Marche[61], and Banca Etruria.[62] The resolution of these banks took place in the same way as the resolution of Carichieti.

In the case of BES, the creation of a bridge bank was considered the only remaining solution for safeguarding the stability of the financial system in Portugal. BES's sound business activities were transferred to the bridge bank. The bridge bank received assets and liabilities, such as cash, retail deposits and performing loans, central bank funding, Government Guaranteed Bonds, and T-Bills (treasury bills backed by the US government Treasury Department). Shares and certain claims on entities of the BES group remained in BES. The Portuguese resolution fund provided the bridge bank with an initial share capital of EUR 4,899 million in exchange for common shares. In order to finance this capital injection, the resolution fund levied EUR 286 million of funds from the Portuguese banking sector. Furthermore, Portugal granted a loan to the resolution fund. The Commission considered that the capital injection by the resolution fund qualified as State aid.[63]

In the cases of Carichieti, Carife, Banca Marche, Banca Etruria and BES, the Commission applied the assessment criteria for liquidation aid as follows.[64]

<u>Criterion 1: Winding up in an orderly manner</u>
The Member State has to submit a winding up plan including the commitments of the Member State.

In the case of BES, Portugal submitted a winding up plan setting out commitments in relation to the bridge bank and BES.[65]

59 EC, 22 December 2015, C(2015) 8373 final (SA.43547 – Carichieti), par. 20-30, 44-81.
60 EC, 22 December 2015, C(2015) 8372 final (SA.41925 – Carife), par. 22-32, 46-80.
61 EC, 22 December 2015, C(2015) 8371 final (SA.39543 – Marche), par. 27-37, 51-85.
62 EC, 22 December 2015, C(2015) 8374 final (SA.41134 – Etruria), par. 22-32, 46-80.
63 EC, 3 August 2014, C(2014) 5682 final (SA.39250 – BES), par. 54-63.
64 The assessment criteria for liquidation aid have been discussed in section 3.5.6.2.
65 EC, 3 August 2014, C(2014) 5682 final (SA.39250 – BES), par. 38, Annex I and II.

Criterion 2: Limitation of costs of winding up
The Commission considered that aid amounts should enable the bank to be wound up in an orderly fashion, while limiting the amount of aid to the minimum necessary.

> In the case of BES, the Commission considered that the Portuguese authorities estimated that immediate liquidation or bankruptcy would increase the resolution costs and that it would also imply a disbursement of the deposit guarantee scheme to reimburse covered deposits. Furthermore, the Commission considered that immediate resolution or bankruptcy as opposed to winding up in an orderly manner would involve a fire sale of assets while no party was interested in an outright sale of the assets and liabilities of BES. Therefore, the orderly resolution of BES was the least costly option for Portugal, also taking into account the commitment of Portugal to not provide any additional capital injections to the bridge bank in the future.[66]

Criterion 3: Own contribution (burden-sharing)
The Commission considered that an appropriate own contribution to the costs of winding up should be provided by the aid beneficiary, particularly by preventing additional aid from being provided to the benefit of the shareholders and subordinated debt holders.

> In the case of Carichieti, the Commission considered that the claims of shareholders and subordinated debt holders were not transferred to any continuing economic activity, but remained in the residual entity and were written down. It also considered that the residual entity had no assets and the resolution fund received a senior claim on the residual entity. This construction ensured that subordinated debt holders participated appropriately in the cost of the winding up. The Commission also noted positively that Italy committed that no future claim of shareholders and holders of subordinated debt or any hybrid instruments of Carichieti or the residual entity would be transferred to the bridge bank.[67] In the case of BES, the Commission noted positively that, as a result of the Portuguese banking resolution law, the burden-sharing extended also to cover claims by related parties (e.g. shareholders and

66 EC, 3 August 2014, C(2014) 5682 final (SA.39250 – BES), par. 75-76.
67 EC, 22 December 2015, C(2015) 8373 final (SA.43547 – Carichieti), par. 104-106.

Board members) of a non-contractual nature (e.g. deposits of qualified shareholders with more than 2% shareholding).[68]

Criterion 4: Limitation of distortions of competition

The Commission considered that the aid should not result in longer term damage to the level playing field and competitive markets, and that measures to limit distortions of competition due to State aid had to be taken as long as the beneficiary bank continued to operate.

> In the cases of Carichieti and BES, the Commission considered that measures to limit distortions of competition could consist of the withdrawal of the banking license of the residual entity and the subsequent launch of insolvency procedures. It also noted that the residual entity would not compete on the market or pursue new activities. Moreover, in the case of BES, the pricing policy of the residual entity was designed to encourage customers to find more attractive alternative options. In addition, it considered, positively in this respect, that a bridge bank is established only for a limited period of time, after which it will be sold or go into winding up in an orderly manner. It also took into account that during the existence of the bridge bank, a strict deposit and loan pricing policy was implemented and that the brands Carichieti and BES ceased to exist.[69]

In its decisions, the Commission also anticipated the subsequent sale of the bridge bank.

> In the case of Carichieti, the Commission mentioned that Italy had committed to notify to the Commission the sale of the bridge bank if a buyer was found.[70]

6.4.4.2 Example 2: Sale following the application of the bridge bank tool

Points 79 to 82 of the 2013 Banking Communication contain specific guidance for the situation in which the economic activity of an entity having benefited from liquidation aid is sold. Where the sale is organised via an open and unconditional competitive tender and the assets are sold to the highest bidder, the sale does not entail State aid to the buyer. If aid is

68 EC, 3 August 2014, C(2014) 5682 final (SA.39250 – BES), par. 89.
69 EC, 22 December 2015, C(2015) 8373 final (SA.43547 – Carichieti), par. 96-101. EC, 3 August 2014, C(2014) 5682 final (SA.39250 – BES), par. 78-88.
70 EC, 22 December 2015, C(2015) 8373 final (SA.43547 – Carichieti), par. 108.

granted to the economic activity to be sold, the compatibility thereof will however be subject to an individual examination. See Section 3.5.6.2.

In the cases of BES, Banca Marche, Banca Etruria, Carichieti and Carife, the sale did not entail State aid to the buyer. It did however entail State aid to the economic activity to be sold (the bridge bank).

In the case of BES, the Portuguese authorities committed that the bridge bank (Novo Banco) would sell all the assets transferred to it, or the resolution fund would sell all of its shares in the bridge bank, no later than 24 months after the date of the first State aid decision by the Commission. That date was subsequently extended by one year. On 4 December 2014, the Portuguese resolution authority started the sale process of the bridge bank with a public announcement. It however suspended the process, since none of the terms and conditions of the offers received were deemed satisfactory. On 15 January 2016, it announced the launch of a new sale process. This resulted in the sale of the bridge bank to Lone Star. This sale was subject to a Contingent Capital Agreement (CCA) set up by Portugal and allowing Lone Star to reclaim funding costs, realised losses and provisions related to an *ex ante* agreed portfolio of existing loan stock, subject to a capital ratio trigger and some additional conditions. The amount that could be reclaimed under the CCA was capped at EUR 3.89 billion, reduced by the amount which the resolution fund – potentially – had to provide in the course of underwriting tier 2 instruments issued by the bridge bank. In addition, Portugal provided a capital backstop in case measures remained unsuccessful in addressing the shortfall of the bridge bank. The Commission considered all three measures (that is, the guarantee of the capital position of the bridge bank payable by the resolution fund, the underwriting of Tier 2 instruments by the resolution fund, and the capital commitment by Portugal) to constitute State aid.

In the cases of Banca Marche, Banca Etruria, Carichieti and Carife, Italy had committed to sell the respective bridge banks by 30 April 2016. The Commission approved the prolongation of the sale deadline for the four bridge banks until 31 December 2016. On 28 April 2017, Italy notified the sale of three of the four bridge banks (Banca Marche, Banca Etruria and Carichieti) to Unione di Banche Italiane S.p.A. (UBI). UBI offered EUR 1 for the equity of the three bridge banks and demanded a capital injection from the resolution fund,

> unlimited guarantees from the resolution fund for misrepresentation, fraud, and for liabilities resulting from the resolution actions, limited guarantees from the resolution fund with specific caps towards specific, identified risks and a positive ruling by the Italian tax authority regarding the availability of deferred tax assets in the bridge banks for the use of UBI at consolidated level. The Commission considered only the capital injection and the limited guarantees to constitute State aid for the benefit of the bridge banks.[71] Carife was sold under the same conditions to BPER Banca S.p.A. Also in this case, the Commission considered only the capital injection and the limited guarantees to constitute State aid for the benefit of the bridge bank.[72]

In the cases of Carichieti, Carife, Banca Marche, Banca Etruria and BES, the Commission applied the following assessment criteria in relation to the aid to the economic activity to be sold (i.e. the bridge bank or its assets).

<u>Criterion 1: Restoring long-term viability through integration</u>
According to the 2013 Banking Communication, if the market exit of an aided entity (the bridge bank) is achieved through a sale to a competitor, the Commission will have to ensure that the aided entity is restored to long-term viability through the integration efforts of the buyer. According to the Restructuring Communication, long-term viability is achieved when a bank is able to compete in the marketplace for capital on its own merits in compliance with the relevant regulatory requirements.

> In the case of BES, the Commission considered that it had to assess two key questions for the purpose of the viability assessment. Namely, that the bank returns to operational viability at the end of the restructuring period, i.e. that the bank will be in a position to remunerate its capital adequately, and secondly, that even in an adverse case, the bank does not deplete its capital base to a level that might raise concerns and would likely lead the bank to request further aid. The Commission came to the conclusion that this criterion was met on the basis of the commitments provided together with the restructuring plan submitted by Lone Star and the bridge bank, and the presence of the backstop.[73]

71 EC, 30 April 2017, C(2017) 3000 final (SA.39543 – Marche, Etruria and Carichieti), par. 30-35, 65-89.
72 EC, 29 June 2017, C(2017) 4564 final (SA.41925 – Carife), par. 33-41, 69-90.
73 EC, 11 October 2017, C(2017) 6896 final (SA.49275 – BES), par. 285.

In the cases of Banca Marche, Banca Etruria and Carichieti, an integration plan for the integration of the three banks into UBI was shared by Italy with the Commission.[74]

Criterion 2: Limitation of aid to the minimum necessary
In line with this criterion, it is not only required to confirm that the aid provided in the notified scenario is limited to the minimum necessary, but also that it would not be cheaper for the public authorities not to provide any aid, at all.

In this respect, it is interesting that the Commission did not discuss in the case of BES that Portugal provided up to EUR 3.89 billion of a contingent recapitalisation without remuneration or other compensation, as the Restructuring Communication requires that banks receiving restructuring aid should pay an adequate remuneration. This requirement also applies to liquidation aid.[75]

Moreover, in the cases of Banca Marche, Banca Etruria and Carichieti, the Commission considered that the distortions of competition stemming from the market presence of the residual entities during their winding up in an orderly manner and of the bridge banks during their existence period were limited, despite the large amount of aid they had received and the absence of remuneration to the State for the aid it had already provided in the resolution, and for the aid notified in relation to the sale of the bridge banks.[76]

In the case of Carife, the Commission specifically noted the presence of three separate earn-out mechanisms which were likely to reduce the net cost to the State. These mechanisms provided for profit sharing in favour of the resolution authority.[77] Although the share purchase agreement concluded with UBI in relation to the sale of Banca Marche, Banca Etruria, and Carichieti, provided for the same earn-out mechanism, this was not specifically mentioned by the Commission in its State aid assessment in relation to this sale.

74 EC, 30 April 2017, C(2017) 3000 final (SA.39543 – Marche, Etruria and Carichieti), par. 36-46.
75 2013 Banking Communication, point 70. Restructuring Communication, point 24.
76 EC, 30 April 2017, C(2017) 3000 final (SA.39543 – Marche, Etruria and Carichieti), par. 119.
77 EC, 29 June 2017, C(2017) 4564 final (SA.41925 – Carife), par. 113.

Criterion 3: Burden-sharing

No separate assessment was made in relation to the required burden-sharing, since burden-sharing was already assessed in relation to the previous capital injection by the respective resolution funds in the respective bridge banks.[78] See section 6.4.4.1.

> In the case of BES, the Commission did, however, consider that it would have been fully in line with State aid rules to further reduce the net cost to the resolution fund by seeking a greater degree of loss participation from senior creditors. It subsequently considered that the degree to which senior bond holders were asked to participate beyond the minimum requirements under State aid rules and the magnitude of losses that correspondingly had to be carried by the resolution fund has been the sole decision and responsibility of the Portuguese authorities.[79] In addition, the Commission considered that the burden-sharing was not undone through any subsequent measures and that the bridge bank had not issued any hybrid or subordinated debt instruments since its inception. It therefore concluded that no further burden-sharing was required.[80]

Criterion 4: Limitation of distortions of competition

The Commission considered that both the continued market presence of residual entities and bridge banks might give rise to competition concerns.

> In the case of BES, the Commission took positive note of the commitments provided with respect to re-focussing Novo Banco on its core market in commercial banking. Moreover, Portugal had committed that Novo Banco would not grow its core loan book during the first years of the restructuring plan. In addition, Portugal gave certain commitments in relation to the pricing policy for loans and certain standard behavioural commitments, namely an acquisition ban, a ban on paying dividends, an advertisement ban, and a cap on remuneration lasting at least until 30 June 2020.[81]

78 EC, 11 October 2017, C(2017) 6896 final (SA.49275 – BES), par. 218-219. EC, 30 April 2017, C(2017) 3000 final (SA.39543 – Marche, Etruria and Carichieti), par. 120. EC, 29 June 2017, C(2017) 4564 final (SA.41925 – Carife), par. 124.

79 EC, 11 October 2017, C(2017) 6896 final (SA.49275 – BES), par. 298.

80 EC, 11 October 2017, C(2017) 6896 final (SA.49275 – BES), par. 218.

81 EC, 11 October 2017, C(2017) 6896 final (SA.49275 – BES), par. 299-310.

6.4.4.3 Example 3: Contribution by national resolution fund / Member State to funding gap under the sale of business tool

State aid can also be involved in the application of the sale of business tool.

> In the resolution of Panellinia Bank, selected bank assets and liabilities, including deposits, were auctioned. The Greek resolution fund would cover the so-called funding gap, which is the difference between the value of the assets and the value of the liabilities transferred from the resolved bank to an acquiring bank. The acquiring bank would have to cover its additional capital needs coming from the increase in its risk weighted assets and the payment of the purchase price. In April 2015, it was decided by the Greek resolution authority that Piraeus Bank would be the acquiring bank. The Commission considered the contribution by the Greek resolution fund to the funding to constitute State aid for the benefit of the economic activities of Panellinia Bank to be transferred to the buyer.[82]
>
> In the resolution of BANIF, selected assets and liabilities were transferred to a private sector purchaser (Banco Santander Totta). The Portuguese resolution fund, together with Portugal, would cover the funding gap. The Commission considered the contribution by the resolution fund and Portugal to constitute State aid to the economic activities to be transferred (also referred to as the Clean Bank).[83]

In the cases of Panellinia Bank and BANIF, the Commission applied the following assessment criteria in relation to the aid to the economic activity to be sold.

Criterion 1: Restoring long-term viability through sale
In line with point 17 of the Restructuring Communication, the sale of an ailing bank to another financial institution can contribute to the restoration of long-term viability if the purchaser is viable and capable of absorbing the transfer of the ailing bank, and may help to restore market confidence.

82 EC, 16 April 2015, C(2015) 2606 final (SA.41503 – Panellinia Bank), par. 21-35, 52-57, 59.
83 EC, 21 December 2015, C(2015) 9763 final (SA.43977 – BANIF), par. 97-102.

> The Commission considered that Piraeus Bank was a viable entity, because it approved its restructuring plan in an earlier decision. In addition, the transferred activities were very small compared to the size of Piraeus bank, as a result of which they could not endanger the restoration of the viability of the latter. Moreover, the integration plan of Piraeus Bank provided that the activities would be largely restructured, and that it ceased to operate as a stand-alone bank. It was therefore considered by the Commission that the transfer of the activities allowed the restoration of Panellinia Bank's viability.[84]
>
> In the case of BANIF, the buyer presented an integration plan of the acquired assets, rights and liabilities of the Clean Bank. The Commission had no reason to doubt the viability of the buyer or its ability to integrate the Clean Bank it acquired.[85]

<u>Criterion 2: Limitation of liquidation costs</u>
The aid amounts should enable the bank to be wound up in an orderly fashion, while limiting the amount of aid to the minimum necessary. [86]

> In the case of Panellinia Bank, the Commission considered that the integration of the transferred activities of the bank into a larger entity and the concomitant realisation of synergies, through the rationalisation of the buyer's branch network, the consolidation of the IT infrastructure, and the reduction of funding costs, would help to limit the costs to the minimum compared to a scenario in which the State sought to restore the bank's viability on a standalone basis.[87]
>
> In the case of BANIF, the Commission considered the orderly resolution aid to be limited to the minimum necessary because the amount of costs incurred in the resolution was lower than the estimated losses in liquidation.[88]

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84 EC, 16 April 2015, C(2015) 2606 final (SA.41503 – Panellinia Bank), par. 80-82.
85 EC, 21 December 2015, C(2015) 9763 final (SA.43977 – BANIF), par. 72-75, 145-152.
86 In the case of BANIF, the limitation of the aid to the minimum necessary is a separate assessment criterion next to the own contribution. In the case of Panellinia Bank this was considered as part of this assessment criterion.
87 EC, 16 April 2015, C(2015) 2606 final (SA.41503 – Panellinia Bank), par. 83.
88 EC, 21 December 2015, C(2015) 9763 final (SA.43977 – BANIF), par. 133.

Criterion 3: Own contribution (burden-sharing)
In order to limit distortions of competition and address moral hazard, an appropriate own contribution to liquidation costs should be provided by the aid beneficiary, particularly by preventing additional aid from being provided to the benefit of the shareholders and subordinated debt holders. Therefore, the claims of shareholders and subordinated debt holders must not be transferred to any continuing economic activity.

> In the case of Panellinia Bank, it was considered by the Commission that the equity and preference shares were not transferred to Piraeus Bank, but remained in Panellinia Bank, the entity in liquidation. Hence, the Commission considered that sufficient burden-sharing was achieved since the shareholders were entitled to proceeds from the liquidation only if the proceeds were sufficient to repay first the resolution fund, which had a large priority claim over other creditors.

> In the case of BANIF, the Commission considered that the costs incurred in resolution would be lower than the estimated losses in liquidation.[89] A bail-in of holders of subordinated debt as well as liabilities from other banks had taken place. In addition, the shareholders and holders of hybrid instruments had fully participated in the losses.[90]

Criterion 4: Measures to limit distortions of competition
The aid should not result in longer-term damage to the level playing field and competitive markets. In that context, measures to limit distortions of competition due to State aid have to be taken.

> In the case of Panellinia Bank, it was concluded by the Commission that given the very small size of the transferred activities, the open sales process, and the full integration of Panellinia Bank's activities into Piraeus Bank, there were no undue distortions of competition, despite the large amount of aid and the absence of remuneration.[91] The resolution fund was not remunerated for contributing to the funding gap.[92]

89 EC, 21 December 2015, C(2015) 9763 final (SA.43977 – BANIF), par. 129-133.
90 EC, 21 December 2015, C(2015) 9763 final (SA.43977 – BANIF), par. 140-144.
91 EC, 16 April 2015, C(2015) 2606 final (SA.41503 – Panellinia Bank), par. 86-89.
92 EC, 16 April 2015, C(2015) 2606 final (SA.41503 – Panellinia Bank), par. 85.

> In the case of BANIF, the Commission positively noted the choice of the sale of business tool as the primary resolution tool, thereby limiting competition concerns. It specifically assessed that the commercial presence of the Clean Bank would be significantly reduced compared with the old BANIF, the fact that the Clean Bank would be bought by a much larger commercial bank, the commitment of Portugal that the BANIF brand would disappear, and the commitment of Portugal to comply with an advertising and acquisition ban. [93]

6.4.4.4 Example 4: The transfer of non-performing assets to an AMC under the asset separation tool

Where the resolution of a bank involves the transfer of impaired assets to an asset management vehicle under the asset separation tool, any aid involved in the transfer should be assessed on the basis of the criteria set out in the Impaired Assets Communication in addition to the criteria that apply to rescue, restructuring or liquidation aid. Aid is notably involved where impaired assets are purchased or insured at a value above the market price, or if the price of the impaired assets guarantee does not compensate the State for its possible maximum liability under the guarantee.[94]

> In the cases of Carichieti, Carife, Banca Marche and Banca Etruria, non-performing loans (NPLs) were transferred from the bridge bank to an Asset Management Company (AMC). The NPLs were transferred above market prices according to the provisional valuation corresponding to EUR 85 million. In return for these NPLs, the bridge bank received debt securities from the AMC with the same notional amount. The resolution fund guaranteed these debt securities in the full amount. The Commission considered the transfer of the NPLs from the bridge bank to the AMC to constitute State aid; it identified the beneficiary of the aid as the bridge bank. [95]

> In the resolution of BANIF, impaired assets were transferred to an AMC. All other assets, rights and liabilities not included in the perimeter of the transfer to the AMC and which were not sold under the sale of business tool (as discussed in section 6.4.4.3) remained in BANIF as a residual bank to be wound up in normal insolvency proceedings.

93 EC, 21 December 2015, C(2015) 9763 final (SA.43977 – BANIF), par. 134-139.
94 Impaired Assets Communication, point 15.
95 EC, 22 December 2015, C(2015) 8373 final (SA.43547 – Carichieti), par. 20-30, 44-81.

The assets remaining in the residual bank included own shares of BANIF and any shares or units that represented the share capital of international subsidiaries of BANIF. The portfolio to be transferred to the AMC included loans, real estate assets, restructuring funds, loans to restructuring funds, real estate funds, and equity stakes. The AMC was financed by share capital provided by the Portuguese resolution fund, the sole and controlling shareholder of the AMC, and the issuance of bonds guaranteed by the resolution fund and counter-guaranteed by Portugal, subscribed by BANIF, and subsequently transferred to the private sector purchaser.[96] The Commission considered that the AMC was capitalized and controlled by the resolution fund and that the transfer of the portfolio from BANIF to the AMC occurred above market prices. It also concluded that the other conditions for the existence of State aid to the economic activities to be transferred to the private sector purchaser were fulfilled.[97]

The resolution of MKB Bank entailed three groups of measures: (1) clean up MKB Bank's balance sheet to increase capital adequacy and improve profitability, (2) reorganize with a view to enhance efficiency, and (3) sell MKB Bank after the implementation of the asset separation tool. The aim of the asset separation tool was to remove uncertainty about the future value of MKB Bank's most problematic assets so that it could concentrate on the implementation of the restructuring plan and restore its viability. The clean-up of the balance sheet appeared to be more difficult than expected as a result of which a substantial part of the assets still remained unsold after the sale process and had to be transferred under the asset separation tool to the AMC. The assets and liabilities of MKB Bank that were not sold or transferred to the AMC remained in MKB Bank (the core bank). As a result of the burden-sharing requirement, the shares in MKB Bank were transferred to the AMC, which is fully owned by the resolution fund. The resolution fund had to sell its shares through an open, transparent and non-discriminatory sales process by the end of June 2016.[98] The application of the asset separation tool contained an element of State aid because the transfer of the assets to the AMC took place above the market value of the assets. [99]

96 EC, 21 December 2015, C(2015) 9763 final (SA.43977 – BANIF), par. 67-68, 76-80.
97 EC, 21 December 2015, C(2015) 9763 final (SA.43977 – BANIF), par. 103-114.
98 Press release, Magyar Nemzeti Bank closes the restructuring of MKB after a successful market-based sales procedure, 30 June 2016.
99 EC, 16 December 2015, C(2015) 9349 final (SA.40441 – MKB Bank), par. 45-53, 81-88.

In the cases set out above, the Commission applied the criteria under the Impaired Assets Communication as follows:

Criterion 1: Eligibility of assets
Whilst the Impaired Assets Communication cites as eligible assets those that have triggered the financial crisis (the Impaired Assets Communication explicitly refers to US mortgage-backed securities), it also allows for the possibility to 'extend eligibility to well-defined categories of assets corresponding to a systemic threat on due justification, without quantitative restrictions'.

> In the cases of Carichieti, Carife, Banca Marche and Banca Etruria, the Commission considered that non-performing loans could be eligible assets for an impaired assets measure.[100] In the case of BANIF, the Commission considered that the impaired measure was targeted not only at non-performing assets, but also contained a large number of heterogeneous asset classes. Most of these asset classes – non-liquid real estate exposures, real estate funds, restructuring funds, as well as NPLs – came with significant impairments and would be very difficult to sell in the market unless at significant discounts.[101]
>
> In the case of MKB Bank, the impaired assets measure was targeted at speculative transactions with land plots and hotels, as well as foreign currency-denominated assets that were not backed up by revenues in the same currency. All transactions in the transfer were non-performing. The Commission therefore assessed that the assets were in line with the eligibility criteria of the Impaired Assets Communication.[102]

Criterion 2: Transparency and disclosure
The Impaired Assets Communication requires full *ex ante* transparency and disclosure of impairments by eligible banks on the assets to be covered by the asset relief measures. The disclosure should take place prior to the government intervention.

100 EC, 22 December 2015, C(2015) 8373 final (SA.43547 – Carichieti), par. 112-113.
101 EC, 21 December 2015, C(2015) 9763 final (SA.43977 – BANIF), par. 158-159.
102 EC, 16 December 2015, C(2015) 9349 final (SA.40441 – MKB Bank), par. 93-95.

> In the cases of Carichieti, Carife, Banca Marche, and Banca Etruria, the Commission considered that the transparency requirements were challenging for the transaction. It noted positively that all assets to be transferred were clearly identified as defaulted loans in the *Sofferenze* category, including a breakdown of each collateralized and uncollateralized part of the portfolio into retail and corporate loans. No complex assets or structured products were being transferred. The Commission further took into consideration that the measures were implemented in resolution in the specific framework of a sale or winding up in an orderly manner commitment in a very short timeframe. It therefore regarded the transparency requirements as fulfilled.[103] A same assessment was made by the Commission in relation to BANIF.[104] In the case of MKB Bank, the Commission considered that a list of assets to be transferred and extensive valuation reporting and loan documentation were provided, facilitating the Commission's assessment.[105]

Criterion 3: Valuation

The disclosure of impairments by eligible banks on the assets to be covered by the asset relief measures should take place based on an adequate valuation of the market value (MV) and real economic value (REV) of the assets to be transferred, certified by recognised independent experts, and validated by the relevant competent authority.

> In the cases of Carichieti, Carife, Banca Marche, and Banca Etruria, the Commission relied on the provisional valuation prepared by the Bank of Italy on the basis of Article 36 BRRD, because it did not have sufficient information about the portfolio to pronounce itself conclusively on the precise value of the REV. It considered that it was, however, possible to establish with reasonable confidence that the transfer value was lower than the appropriate REV of the portfolio and that the aid provided through the transfer could be compatible with the rules of the internal market.[106] In addition, Italy would provide the Commission with the results of the final valuation as soon as they were available.

103 EC, 22 December 2015, C(2015) 8373 final (SA.43547 – Carichieti), par. 114-118.
104 EC, 21 December 2015, C(2015) 9763 final (SA.43977 – BANIF), par. 161-166.
105 EC, 16 December 2015, C(2015) 9349 final (SA.40441 – MKB Bank), par. 96-97.
106 EC, 22 December 2015, C(2015) 8373 final (SA.43547 – Carichieti), par. 119-126.

In the case of BANIF, the Commission considered that a rough estimate for the REV could be calculated, but that the timelines for the proposed impaired asset measure did not allow for compliance with the valuation requirement.[107] It even stated that the very short time delay in which the asset separation tool is normally conducted seemed to be in direct conflict with the requirements of *ex ante* valuation.[108]

In the case of MKB Bank, the Commission assessed that the Hungarian authorities had provided detailed documents explaining how the MV and the REV of the asset transfer to the AMC was calculated. The Commission subsequently scrutinized the valuation and the underlying methodology in order to ensure a consistent approach at Union level. The final valuation of the Commission's expert concurred with Hungary's assessment of the MV and REV.[109]

Criterion 4: Management of the assets

Section 5.6 of the Impaired Assets Communication stipulates the necessity of ensuring a clear functional and organisational separation between the beneficiary bank and the assets to be transferred, notably as to their management, staff, and clientele

In the cases of Carichieti, Carife, Banca Marche, and Banca Etruria, the Commission considered that the NPL to be transferred from the bridge bank would be managed by the AMC, which was fully independent from the bridge bank.[110] The Commission made the same assessment in relation to the transfer in the case of BANIF and MKB Bank of non-performing assets to the newly created AMC.[111]

Criterion 5: Burden-sharing

Section 5.2 of the Impaired Assets Communication repeats the general principle that banks ought to bear the losses associated with impaired assets to the maximum extent so as to ensure equivalent shareholder responsibility and burden-sharing. Assets should therefore be transferred at a price that matches or remains below the REV.

107 EC, 21 December 2015, C(2015) 9763 final (SA.43977 – BANIF), par. 167-172.
108 EC, 21 December 2015, C(2015) 9763 final (SA.43977 – BANIF), par. 185.
109 EC, 16 December 2015, C(2015) 9349 final (SA.40441 – MKB Bank), par. 100-103.
110 EC, 22 December 2015, C(2015) 8373 final (SA.43547 – Carichieti), par. 128.
111 EC, 21 December 2015, C(2015) 9763 final (SA.43977 – BANIF), par. 173-174. EC, 16 December 2015, C(2015) 9349 final (SA.40441 – MKB Bank), par. 98-99.

In the case of BANIF, the Commission considered that if it is not in a position to ensure that the transfer value is lower than the REV, the aid can only be accepted if conditions are introduced "*allowing the recovery of this additional aid at a later stage, for example through claw-back mechanisms*". The Commission noted in its decision on BANIF that in view of the delayed assessment of the REV in this case, a claw-back mechanism would be difficult to implement because of the legal uncertainty related to such a claw-back. However, it concluded that because of the extremely conservative value for the proposed transfer value of EUR 746 million, the likelihood would be very low that the full valuation later would find a REV lower than this amount.[112]

The requirements under the Impaired Assets Communication apply in conjunction with the requirements set out in the 2013 Banking Communication and – if restructuring aid – the Restructuring Communication.

<u>Restructuring aid (Restructuring Communication)</u>
In the case of MKB Bank, the asset separation tool was applied as part of the restructuring. The Commission therefore considered the aid element in the application of the asset separation tool to be restructuring aid in the form of an impaired asset measure. It assessed the aid on the basis of the Restructuring Communication and the Impaired Assets Communication. As a result, the requirements set out for restructuring aid were also taken into account (e.g. restoration of long-term viability, own contribution and burden-sharing and measures limiting distortions of competition). As part of its assessment of the burden-sharing requirement, the Commission took into account that the sole shareholder of MKB Bank, the Hungarian State, was fully written down, that the resolution fund via the AMC became the sole shareholder of the core bank, and that there were no subordinated debt holders in MKB Bank.[113]

112 EC, 21 December 2015, C(2015) 9763 final (SA.43977 – BANIF), par. 175-183.
113 EC, 16 December 2015, C(2015) 9349 final (SA.40441 – MKB Bank), par. 114-121.

Liquidation aid (Section 6 of 2013 Banking Communication in combination with the Restructuring Communication)
In the cases of Carichieti, Carife, Banca Marche, Banca Etruria and BANIF the aid element in the application of the asset separation tool was considered liquidation aid in the form of an impaired asset measure that had to be assessed on the basis of Section 6 of the 2013 Banking Communication in addition to the Impaired Assets Communication.

In the case of BANIF, the Commission was confronted with the fact that the requirements of the Impaired Assets Communication could not be met upfront. The Commission considered that the assessment framework set out for liquidation aid under the 2013 Banking Communication did not provide for the possibility of providing impaired asset measures on the basis of temporary approval. In order to ensure that the intention of the European Co-legislators can be accommodated in the State aid framework, the Commission however considered that the conditions of Section 3.2 of the 2013 Banking Communication (enabling rescue aid in the form of impaired asset measures) also applied *mutatis mutandis* to liquidation aid in resolution. It therefore considered that in this very specific case in which BANIF ceased to exist within a very short timeframe and was fully assumed into a much larger entity, it could grant the temporary approval of the impaired asset measure on the basis of a very conservative transfer value for a period of three months, requiring a full valuation of the market value and real economic value during that time, and approving the measure finally in a second decision.[114] In this second decision, the Commission considered that the difference between the market value established by external experts appointed by the Commission and the net transfer value (that difference being the State aid amount) was actually lower than calculated in the first decision. In addition, the net transfer value was lower than the real economic value as a result of which the transfer occurred in line with the Impaired Assets Communication. Moreover, the asset classes that were transferred in a higher proportion still satisfied the eligibility criteria of the Impaired Assets Communication. The Commission therefore concluded that the impaired asset measure was compatible with the internal market.[115]

114 EC, 21 December 2015, C(2015) 9763 final (SA.43977 – BANIF), par. 186-187.
115 EC, 21 December 2016, C(2016) 7526 final (SA.43977 – BANIF), par. 32-42.

6.4.5 The assessment of resolution schemes

Resolution aid can also be granted in the form of schemes instead of on an *ad hoc* basis.[116] For example, Poland and Croatia have adopted resolution schemes.

> Under the Polish resolution scheme, only cooperative banks and small commercial banks with total assets not exceeding EUR 3 billion are eligible to use the scheme once a resolution procedure has been initiated by the Polish resolution authority. The scheme provides that funds in the Polish deposit guarantee scheme and the Polish resolution fund can be used after write down or conversion of shareholders' capital and other capital instruments. The bail-in requirements also have to be complied with. The Commission assessed this resolution scheme on the basis of the assessment criteria for liquidation aid and liquidation schemes.[117] In Croatia a similar resolution scheme was assessed and approved by the Commission for the resolution of small banks with total assets below EUR 1.5 billion.[118] Both Poland and Croatia mentioned the significant role of the (cooperative and) small banks in their financial system. Croatia specifically mentioned that the strong regional presence of the small banks is vital for the provision of loan and deposit services for retail and SMEs.[119] Poland specifically mentioned that the cooperative banks have an important role in providing financial services to rural areas and the agricultural sector.[120] Both Poland and Croatia therefore anticipate that these banks should be put in resolution instead of being wound up in normal insolvency proceedings.
>
> In that respect, it is interesting that Italy has notified a liquidation scheme to the Commission for the benefit of banks with total assets below EUR 3 billion.[121] Contrary to Poland and Croatia, Italy therefore seems to anticipate that these banks will normally not be put in resolution, but wound up in normal insolvency proceedings. It considers the liquidation scheme to be apt to remedy a serious disturbance in the economy of a Member State. It argues that there

116 See section 3.5.7 for an explanation of the concept of aid schemes.
117 EC, 20 December 2016, C(2016) 8780 final (SA.46575 – Poland), points 18-27, 86-88.
118 EC, 5 October 2016, C(2016) 6417 final (SA.46066 – Croatia).
119 EC, 5 October 2016, C(2016) 6417 final (SA.46066 – Croatia), par. 55.
120 EC, 20 December 2016, C(2016) 8780 final (SA.46575 – Poland), point 69.
121 EC, 13 April 2018, C(2018) 2295 final (SA.50640 – Italy).

is a strong regional presence of small banking institutions which are vital for the provision of loan and deposit services for retail and small and medium-sized companies. Pockets of vulnerabilities may remain amongst the small banks in question that can be addressed through the liquidation scheme. The Commission follows the position of the Italian State.[122]

Although different decisions are made in respect of putting the bank in resolution or winding up the bank in normal insolvency proceedings, all three Member States anticipate that part of the failing bank's assets and liabilities will be transferred to a purchaser, either under the application of the sale of business tool (Poland, Croatia) or in normal insolvency proceedings (Italy). The outcome of the resolution and liquidation process, respectively, may therefore not be very different in practice. In terms of public funding involved, the difference is that in Italy, the anticipated aid measure involves support from the deposit guarantee scheme only, while in Poland and Croatia support from the national resolution funds is also anticipated.

6.4.6 The assessment of supranational EPFS

This section discusses the specific procedures set out in the SRMR and the ESM DRI Guidelines for the assessment of the use of the SRF and the ESM DRI.

6.4.6.1 The assessment of SRF contributions

As discussed in section 5.2.1.1, the Commission applies the criteria established under the State aid regime for the banking sector to the use of the SRF, in order to ensure that resolution takes place on the same terms both inside and outside the European Banking Union.[123] Basically, the procedure set out for the assessment of State aid under the State aid regime for the banking sector is copied in the SRMR.

122 EC, 13 April 2018, C(2018) 2295 final (SA.50640 – Italy), par. 21-22, 69-70.
123 Article 19(3), second paragraph, SRMR. Iftinchi 2017, p. 77.

If resolution action requires the use of the SRF, the SRB always has to adopt the resolution scheme.[124] The adoption of the resolution scheme may not take place until such time as the Commission has adopted a positive or conditional decision concerning the compatibility of the use of the SRF with the internal market.[125] The SRB has to act in conformity with a decision on that aid taken by the Commission.[126]

When the SRF is used, the SRB replaces the rights and obligations of a Member State in a State aid procedure.[127] The SRB must notify the Commission of the proposed use of the SRF. The SRB's notification includes all the information necessary to enable the Commission to make its assessment. [128] The notification triggers a preliminary investigation by the Commission during the course of which the Commission can request further information from the SRB. The Commission assesses whether the use of the SRF would distort, or threaten to distort, competition by favouring the beneficiary or any other undertaking so as, insofar as it would affect trade between Member States, to be incompatible with the internal market. For the use of the SRF, the Commission applies the criteria established for the application of State aid rules as enshrined in Article 107 TFEU.[129]

If the Commission has serious doubts as to the compatibility of the proposed use of the SRF with the internal market, or where the SRB has failed to provide the necessary information pursuant to a request of the Commission, the Commission will open an in-depth investigation and notify the SRB accordingly. The SRB, any Member State or any person, undertaking or association whose interests may be affected by the use of the SRF, may submit comments to the Commission within such timeframe as may be specified in the notification. The SRB may submit observations on the comments submitted by Member States and interested third parties within such timeframe as may be specified by the Commission. At the end of the period of investigation, the Commission will make its assessment as to whether the use of the SRF would be compatible with the internal market.[130]

124 Article 7(3) SRMR.
125 rticle 19(1) SRMR.
126 Article 19(9) SRMR.
127 Iftinchi 2017, p. 77.
128 Article 19(3) SRMR.
129 Article 19(3), second paragraph, SRMR.
130 Article 19(3) SRMR.

In making its assessments and conducting its investigations, the Commission is guided by all of the relevant regulations adopted under Article 109 TFEU as well as relevant communications, guidance and measures adopted by the Commission in application of the rules of the EU Treaties relating to State aid in force at the time the assessment is to be made. Those measures will be applied as though references to the Member State responsible for notifying the aid were references to the SRB, and with any other necessary modifications.[131]

The Commission will adopt a decision on the compatibility of the use of the SRF with the internal market, to be addressed to the SRB and to the national resolution authorities of the Member State or Member States concerned. That decision may be contingent on conditions, commitments or undertakings in respect of the beneficiary.[132]

> The conditions which may be imposed by the Commission may include, but are not limited to, burden-sharing requirements, including restrictions on the payment of dividends on shares or coupons on hybrid capital instruments, on the repurchase of own shares or hybrid capital instruments, or on capital management transactions, restrictions on acquisitions of stakes in any undertaking either through an asset or share transfer, prohibitions against aggressive commercial practices or strategies, or advertising support from public aid, requirements concerning market shares, pricing, product features or other behavioural requirements, requirements for restructuring plans, governance requirements, reporting and disclosure requirements, requirements relating to the sale of the beneficiary or of all or part of its assets, rights and liabilities, and requirements relating to the liquidation of the beneficiary.[133]

The decision can also place obligations on the SRB, the national resolution authorities in the Member State or Member States concerned, or the beneficiary, to enable compliance to be monitored. This may include requirements for the appointment of a trustee or other independent person to assist in monitoring. A trustee or other independent person may perform the functions as specified in the Commission's decision.[134]

131 Article 19(3) SRMR.
132 Article 19(3) SRMR.
133 Recital (30) SRMR.
134 Article 19(3) SRMR.

The Commission may issue a negative decision addressed to the SRB, where it decides that the proposed use of the SRF would be incompatible with the internal market and cannot be implemented in the form proposed by the SRB. Upon receipt of such a decision, the SRB has to reconsider its resolution scheme and prepare a revised resolution scheme.[135]

Where the Commission has serious doubts as to whether its decision is being complied with, it will conduct any necessary investigations. For that purpose, the Commission can exercise the powers available to it under the regulations and other measures, and it will be guided by them.[136] If, on the basis of the investigations carried out by the Commission, and after giving notice to the parties concerned to submit their comments, the Commission considers that the decision has not been complied with, it will issue a decision to the national resolution authority in the Member State concerned requiring that authority to recover the misused amounts within a period to be determined by the Commission. The SRF aid to be recovered pursuant to a recovery decision has to include interest at an appropriate rate fixed by the Commission and has to be paid to the SRB. The SRB will pay any amounts received into the SRF and take these into consideration when determining contributions. The recovery procedure respects the right to good administration and the right of access to documents, of the beneficiaries.[137]

Member States have to ensure that their national resolution authorities have the powers necessary to ensure compliance with any conditions laid down in a Commission decision, and to recover misused amounts pursuant to a Commission decision.[138]

Without prejudice to the reporting obligations that the Commission may establish in its decision, the SRB will submit annual reports assessing the compliance of the use of the SRF with the decision to the Commission .[139]

If the Commission, following a recommendation of the SRB or on its own initiative, considers that the application of resolution tools and actions does not respond to the criteria on the basis of which its initial decision was made, it may review this decision and adopt the appropriate amendments.[140]

135 Article 19(3) SRMR.
136 Article 19(4) SRMR.
137 Article 19(5) SRMR.
138 Article 19(11) SRMR.
139 Article 19(6) SRMR.
140 Article 19(9) SRMR.

On application by a Member State, the Council may, acting unanimously, decide that the use of the SRF is considered compatible with the internal market, if such a decision is justified by exceptional circumstances. If, however, the Council has not made its attitude known within seven days of the said application being made, the Commission will give its decision on the case.[141]

6.4.6.2 The assessment of the ESM DRI

In respect of the ESM DRI, the ESM DRI Guideline provides that the financial assistance is to be provided in accordance with the ESM DRI Guideline as well as the State aid provisions under Article 107 and 108 TFEU.[142]

In accordance with the ESM DRI Guideline, the ESM DRI can be applied by the ESM on the request of a participating Member State of the SSM. After this request, the Commission, in liaison with the ECB and IMF (wherever appropriate), will assess whether the requesting participating Member State meets access criteria 4 and 5.[143] Likewise, the ESM, in liaison with the Commission, the relevant resolution authority, and the ECB in its capacity as the supervisor, will assess whether the bank meets access criteria 1 and 2.[144] Based on these assessments, the ESM Board of Governors decide whether the eligibility criteria are met and if so, may decide to grant financial assistance through the ESM DRI.[145]

After the decision of the ESM Board of Governors, the participating Member State of the SSM concerned has to notify the Commission of the intention to grant financial assistance through the ESM DRI. The ESM will act as an agent for the participating Member State throughout the procedure.[146] The ESM has to draw up a restructuring plan to ensure the viability of the bank after recapitalisation, jointly with the bank and the participating Member State concerned, and in consultation with the ECB. This plan has to be submitted to the Commission for approval. Any direct recapitalisation will only be disbursed once the restructuring plan has been approved by the Commission.[147]In parallel, the ESM's Managing Director,

141 Article 19(10) SRMR.
142 Article 1(3) ESM DRI Guideline.
143 See section 5.3.5.7.
144 See section 5.3.5.7.
145 Article 4(2) and (3) ESM DRI Guideline.
146 Article 4(4) ESM DRI Guideline.
147 Article 4(11) ESM DRI Guideline.

in liaison with the Commission and the ECB, and with the assistance of independent experts, will conduct a due diligence exercise, including a rigorous economic valuation of the assets.[148] The ESM Board of Governors will adopt a financial assistance facility agreement (FFA) detailing the financial assistance following the decision from the Commission under the State aid regime for the banking sector.[149]

Moreover, the ESM's Managing Director, in liaison with the Commission and the ECB, can impose additional institution-specific conditions not required under the State aid regime for the banking sector. These can include rules on the remuneration of the management and dividend policy. The institution-specific conditions are laid down in an institution-specific agreement to be established between the ESM, requesting participating Member State of the SSM, and the bank(s) concerned.[150]

Lastly, the Commission, in liaison with the ECB, the ESM's Managing Director and, wherever appropriate, the IMF, can impose policy conditions related to the financial sector of the participating Member State concerned, its supervision, corporate governance of banks, and relevant domestic legislation. These policy conditions may even relate to the general economic policy of the participating Member State concerned, and will be included in the Memorandum of Understanding (MoU) attached to the financial assistance.[151]

6.4.7 Compatibility of resolution aid with the resolution framework

In addition to its assessment on the basis of the State aid regime for the banking sector[152] as set out in the previous sections, the Commission also assesses in its State aid decisions whether resolution aid violates 'intrinsically linked provisions of the BRRD and SRMR'.

148 Article 4(5) and (6) ESM DRI Guideline.
149 Article 4(10) ESM DRI Guideline.
150 Article 4(7)(b) ESM DRI Guideline.
151 Article 4(7)(a) ESM DRI Guideline. According to Lo Schiavio this shows that conditionality of support is far more important than a system of financial assistance to banks (Lo Schiavo 2018, p. 170).
152 For the SRF and ESM DRI: in combination with the SRMR and ESM DRI.

6.4.7.1 Resolution aid *ad hoc*

It can be read in the decisions taken by the Commission in respect of *ad hoc* resolution aid, that it has considered the following provisions to be intrinsically linked provisions, depending on the specifics of the resolution aid measure:

1. The general principles governing resolution provided by Article 34 BRRD;[153]
2. The resolution conditions set out in Article 32 BRRD;[154]
3. The possibility to perform a provisional valuation for the purposes of valuation pursuant to Article 36(2) BRRD;[155]
4. The requirement to establish and use national resolution funds following Article 100(5) BRRD;[156]
5. The requirement that the asset separation tool is only applied together with another resolution tool pursuant to Article 37(5) BRRD.[157]

In all of its decisions, without going into much detail, the Commission assessed that these intrinsically linked provisions were not violated by the proposed aid measures. It may be that other provisions of the resolution framework also qualify as 'intrinsically linked'. This will have to become clear from future State aid decisions. In any event, it is stated in Recital 57 BRRD, that the Commission should separately assess whether the GFST do not infringe any intrinsically linked provisions of Union law, including those relating to the minimum loss absorption requirement of 8 % contained in the BRRD, as well as whether there is a very extraordinary situation of a systemic crisis justifying resorting to those tools under the BRRD while ensuring the level playing field in the internal market. At the time of writing this dissertation, the Commission has not yet assessed the use of the GFST.

Public funding provided to a bank in resolution does not always qualify as State aid. In case public funding does not qualify as State aid, the Commission does not have to assess whether it breaches any intrinsically linked provisions of the resolution framework.

153 EC, 22 November 2015, C(2015) 8373 final (SA.43547 – Carichieti), par. 138.
154 EC, 22 November 2015, C(2015) 8373 final (SA.43547 – Carichieti), par. 139.
155 EC, 22 November 2015, C(2015) 8373 final (SA.43547 – Carichieti), par. 139.
156 EC, 22 November 2015, C(2015) 8373 final (SA.43547 – Carichieti), par. 141.
157 EC, 21 December 2015, C(2015) 9763 final (SA.43977 – BANIF), par. 197.

An example is the case of Bank of Peloponesse, in which the Commission concluded that the resolution support by the national resolution fund did not constitute State aid.[158]

6.4.7.2 Resolution schemes

It can be read in the decisions taken by the Commission since the introduction of the resolution framework in respect of resolution schemes, that it has considered the following provisions to be intrinsically linked provisions of the resolution framework in relation to resolution schemes:

1. The requirement to write down and convert capital instruments pursuant to Article 59(3) BRRD;[159]
2. The requirements under which a national resolution fund may make a contribution where a resolution authority decides to exclude eligible liabilities from the scope of the bail-in tool pursuant to Article 44(5) BRRD.[160]

In relation to the Italian liquidation scheme, the Commission considered that the notified State support would be granted under national insolvency law following the determination that there is no public interest in resolution and that it therefore does not circumvent Article 18(1) SRMR and Article 32(1) BRRD.

The Commission also considered whether the use of the deposit guarantee scheme did not violate intrinsically linked provisions of the DGS Directive.[161]

6.4.7.3 Supranational EPFS

At the time of writing this dissertation, the SRF and ESM DRI have not yet been used. It is therefore unclear which provisions of the resolution framework qualify as intrinsically linked provisions in relation to the use of SRF contributions and the ESM DRI. It could however be expected that the access criteria as discussed in section 5.3.5.2 (in respect of the SRF) and 5.3.5.7 (in respect of the ESM DRI) qualify as intrinsically linked provisions.

158 EC, 17 December 2015, C(2015) 9682 final (SA.43886 – Bank of Peloponnese), par. 56. See further section 3.3.4.
159 EC, 20 December 2016, C(2016) 8780 final (SA.46575 – Poland), par. 89. EC, 2 August 2017, C(2017) 5458 final (SA.44031 – Denmark), par. 77.
160 EC, 20 December 2016, C(2016) 8780 final (SA.46575 – Poland), par. 89. EC, 2 August 2017, C(2017) 5458 final (SA.44031 – Denmark), par. 77.
161 EC, 13 April 2018, C(2018) 2295 final (SA.50640 – Italy), par. 101-103.

6.5 The assessment of State aid outside resolution

As discussed in Chapter 5, State aid can also still be granted outside of resolution in the form of precautionary guarantees, precautionary recapitalisation and liquidation aid.

6.5.1 Precautionary guarantees and precautionary recapitalisation

The resolution framework provides for access criteria for precautionary guarantees and precautionary recapitalisation, as discussed in section 5.3.2.2. The Commission's decisions assessing these State aid measures, show that these access criteria are considered by the Commission to qualify as intrinsically linked provisions of the resolution framework.[162] The assessment by the Commission of these criteria is discussed in section 5.3.2.2. In addition, the Commission assesses precautionary guarantees and precautionary recapitalisation on compatibility with the internal market under the State aid regime for the banking sector. See sections 3.5.4 and 3.5.6 for a discussion of the assessment criteria that apply to funding guarantees and (rescue) recapitalisation. As a result, it is necessary to take both the access and assessment criteria into account in the design of precautionary guarantees and precautionary recapitalisation. Some remarks can be made in that respect.

First, some of the assessment criteria under the State aid regime for the banking sector overlap with the access criteria set out in the resolution framework.[163] The Commission does not seem to make a separate assessment of the access criteria for precautionary guarantees and precautionary recapitalisation that overlap with assessment criteria under the State aid regime for the banking sector. For example, it can be read in the Commission decisions, that it deems the access criterion in respect of remuneration and the access criterion that the measure is granted – and proportionate – to remedy a serious disturbance in the economy and to preserve financial stability to be fulfilled on the basis of its assessment under the State aid regime for the banking sector.

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162 See e.g. EC, 7 June 2018, C(2018) 3546 final (SA.51087 – Greece), par. 41. EC, 4 July 2017, C(2017) 4690 final (SA.47677 – MPS), par. 120.

163 These are the condition in relation to remuneration and the condition that the measure is granted – and proportionate – to remedy a serious disturbance in the economy and to preserve financial stability.

Secondly, some assessment criteria apply in addition to the access criteria under the resolution framework. For example, under the State aid regime for the banking sector funding guarantees may only be granted for new issues of banks' senior debt (subordinated debt is excluded) with maturities from three months to five years (or a maximum of seven years in the case of covered bonds).[164] In addition, for some funding guarantees, a restructuring or wind up plan needs to be submitted, unless the aid is reimbursed within two months.[165] Furthermore, the Member State awarding the guarantee should commit to a number of behavioural safeguards.[166]

Thirdly, the assessment and access criteria may be contradictory. For example, under the resolution framework, the award of precautionary guarantees triggers the exercise of the PONV conversion power,[167] while under the State aid regime for the banking sector, the burden-sharing requirements are only triggered in case restructuring aid is granted. If the aid is reimbursed within two months, there will be no restructuring or liquidation obligations triggered. It seems to be reasonable to interpret the exercise of the PONV conversion power in relation to precautionary guarantees in such a way that this is only necessary in cases where the aid is not reimbursed within two months.

> The Commission also does not seem to assess compliance with the exercise of the PONV conversion power in relation to precautionary guarantees notified as rescue aid. See, for example, the decision by the Commission in relation to the precautionary guarantees granted to Attica Bank.[168]

Another example can be found in the applicability of the burden-sharing requirements under the State aid regime in the case of precautionary recapitalisation. In all the cases of precautionary recapitalisation described in this dissertation, precautionary recapitalisation was assessed as being restructuring aid. In other words, in all cases, the Member States submitted a restructuring plan to the Commission on the basis of which the Commission assessed whether the bank could be restored to long-term viability. This implies that the burden-sharing requirements under the State

164 See e.g. EC, 7 October 2016, C(2016) 6573 final (SA.46558 – Attica Bank), par. 34.
165 2013 Banking Communication, point 59(d) and (e). See e.g. EC, 7 October 2016, C(2016) 6573 final (SA.46558 – Attica Bank), par. 38.
166 See e.g. EC, 7 October 2016, C(2016) 6573 final (SA.46558 – Attica Bank), par. 18, 39.
167 Article 59(3)(e) BRRD.
168 EC, 7 October 2016, C(2016) 6573 final (SA.46558 – Attica Bank), par.

aid regime should be met, unless this would endanger financial stability or lead to disproportionate results. The burden-sharing requirements apply despite the fact that precautionary recapitalisation is excluded from the application of the PONV conversion power.[169]

> In a letter dated 30 July 2013, Mr Draghi requested Mr Almunia to reconsider the applicability of the burden-sharing requirements under the State aid regime as a result of which subordinated debtors are mandatorily converted in the case of precautionary recapitalisation, because this could negatively impact the subordinated debt market. It would impact pricing, increase contractual uncertainty regarding the situations under which subordinated debt could be converted, and could be considered disproportionate for the subordinated creditors that face breach of their initial contract. It could even destroy the very confidence in Eurozone banks that everyone was attempting to restore.[170] The Commission did however not respond to this request. For example, in the case of the precautionary recapitalisation of MPS, both shareholders and junior debt holders contributed to limiting the use of State aid.[171]

Fourthly, it is unclear who has the authority to decide that the conditions of precautionary recapitalisation are being met or not. Donnelly and Asimakopoulos take the stance that it is up to the ECB and the SRB to decide this.[172] Taking into account that the assessment of these conditions forms part of the determination whether a bank is failing or likely to fail, this seems to be a correct approach.[173] In its decision in respect of the precautionary recapitalisation of MPS the Commission states: "*The Commission concludes that the conditions under which the aid measures (Measure 1 and Measure 2) are granted are in line with the exemption provided for in Article 32(4)(d) BRRD. Therefore, the aid measures do not trigger the "failing or likely to fail" criterion under the BRRD in relation to the Bank and can be implemented outside resolution*."[174] It therefore seems that the Commission also sees a role for itself in this respect, albeit that this could – in the author's view – not extend beyond the role of State aid authority.

169 2013 Banking Communication, point 45. Ventoruzzo and Sandrelli 2019, p. 39-40.
170 Letter from Mr Draghi to Mr Almunia, 30 July 2013, L/MD/13/474.
171 EC, 4 July 2017, C(2017) 4690 final (SA.47677 – MPS), par. 101-106.
172 Donnelly and Asimakopoulos *JCMS* 2019, p. 10.
173 Article 32(1)(a) BRRD. Article 18(1)(a) and the second paragraph SRMR.
174 EC, 4 July 2017, C(2017) 4690 final (SA.47677 – MPS), par. 137.

6.5.2 Liquidation aid

In a fact sheet dated 25 June 2017, the Commission stated: "*While the winding up of smaller banks may not affect the European financial system, their market exit may still have effects in the regions where such banks are most active. Therefore, outside the European banking resolution framework, it is for Member States to decide whether they consider a bank exit to have a serious impact on the regional economy, e.g. on the financing of small and medium enterprises in the regional economy, and whether they wish to use national funds to mitigate these effects. EU state aid rules, in particular the 2013 Banking Communication, foresee this possibility, subject, amongst other things, to burden-sharing rules and clear commitments that the entities effectively exit the market to ensure that competition distortions are minimised.*"[175] The Commission therefore specifically acknowledges that liquidation aid may still be necessary after the introduction of the resolution framework. In its assessment of this liquidation aid, the Commission applies the conditions set out in Section 6 of the 2013 Banking Communication, including burden-sharing by shareholders and subordinated creditors, but not by senior creditors.[176] See section 5.3.6 for examples of liquidation aid granted after the introduction of the resolution framework.

Liquidation aid is granted outside the scope of the resolution framework as a result of which there are no intrinsically linked provisions of the resolution framework that impact the assessment of liquidation aid under the State aid regime for the banking sector. One exemption in that respect is that winding up in normal insolvency proceedings is only possible if resolution is not in the public interest.[177]

> In relation to liquidation aid granted to Banca Popolare di Vicenza and Veneto Banca under national insolvency law, the Commission considered that it could not identify provisions of the resolution framework which would be indissolubly linked to the specific aid measures under examination.[178]

The assessment by the Commission of liquidation schemes is discussed in section 6.4.5.

175 EC Factsheet 2017.
176 EC Factsheet 2017.
177 EC, 13 April 2018, C(2018) 2295 final (SA.50640 – Italy), par. 101-103.
178 EC, 25 June 2017, C(2017) 4501 final (SA.45664 – Banca Popolare di Vicenza and Veneto Banca), par. 142-143. See also EC, 2 July 2015, C(2015) 4599 final (SA.41924 – Banca Romagna), par. 81.

6.6 State aid control by the Commission after the introduction of the resolution framework

This section discusses the impact of the resolution framework on State aid control by the Commission and the tensions identified in the exercise of this control as a result.

6.6.1 Impact of the resolution framework on State aid control by the Commission

The previous sections have shown that State aid control by the Commission has been impacted at two different levels by the resolution framework. The first impact is at an institutional level. Section 6.2 showed that as a result of the resolution framework, the Commission not only has a role as State aid authority, but also as co-resolution authority. The second impact is at a more procedural level, impacting the assessment by the Commission of State aid awards. As shown in sections 6.3, 6.4 and 6.5, the Commission has to assess State aid awards not only on compatibility with the internal market under the State aid regime for the banking sector, but also on compliance with intrinsically linked provisions of the resolution framework, with the exception of liquidation aid awards. In addition, the Commission has to apply its State aid regime for the banking sector on aid granted in resolution.

> Liquidation aid awards are not assessed on compliance with intrinsically linked provisions of the resolution framework because the situation in which a bank is wound up in normal insolvency proceedings is not covered by the resolution framework but by the national insolvency regimes.

The institutional and procedural impact of the resolution framework on State aid control by the Commission in the banking sector differs, depending on the situation of the failing bank, as shown in Table 10.[179]

179 See also Van Lambalgen 2018, p. 114-116. He does not make a distinction between situation iii) and iv).

Table 10: Institutional and procedural impact of resolution framework on State aid control by the Commission in the banking sector

Situation	Institutional impact	Procedural impact
i) A bank is put in resolution and receives State aid (resolution aid)	The Commission does not only act as State aid authority, but also as co-resolution authority. It has to endorse the decision of the SRB to put the bank in resolution.	The Commission has to assess State aid awards not only on compatibility with the internal market under the State aid regime for the banking sector, but also on compliance with intrinsically linked provisions of the resolution framework.
ii) A bank is put in resolution and does not receive State aid	The Commission only acts as co-resolution authority.	N/A
iii) A bank receives State aid without triggering resolution (precautionary guarantees and precautionary recapitalisation)	The Commission only acts as State aid authority.	The Commission has to assess State aid awards not only on compatibility with the internal market under the State aid regime for the banking sector, but also on compliance with intrinsically linked provisions of the resolution framework.
iv) Resolution action is not in the public interest and the bank receives State aid (liquidation aid)	The Commission only acts as State aid authority. The Commission is not involved in the decision of the SRB that resolution is not in the public interest.	The Commission has to assess State aid awards only on compatibility with the internal market under the State aid regime for the banking sector.

6.6.2 *Tension between the different roles*

There can be certain tensions between the different roles that the Commission fulfils, since, on the one hand it is involved in the decision to put a bank in resolution – thereby restricting the access to EPFS – , while on the other hand it has to assess the compatibility of proposed State aid measures with the internal market.

The tension between the different roles of the Commission became clear in the cases of Banca Popolare di Vicenza and Veneto Banca. In these cases, the SRB concluded that resolution was not in the public interest; the banks were put in liquidation instead. In order to ensure that this liquidation took place in an orderly manner, State aid was awarded by the Italian State, involving cash injections of about EUR 4.785 billion and State guarantees of a maximum of about EUR 12 billion.[180] This State aid was assessed by the Commission under Article 107(3)(b) TFEU following the statement of the Italian authorities that "*it would not be possible to avoid a serious disturbance in the economy in the areas where VB and BPVI operate with a particular impact on interruption of SME's business activities and lending to households*."[181] This course of action has been criticized in the literature.[182] In particular, it is not understood why resolution is not in the public interest, while the award of State aid is subsequently justified to remedy a serious disturbance in the economy of a Member State. A few remarks can be made in that respect.

6.6.2.1 Commission cannot endorse assessment of resolution conditions

The Commission only has the power to endorse a decision by the SRB to adopt a resolution scheme. It does *not* have the power to endorse the decision by the SRB concerning the assessment of the conditions for resolution without the resolution scheme being adopted. In that case, it is only an observer at the SRB meetings. Moreover, the Council plays no role should the SRB decide that resolution is not in the public interest.

> Taking into account the political sensitivity of this decision and the potential impact that this negative decision may have on the financial stability of Member States and the Union, it should be considered in the author's view whether the Council should be given the power to intervene on the request of a Member State and on the proposal of the Commission, should the SRB decide that there is no public interest that justifies the resolution of a bank. Another option is to subject the assessment of the conditions for resolution to the same decision-making process as applies to the decision to put a bank in resolution.

6.6.2.2 Cooperation in assessment of resolution objective 'protection of public funds'

In addition, it is not clear from the publicly available information if, and to what extent, information has been shared between the Commission and the SRB in respect of the intention of Italy to award State aid. For resolution to

180 See section 5.3.6.1.

181 EC, 25 June 2017, C(2017) 4501 final (SA.45664 – Banca Popolare di Vicenza and Veneto Banca), par. 98.

182 See e.g. Bodellini *Cambridge Yearbook of European Legal Studies* 2017, p. 161; Hellwig 2017, p. 20; Asimakopoulos *ECLJ* 2018; Ventoruzzo and Sandrelli 2019, p. 71-75.

be in the 'public interest', it should be necessary for the achievement and be proportionate to one or more of the resolution objectives, and winding up of the bank in normal insolvency proceedings should not meet those resolution objectives to the same extent. One of the resolution objectives is to protect public funds by minimising reliance on EPFS. The assessment that is made by the SRB in relation to this objective in the cases of Banca Popolare di Vicenza and Veneto Banca only refers to the use of deposit guarantee schemes. No reference is made to the State aid that Italy was about to award to the failing banks.[183]

The decisions of the SRB concerning the assessment of the conditions for resolution in respect of Banca Popolare di Vicenza and Veneto Banca were made on 23 June 2017. On 25 June 2017, the Commission approved the award of State aid by the Italian State. It seems very unlikely that the SRB was not informed by the Commission about Italy's plans to award that State aid. But, if it was not informed about these plans, this should, in the author's view, have led to the conclusion that it had insufficient information to make its assessment in relation to the fulfilment of the resolution conditions. In the author's view, it is necessary for the SRB to be fully aware of the plans of the Member State so that it can include any considerations in that respect in its assessment of the resolution conditions. Its assessment in the cases of Banca Popolare di Vicenza and Veneto Banca seems to be incomplete in that respect.

> In order to ensure that the SRB is fully informed when it makes its assessment, it seems to be relevant to require that the Commission, as soon as it receives a (formal or informal) request for approval of a State aid award from a Member State, contacts the SRB. This could be part of a memorandum of understanding (MoU) between the Commission and the SRB. Such notification obligation already rests on the SRB on the basis of Article 19(2) SRMR. At the time of writing this dissertation, no MoU between the SRB and the Commission was publicly available.[184]

183 SRB, Decision of 23 June 2017 concerning the assessment of the conditions for resolution in respect of Veneto Banca S.p.A., SRB/EES/2017/11, p. 18. SRB, Decision of 23 June 2017 concerning the assessment of the conditions for resolution in respect of Banca Popolare di Vicenza S.p.A., SRB/EES/2017/12, p. 18.

184 The formal adoption is however envisaged for 2019 (SRB Annual Report 2019, p. 25).

6.6.2.3 Retail investor protection may be underlying rationale for decisions

In the cases of Banca Popolare di Vicenza and Veneto Banca, it is questionable whether resolution was not in the public interest. Whether or not the SRB made the right assessment in relation to whether resolution would serve the resolution objective of 'financial stability' is difficult to assess without having all the facts. Taking into account the amount of State aid that Italy notified to the Commission, the case of Banca Popolare di Vicenza and Veneto Banca could however potentially also have been warranted in the public interest in order to protect public funds. This, however, requires that resolution would have protected public funds better than liquidation. This was potentially only the case would the bail-in tool have been applied by the SRB. Moreover, the bail-in tool *should* have been applied in order for Italy to be able to award State aid to the banks in resolution. This was problematic, because this would have led to the bail-in of retail creditors, unless the SRB had excluded the retail liabilities from the scope of the bail-in tool. This would, however, have necessitated the SRF to step in to fill the funding gap before there could be any access to State aid from Italy. It is possible that the SRB did not want to set a precedent in relation to retail liabilities, or that the SRF was not quite ready yet for assisting Banca Popolare di Vicenza and Veneto Banca.

If the underlying rationale for not placing the banks in resolution was indeed the protection of retail investors – or the protection of the SRF –, this is, in the author's view, a sign that the resolution framework lacks transitional provisions for banks that have insufficient levels of bail-inable debt that can actually be bailed-in, than that the resolution conditions are not fit for purpose.

6.6.2.4 Resolution and State aid control may serve different purposes

While both the State aid regime for the banking sector and the resolution framework serve the purpose of ensuring financial stability while State aid is kept to the minimum, there are some differences between the regimes that may make the Commission and the SRB take different interests into account when making their assessment.

First, the Commission, being the State aid authority, has foremost to ensure that any aid measure is compatible with the internal market. In its assessment, it balances public policy objectives, such as financial stability, against distortions of competition between banks and across Member States.[185] Distortions should always be kept to the minimum. The assessment is made in relation to the particular State aid award or scheme under discussion; it does not assess the policy of a Member State in general.[186] Ensuring fair competition is not one of the resolution objectives. The SRB does, however, have to undertake every action, proposal or policy with full regard and duty of care for the unity and integrity of the internal market.[187] In addition, efficiency and integrity of the internal market is an explicit assessment criterion in the resolvability assessment.[188]

> Article 107(3) TFEU gives the Commission the possibility to balance the necessity and proportionality of a public policy objectives versus distortions of competition. The introduction of the resolution framework may give the Commission room to tighten its assessment, and to focus more on prevention of distortion of competition, since financial stability is better safeguarded.[189]

Secondly, the Commission should, on the basis of Article 107(3)(b) TFEU, assess whether the aid is appropriate to remedy a serious disturbance in the economy of a Member State. It is therefore focused on the results of the aid at a national level. Even more, according to a fact sheet dated 25 June 2017, the Commission, in its assessment of liquidation aid, accounts for whether the Member States decides that the bank exit has a "*serious impact on the regional economy*".[190] This interpretation was presented in the case of Banca Popolare di Vicenza and Veneto Banca.[191] This seems to be contrary to the interpretation of the EU Courts that the compatibility assessment under Article 107(3)(b) TFEU only justifies aid that remedies a disturbance that *affects the whole economy*, and not just a region or sector.[192]

185 See also Lastra, Russo and Bodellini 2019, p. 17-18. Grünewald 2014, p. 133-134.
186 See Hellwig 2017-1, p. 18 for a critical note.
187 Article 6(2) SRMR.
188 Article 10(5) SRMR.
189 See also Olivares-Caminal and Russo 2017, p. 13. Bruzzone, Cassella and Micossi 2017, p. 536.
190 EC Factsheet 2017.
191 EC, 25 June 2017, C(2017) 4501 final (SA.45664 – Banca Popolare di Vicenza and Veneto Banca), par. 98.
192 GC, 15 December 1999, T-132/96 and T-143/96, EU:T:1999:326 (*Freistaat Sachsen and Others v Commission*), par. 167. Nicolaides *Maastricht J.* 2017, p. 346.

While the Commission therefore seems to tend to take the regional impact of an aid measure into consideration, the SRB should ensure that appropriate account is taken of both national and EU financial stability.[193] The financial stability assessments made by the Commission and the SRB may then take place at different levels.[194]

A last difference between the assessment by the SRB and by the Commission, is that the Commission's assessment is based on the request of a Member State to approve a State aid measure. In cases where a Member State motivates that the aid measure is appropriate to remedy a serious disturbance, the Commission seems to go with that motivation.[195]

> Since it started using Article 107(3)(b) TFEU as the legal basis for its assessment in the fall of 2008, the Commission has not once taken the position that this is not the case. It seems that the Commission restricts its assessment in that respect to whether there are grounds to dispute the assessment and thus not to conduct its own full assessment.[196] This seems reasonable taking into account the short timelines and the insights required in relation to the position of the bank and the economy of a Member State to conduct the assessment.

The SRB's assessment is more independent in that respect. The assessment whether resolution is necessary in the public interest is made by the SRB itself.[197]

> This independence should also be seen against the background that Member States have accepted giving up part of their budget sovereignty by giving the Commission the power to assess State aid awards. Decisions or actions of the SRB, on the other hand, cannot impinge on the budgetary sovereignty and fiscal responsibilities of the Member States.[198]

193 Recital (39) SRMR.
194 See also Enria 2017; Grünewald 2017, p. 301-302.
195 Hellwig 2017, p. 19.
196 See e.g. EC, 5 October 2016, C(2016) 6417 final (SA.46066 – Croatia), par. 56.
197 Article 32(1) BRRD. Article 18(1) SRMR.
198 Article 6(6) SRMR.

6.6.2.5 Distinction between DG COMP and DG FISMA

This dissertation consistently refers to the Commission, without making a distinction between the different Directorates General within the Commission. The Commission is however divided into departments that develop policies for specific areas (the Directorates General or DGs). Each DG is headed by a Commissioner and has its own strategic and management plan. The DG Competition (DG COMP) is responsible for EU policy on competition and for enforcing EU competition rules, including the State aid rules. The DG Financial Stability, Financial Services and Capital Markets Union (DG FISMA) is responsible for the EU policy on banking and finance. As such, both departments are involved in the resolution of failing banks.

> DG FISMA prepares the Commission decisions on the resolution of banks under the SRM, in which it endorses (or not) the decision by the SRB.[199] DG COMP prepares the decisions on State aid awards.

Both departments can have different priorities, as a result of which the involvement of the Commission as co-resolution authority is not necessarily completely aligned with the involvement of the Commission as State aid authority. However, any service preparing a Commission decision or proposal must take account of the fact that the Commission as a whole will bear responsibility for the measure in question and must act accordingly, i.e. in conjunction with other services as appropriate.[200]

6.6.3 Tension between the different rules

Another potential for tension is created by the fact that two sets of rules may have to be taken into account by the Commission when assessing State aid measures in the banking sector. These sets of rules are not always coherent, as could be seen in the example of precautionary guarantees and the exercise of the PONV conversion power (see section 6.5.1).

199 DG FISMA, Annual Activity Report 2017, p. 17-18.

200 EC State Aid Manual of Procedures, Section 14-1. See critically in respect of the coordination between DG COMP and other Commission departments during the GFC: Lannoo 2010, p. 37.

6.6.3.1 Lack of coherence between State aid regime and resolution framework

Both the State aid regime for the banking sector and the resolution framework set rules in respect of the award of State aid, while these are not always aligned. An example, is the application of the PONV conversion power in case of the award of precautionary guarantees.[201] In cases where there is a lack of coherence, the question arises how the State aid regime and the resolution framework relate. Does one take precedence over the other, or are they equal? This question can be answered along different lines. One could, for example, take temporal aspects into account, resulting from the fact that the State aid regime precedes the resolution framework. One could also look at the hierarchy of norms instituted by the Lisbon Treaty, according to which the TFEU and TEU sit in the first tier; the second tier is formed by the general principles of law and regulations, directives, decisions, delegated acts, and implementing acts constitute the third tier.[202] It is, however, in the author's view, too straightforward to establish a hierarchical relationship between the State aid regime and the resolution framework on this basis.

The resolution framework provides that Member States and national resolution authorities should comply with the Union State aid framework, where applicable.[203] It also provides that the SRB should act in compliance with Union law and the decisions taken by the Commission concerning the compatibility of the use of aid with the internal market.[204] This indicates that the resolution framework acknowledges the priority of the State aid regime for the banking sector. In addition, outside of resolution, the State aid rules apply.[205] The 2013 Banking Communication, on the other hand, intends to help a smooth passage to the resolution framework.[206] Moreover, section 6.3.2 discussed that the Commission, in its State aid assessment, includes whether aid measures granted to the banking sector violate 'intrinsically linked provisions of the BRRD and SRMR', since the Commission's assessment of State aid awards may never produce a result which is contrary to the specific provisions of the EU Treaties.

201 See section 5.3.3.
202 Gortsos 2019-2, p. 147.
203 Articles 32(4), 34(3), 36(5), 37(10)(b), 38(2), 39(2), 41(1)(g) and (4), 42(6), 44(12), 52(1), 56(1), 63(2) last paragraph BRRD.
204 Articles 5(2), 18(9), 19 and 23 SRMR.
205 Kokkoris *ICR* 2013, p. 392-393.
206 2013 Banking Communication, point 13.

As a result, both the State aid regime for the banking sector and the resolution framework seem to start from the premise that the rules set out therein should be mutually acknowledged. Although there is no case-law – yet – on the hierarchical relationship between the State aid regime for the banking sector and the resolution framework, it is settled case-law that the provisions relating to the free movement of goods and those relating to State aid have a common purpose, namely to ensure the free movement of goods between Member States under normal conditions of competition,[207] as Articles 107 and 108 TFEU may in no case be used to frustrate the rules of the TFEU on the free movement of goods.[208] On the basis of this case-law, Advocate-General Wathelet took the view in the case of *„ZPT" AD v Narodno sabranie na Republika Bulgaria and Others* that the TFEU does not establish a hierarchy between its rules prohibiting quantitative restrictions and on State aid. He consequently stated that national measures or measures adopted by the institutions of the EU must be consistent with both the rules of the TFEU on the prohibition of quantitative restrictions and the rules on State aid.[209]

The same line could arguably be followed in relation to the hierarchical relationship between the State aid regime for the banking sector and the resolution framework. After all, the resolution framework is based on Article 114 TFEU and therefore has, as its object, the establishment and functioning of the internal market, ensuring the free movement of banking services. The outcome that there is no hierarchy between the State aid regime for the banking sector and the resolution framework, and that measures adopted by Member States and EU institutions should be consistent with both rules of the State aid regime and the resolution framework, seems to be in line with the approach taken by the Commission in its State aid decisions. This means that if there is any inconsistency between these rules, either the State aid regime or the resolution framework should be amended in order to align them. In the example of precautionary guarantees and the exercise of the PONV conversion power, it is the author's view that the resolution framework should be amended in order to ensure

207 ECJ, 5 June 1986, C-103/84, ECLI:EU:C:1986:229 (*Commission v Italy*), par. 19.

208 See, by analogy, ECJ, 5 June 1986, C-103/84, ECLI:EU:C:1986:229 (*Commission v Italy*), par. 19, ECJ, 20 March 1990, C-21/88, EU:C:1990:121 (*Du Pont de Nemours Italiana*), par. 19 to 22, ECJ, 23 April 2002, C-234/99, ECLI:EU:C:2002:244 (*Nygård*), par. 57-64.

209 Opinion of Advocate-General Wathelet, 29 November 2017, C-518/16, ECLI:EU:C:2017:912 (*„ZPT" AD v Narodno sabranie na Republika Bulgaria and Others*), par. 34 and 35.

that the use of precautionary guarantees is no trigger for the exercise of the PONV conversion power.

Finally, although no inconsistency, it should be practically considered that the resolution framework places considerable constraints on the application of the State aid rules in respect of timing. An example is the valuation of impaired assets in case the asset separation tool is applied. *Ex ante* valuation of impaired asset measures may not be possible in that case. This has forced the Commission to approve liquidation aid on a temporary basis, although the 2013 Banking Communication does not provide for this situation.[210] In this case, the State aid regime for the banking sector may have to be amended to cater for this possibility. This brings us to the next topic.

6.6.3.2 State aid regime for the banking sector is outdated

The 2013 Banking Communication has not been updated since its introduction, which may give the impression that, as far as the EU is concerned, the crisis rages on and taxpayers can foot the bill when banks collapse.[211] According to Mr Stiefmueller, a senior policy analyst at the independent watchdog Finance Watch in Brussels, this has, in the world of bank regulation, maintained two parallel universes: one where bank bailouts are frowned on as an abuse of taxpayers' money, and another where bank bailouts are considered as a politically more expedient and cheaper way of solving banking crises. He states that these two sets of rules are not compatible.[212] Although the author does not concur with this view, it cannot be denied that the resolution framework has an impact on State aid control by the Commission, as described in this chapter. It has therefore become very challenging to fully comprehend State aid control by the Commission in the banking sector without knowledge of both the State aid regime for the banking sector and the resolution framework.

In a resolution of 16 January 2019, the European Parliament calls on the Commission to assess the recovery and resolution of banks in the light of State aid rules, to examine regulation in the light of the BRRD, and to propose transparent application of the rules on State aid in relation to the BRRD.[213] In March 2019, the European Court of Auditors published information on an upcoming audit in respect of control of State aid to banks.

210 See section 6.4.4.4.
211 Weber and Groendahl 2017.
212 Weber and Groendahl 2017.
213 EP Annual Report Resolution 2018, under 26.

This audit, *inter alia*, examines whether current State aid rules and the Commission's procedures are fit for the purpose of identifying and controlling State aid to banks.[214] In other words, steps are taken towards revision of the State aid regime for the banking sector, albeit the direction to be taken is still unclear, at the time of writing this dissertation.

6.6.3.3 Lack of harmonisation of national insolvency proceedings

The lack of harmonisation of the national insolvency regimes contributes to the tension that exists between the resolution framework and the State aid regime for the banking sector.[215] The cases of Banca Popolare di Vicenza and Veneto Banca are illustrative in that respect. In the absence of harmonised national insolvency proceedings, Italy could adopt a decree according to which liquidation measures could be taken in respect of failing banks outside the resolution framework and with the support of State aid.[216]

6.7 Conclusion

The State aid regime for the banking sector has not changed as a result of the introduction of the resolution framework. The Commission still assesses State aid awards to failing banks on the basis of the 2013 Banking Communication. This does not, however, mean that the resolution framework has not had an impact on the exercise of State aid control by the Commission. This impact has both an institutional and a procedural dimension.

At an institutional level, the role of the Commission as State aid authority has been extended to the assessment of supranational EPFS. The resolution framework provides for the analogue application of State aid control to the SRF. Moreover, the resolution framework regulates the relation between the SRB and the Commission, as a result of which the SRB has to comply with similar obligations as the Member States when the SRF is used. Similar provisions apply in respect of the ESM DRI on the basis of the ESM DRI Guideline.

214 European Court of Auditors, Audit Preview – Control of State aid to banks, March 2019, p. 8.

215 As an important exception, the BRRD has to some extent harmonized the order of priority under national law in resolution and standard insolvency proceedings (Schillig 2018, p. 16). In addition, BRRD II provides for harmonisation of the 'insolvency conditions' (see section 6.6.1).

216 See critically Donnelly and Asimakopoulos *JCMS* 2019, p. 12-13.

Furthermore, with the introduction of the resolution framework, the Commission has acquired the new role of co-resolution authority within the SRM. This entails that the assessment of the discretionary aspects of the resolution decisions taken by the SRB is exercised by the Commission, together with the Council. The Commission has also been empowered to adopt delegated acts to specify further criteria or conditions to be taken into account by the SRB in the exercise of its different powers. Moreover, the Commission checks, as an observer to the SRB meetings on an ongoing basis, that the resolution scheme adopted by the SRB complies fully with the SRMR, balances the different objectives and interests at stake appropriately, respects the public interest, and preserves the integrity of the internal market. Lastly, the resolution framework has introduced the authority for the Commission to make an assessment when certain liabilities are excluded from the application of the bail-in tool under the BRRD or the SRMR. This is without prejudice to the assessment by the Commission under the State aid regime

At a procedural level, the resolution framework impacts the assessment by the Commission of State aid awards. Since the introduction of the resolution framework, the Commission has to apply the State aid regime for the banking sector on aid granted in resolution (resolution aid). This term is not included in the 2013 Banking Communication, as a result of which it is not clear which framework applies to the assessment by the Commission of resolution aid. This chapter has discussed the criteria that can be established based on the Commission's decision practice in respect of resolution aid. In addition, the Commission has to assess State aid awards not only on compatibility with the internal market under the State aid regime for the banking sector, but also on compliance with intrinsically linked provisions of the resolution framework. As a result, the Commission has to be aware of the dynamics of resolution procedures in its assessment, including the tight timelines.

This chapter has shown that the exercise of State aid control by the Commission after the introduction of the resolution framework is not without challenges. First, the Commission has to deal with tensions between its different roles, while taking its different mandates and the cooperation with the SRB into account. In addition, it has to deal with tensions between different sets of rules. Although the resolution framework acknowledges the priority of the State aid regime for the banking sector, since all the measures that can be taken in the process of resolution of a bank (and also outside thereof) need to account for the State aid rules, the Commission cannot approve a State aid award if it violates intrinsically linked provisions of the resolution framework. As long as these rules overlap or complement each other there may be no real issues in that respect. This is, however, different where these rules contradict each other. Especially in the absence of a (much desired) revision of the State aid regime for the banking sector, it has become challenging to fully comprehend State aid control by the Commission in the banking sector without knowledge of both the State aid regime for the banking sector and the resolution framework.[217]

217 See also Bierens 2015 p. 28 on the risks that result from regulation and, most notably, from increased complexity of the law.

CHAPTER 7

THE IMPACT OF THE RESOLUTION FRAMEWORK ON THE RESTRUCTURING PROCESS OF A FAILING BANK

> *"Indeed the window of opportunity between closing a bank so early that the owners may sue and so late that the depositors may sue may have become vanishingly small."*
>
> *Goodhart 2014*

7.1 Introduction

After the resolution authority (the SRB or the national resolution authority) has put the bank in resolution, the resolution of the bank starts. The application of the resolution tools may trigger restructuring of the bank, but this is not necessarily so. When resolution involves the award of State aid, e.g. through the use of GFST, the restructuring process under the State aid regime for the banking sector may also apply. As a result, the restructuring process of a failing bank has become multi-faceted after the introduction of the resolution framework. After all, a failing bank may not only be faced with the restructuring process under the State aid regime for the banking sector, but also under the resolution framework. Although these restructuring processes may be triggered at the same time, they may differ and impose different restructuring obligations on the bank.

Prior to the introduction of the resolution framework, the restructuring (or liquidation) of a bank was the domain of the Commission, being the State aid authority, and the Member State, working together with the beneficiary bank and the competent authority, assuming that the restructuring process was triggered by the award of State aid. Under the resolution framework another actor has been introduced on stage: the resolution authority. The Commission, in its role as the State aid authority, will have to work together with the resolution authorities and *vice versa* in order to ensure an efficient restructuring process.

> Within the SRM, the Commission also acts as resolution authority (see section 6.2.2). In this chapter, references to the Commission should be read as references to the Commission acting in its role as State aid authority, unless otherwise indicated.

This chapter discusses the impact of the resolution framework on the restructuring process of a failing bank. It is structured as follows. Section 7.2 first describes the restructuring processes that a failing bank can be subject to after the introduction of the resolution framework. Section 7.3 subsequently assesses the competences of the different authorities in the restructuring process of a failing bank. Section 7.4 pays particular attention to the burden-sharing obligation in case a failing bank receives public funding after the introduction of the resolution framework. Section 7.5 further analyses the impact that the resolution framework has on the restructuring process of a failing bank and identifies any challenges in this process. Section 7.6 concludes this chapter.

> This chapter only applies to the restructuring of banks that started after the resolution framework entered into force. The restructuring of banks that started prior to the introduction of the resolution framework remains managed by the national authorities on the basis of the State aid regime for the banking sector only.[1] The situation where a bank is not restructured but wound up in normal insolvency proceedings is not discussed in this chapter.

7.2 The restructuring process of a failing bank

This section further discusses the restructuring process of a failing bank after the introduction of the resolution framework, including the restructuring obligations of such a bank.

7.2.1 The restructuring process under the resolution framework

7.2.1.1 Restructuring in resolution

Resolution does not necessarily lead to restructuring of the bank.[2] This depends on the resolution tool applied by the resolution authority.[3] While the bail-in tool is primarily aimed at preserving the bank as an autonomous

1 See e.g. EC, Press Release – State aid: Commission approves aid for financing the orderly market exit of Cyprus Cooperative Bank Ltd, involving sale of some parts to Hellenic Bank, IP/18/4212, 19 June 2018.
2 Nicolaides *Maastricht J.* 2017, p. 343.
3 See section 4.4.3 for an overview of the resolution tools.

legal entity, the transfer tools normally involve the disappearance of the bank as such.[4] The bail-in tool is therefore referred to as a 'going concern' solution, while the transfer tools are in principle 'gone concern' solutions.[5]

> The bail-in tool may, also be combined with a transfer tool, e.g. in order to provide funding to a bridge bank[6] or to enable a sale under the sale of business or asset separation tool by converting to equity or reducing the principal amount of claims or debt instruments transferred under these tools. In these cases, the application of the bail-in tool may qualify as a 'gone concern' solution.

The resolution framework only sets out the criteria for the restructuring process of a bank in resolution, when the bail-in tool is applied with the objective of restoring the capital of the failing bank to enable it to continue to operate as a *going concern*. In that case, resolution through bail-in should be accompanied by (i) replacement of management, except where retention of management is appropriate and necessary for the achievement of the resolution objectives, and (ii) a subsequent restructuring of the bank and its activities in a way that addresses the reasons for its failure. That restructuring should be achieved through the implementation of a business reorganisation plan.[7] The contents of the business reorganisation plan have been discussed in section 4.7.1.2.

> In short, the business reorganisation plan has to set out the measures aiming to restore the long-term viability of the bank or its parent company or parts of its business within a reasonable timescale. These measures may, for example, include the reorganisation of the activities of the bank, changes to the operational systems and infrastructure, the withdrawal from loss-making activities, restructuring of existing activities, and the sale of assets or business lines.[8] The business reorganisation plan should, in principle, be submitted to the resolution authority within one month after the application of the bail-in tool for recapitalisation purposes. In exceptional circumstances or where the business reorganisation plan is required

4 For example, viable assets (critical functions) are transferred to a purchaser or bridge institution, while the residual entity is wound up in normal insolvency proceedings (Article 37(6) BRRD).
5 Recital (69) BRRD. Boccuzzi 2016, p. 78.
6 Recital (68) BRRD.
7 Recital (69) BRRD. Article 51(1) BRRD.
8 Article 52(4) and (6) BRRD.

to be notified within the State aid regime, the resolution authority may extend the period up to a maximum of two months or until the deadline laid down by the State aid regime, whichever occurs earlier.[9]

Where the business reorganisation plan includes measures already featuring in the latest versions of previously prepared recovery or resolution plans for the bank, these should be limited to elements which remain relevant following that bank's failure and resolution and the situation in the relevant markets.[10]

The resolution framework does not provide any guidance in relation to the (potential) restructuring process in other situations in resolution, with the exception of the following:

1. The resolution power to remove or replace the management body and senior management should normally be exercised as part of resolution, unless the retention of such management body and/or senior management is considered necessary for the achievement of the resolution objectives; and
2. The continuity arrangements as discussed in section 4.7.1.4.

In addition, when the transfer tools are used, the market party that will acquire the assets, rights and liabilities or shares or other instruments of ownership in the failing bank, may also want to restructure this bank or its assets, rights or liabilities. This, however, takes place outside the resolution framework.

7.2.1.2 Restructuring outside of resolution

The resolution framework does not provide for a restructuring process and no business reorganisation plan is required to be drawn up when a bank is subject to precautionary recapitalisation or makes use of precautionary guarantees.

9 Article 52(1) and (3) BRRD.
10 EBA Guidelines on the minimum criteria to be fulfilled by a business reorganisation plan, par. 4.1-4.3.

7.2.1.3 The introduction of *ex ante* restructuring

Although the resolution framework may not provide much guidance on the restructuring process of a bank *in* resolution or in case of precautionary recapitalisation or precautionary guarantees, it does introduce a clear framework for restructuring *prior* to resolution (hereinafter referred to as *ex ante* restructuring).[11] Resolution authorities can already force a bank to restructure prior to any financial difficulties arising which may lead to the resolution of the bank. This takes place on the basis of the recovery and restructuring plan.[12]

All banks need to prepare a recovery plan which includes triggers for measures to be taken by the bank for the restoration of its financial position following a significant deterioration (recovery measures).[13] The recovery plan is assessed by the competent authority. In addition, the resolution authority may examine the plan with a view to identifying any actions in the plan which may adversely impact the resolvability of the bank, and may make recommendations to the competent authority with regard to those matters.[14] Where the competent authority assesses that there are material deficiencies in the recovery plan, or material impediments to its implementation, it has to require the bank to submit a revised plan. Where the competent authority considers that the deficiencies and impediments have not been adequately addressed by the revised plan, it may direct the bank to make specific changes to the plan. If the bank fails to do so, the competent authority may as an *ultimum remedium* direct the bank to take any measures it considers necessary and proportionate.[15] These measures may include directing the bank to reduce its risk profile, including liquidity risk, enable timely recapitalisation measures, review the bank's strategy and structure, make changes to the funding strategy so as to improve the resilience of the core business lines and critical functions, or make changes to the governance structure of the institution.[16] The author considers these to be *ex ante* restructuring measures.

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11 See also Bierens *Ondernemingsrecht* 2017, p. 4.
12 Also, the competent authorities have possibilities to restructure a bank through early intervention measures or supervisory measures. See sections 2.4.7.1 and 2.4.7.2. These restructuring possibilities are not further discussed in this chapter.
13 Article 5(1) BRRD.
14 Article 5 BRRD.
15 Article 6 BRRD.
16 Article 6(6) BRRD.

In addition to the recovery plan prepared by the bank itself, the relevant resolution authority prepares a resolution plan for each bank on the basis of the information provided by the bank.[17] The resolution plan provides for the resolution actions which the resolution authority may take where the bank meets the conditions for resolution.[18] For the purposes of drawing up (and updating) the resolution plan, the relevant resolution authority has to make a resolvability assessment.[19] Where the resolution authority determines in this assessment that there are substantive impediments to the resolvability of a bank, it will request the bank to propose possible measures. Where the resolution authority assesses that these measures do not effectively reduce or remove the impediments, it has to require the bank to take alternative measures.[20] The author also considers these alternative measures to be *ex ante* restructuring measures. Alternative measures can, for example, include the requirement to revise any intragroup financing agreements, to limit maximum individual and aggregate exposures, to divest specific assets, to limit or cease specific existing or proposed activities, to change legal or operational structures of the bank, to set up a parent financial holding company in a Member State, to issue eligible liabilities, or to renegotiate any eligible liability, additional Tier 1 instrument or Tier 2 instrument it has issued.[21]

7.2.2 The restructuring process under the State aid regime for the banking sector

When a bank receives State aid, the restructuring process as laid down in the State aid regime for the banking sector may apply, depending on the circumstances:

– Recapitalisation and asset relief measures must in principle be preceded by the approval by the Commission of a restructuring plan. Only when recapitalisation or asset relief measures are required to preserve financial stability, can this be granted before a restructuring plan is approved. This restructuring plan has to be submitted within two months of the date of the decision temporarily approving the aid.
– Funding guarantees and liquidity support can be granted as rescue aid before a restructuring (or winding up) plan is approved. A

17 Article 10 and 11 BRRD.
18 Article 10(1) BRRD.
19 Article 15(3) BRRD.
20 Article 17 BRRD.
21 Article 17(5) BRRD.

restructuring (or winding up) plan must however be submitted to the Commission within two months for any bank granted guarantees on new liabilities or on renewed liabilities for which, at the time of the granting of the new guarantee, the total outstanding guaranteed liabilities (including guarantees accorded before the date of that decision) exceed both a ratio of 5% of total liabilities and a total sum of EUR 500 million. In addition, for any bank which causes the guarantee to be called on, an individual restructuring (or winding up) plan must be submitted within two months after the guarantee has been activated.[22]

– Liquidation aid to assist the winding up of the bank in an orderly manner must be preceded by the approval by the Commission of a plan for the orderly liquidation of the bank (winding up plan).
– Liquidation aid to the economic activity to be sold must be preceded by the approval by the Commission of a plan for the integration of the economic activity in the buyer (integration plan).

The State aid regime for the banking sector provides that a capital raising plan should be implemented by the bank as part of or before the restructuring process in order to ensure that the award of State aid is as limited as possible.

> As soon as a capital shortfall likely to result in a request for State aid has been identified, a Member State can enter into pre-notification contacts with the Commission on the basis of a capital raising plan.[23]

The capital raising plan sets out capital raising measures (e.g. right issues, conversion of debt into equity, liability management exercises, capital-generating sales, securitisation), burden-sharing measures (absorption of losses by equity, hybrid capital holders and/or subordinated debt holders) and safeguards preventing the outflow of funds (e.g. dividend bans, prohibition to repurchase shares).[24] Only if the capital raising measures and safeguards are not sufficient to fill the capital shortfall, then shareholders and subordinated creditors will be required to contribute through burden-sharing measures.[25] If after the implementation of all the measures a capital shortfall remains, it can in principle be covered by State aid.[26]

22 2013 Banking Communication, point 59(d) and (e).
23 2013 Banking Communication, point 32.
24 See section 3.7.1.2.
25 Nicolaides 2016, p. 7.
26 2013 Banking Communication, point 49.

Further details of the restructuring and liquidation process under the State aid regime for the banking sector have been discussed in section 3.7.

7.2.3 *Co-existence of restructuring processes*

This section elaborates on the co-existence of the restructuring processes under the State aid regime for the banking sector and the resolution framework, as discussed in the previous sections.

7.2.3.1 Applicable restructuring processes

Table 11 shows that the restructuring processes under the State aid regime for the banking sector and the resolution framework are partly overlapping, but also differ.

Table 11: Applicable restructuring processes

Restructuring process	***Resolution framework***	***State aid regime for the banking sector***
Ex ante restructuring	Yes, on the basis of the recovery plan the competent authority may as an *ultimum remedium* direct the bank to take any measures it considers necessary and proportionate. In addition, the resolution authority has the power to require the bank to take alternative measures on the basis of the resolution plan.	N/A
Restructuring planning	Yes, a business reorganisation plan has to be prepared, **but onl**y in case the bail-in tool is used as a 'going concern' tool	Yes, a restructuring plan has to be prepared when rescue aid is not reimbursed within two months and/or more structural aid (restructuring aid) is required. In addition, a capital raising plan has to be prepared before or as part of the submission of a restructuring plan.

Obligation to take capital raising measures, burden-sharing measures and safeguards preventing the outflow of funds	The second resolution condition requires that the failure of the bank cannot be prevented by alternative private sector measures or supervisory actions. If a bank is failing or likely to fail, it should therefore first turn to alternative sector measures or supervisory actions in order to return to viability. Only, if these measures cannot prevent the failure of the bank, can it be put in resolution or wound up in normal insolvency proceedings. The second resolution condition therefore has the same effect as the capital raising measures and safeguards preventing the outflow of funds included in the capital raising plan. Moreover, the recovery and resolution plan can contribute on an *ex ante* basis to limiting the burden when a bank is failing. The burden-sharing measures are taken by the resolution authorities through exercising the PONV conversion power and the bail-in tool.	Yes, on the basis of the capital raising plan.
Obligation to take measures to restore the long term viability of the bank	Yes, on the basis of the business reorganisation plan	Yes, on the basis of the restructuring plan.
Obligation to take measures that will limit the distortion of competition	N/A	Yes, on the basis of the restructuring plan. These measures could be structural measures, corporate governance measures, behavioural measures and/or government measures.

Monitoring arrangements	Although monitoring arrangements do not form part of the business reorganisation plan, the management body or the person or persons appointed by the resolution authority has to submit a report to the resolution authority at least every six months on progress in the implementation of the plan.	Yes, as part of the restructuring plan.
Removal or replacement of management body and/or senior management	Yes, the resolution power to remove or replace the management body and senior management should normally be exercised as part of resolution, unless the retention of such management body and/or senior management is considered necessary for the achievement of the resolution objectives	Yes, on the basis of the restructuring plan. If recourse to State aid could have reasonably been averted through appropriate and timely management action, any entity relying on State aid for its restructuring or winding up in an orderly manner should normally replace the CEO, as well as other board members, if appropriate.
Continuity arrangements	The resolution authorities can require a bank in resolution, or any of its group companies, to provide any services or facilities that are necessary to enable a recipient to operate effectively the business transferred to it.	The State aid regime for the banking sector does not provide for similar continuity arrangements.

There are a number of cases in which State aid was granted after the introduction of the resolution framework. In section 6.4.4, four examples were discussed of the award of State aid in resolution. In addition, section 5.3.2 discussed examples of precautionary recapitalisations and guarantees. The applicable restructuring processes in these cases are summarised in Table 12.

Table 12: Applicable restructuring processes in examples of State aid awards

Example	***Restructuring process under resolution framework***	***Restructuring process under State aid regime for the banking sector***
In resolution		
Capital injection from a resolution fund to a bridge bank (e.g. *Carichieti, Carife, Banca Marche, Banca Etruria and BES*)	N/A	Winding up plan has to be submitted and approved prior to award of the aid

Sale following the application of the bridge bank tool (e.g. *Carichieti, Carife, Banca Marche, Banca Etruria and BES*)	N/A	Integration plan has to be submitted and approved prior to award of the aid
Contribution by national resolution fund / Member State under sale of business tool (e.g. *Panellinia Bank and BANIF*)	N/A	Integration plan has to be submitted and approved prior to award of the aid
Transfer of non-performing assets to AMC under asset separation tool (as part of restructuring process) (e.g. *MKB Bank)*	N/A	Restructuring plan has to be submitted and approved prior to award of the aid
Transfer of non-performing assets to AMC under asset separation tool (as part of liquidation process) (e.g. *Carichieti, Carife, Banca Marche, Banca Etruria and BANIF)*	N/A	Integration plan has to be submitted and approved prior to award of the aid
Outside of resolution		
Precautionary guarantees (e.g. *BES, Attica Bank, MPS, Banca Popolare di Vicenza, Veneto Banca, Banca Carige*)	N/A	Restructuring or a winding up plan has to be submitted within two months of the granting of the guarantees (unless the aid is reimbursed within two months)
Precautionary recapitalisation (e.g. *Piraeus Bank, Alpha Bank, Eurobank, National Bank of Greece, MPS, LCUU*)	N/A	Restructuring plan has to be submitted and approved prior to the award of the aid (unless it concerns rescue recapitalisation)

The table shows that in none of the cases a restructuring process was triggered under the resolution framework. Restructuring is, in all cases, solely covered by the State aid regime for the banking sector.

This can be explained by the fact that the restructuring process under the State aid regime for the banking sector actually only applies in addition to the restructuring process under the resolution framework when resolution involves the award of State aid and the bail-in tool is used as a going concern solution; e.g. when the GFST are used.

At the time of writing this dissertation, the bail-in tool had not yet been applied as a going concern solution. Section 4.4.3.4 discussed the application of the bail-in tool. It mentions the cases of HETA, Andelskassen and Jadranska Banka. In all these cases, the bail-in tool was applied in support of a transfer tool. In the case of HETA, the asset separation tool and sale of business tool were applied prior to the introduction of the resolution framework.

7.2.3.2 Comparison of restructuring obligations on the basis of the restructuring plan and the business reorganisation plan

Table 11 showed that there is an overlap between the restructuring obligations on the basis of a restructuring plan and business reorganisation plan. Both the restructuring plan and the business reorganisation plan need to include measures to restore the long-term viability of the bank.

Laitenberger mention that zombie banks artificially kept alive distort competition and market prices, do not provide for financial stability, and cannot lend to the real economy.[27] Restoration of the long-term viability of the bank is therefore important, both from a State aid law perspective and a resolution law perspective.

It can be read in the Restructuring Communication that long-term viability is achieved when a bank is able to cover all its costs including depreciation and financial charges, and provide an appropriate return on equity, taking into account its risk profile. The restructured bank should be able to compete in the marketplace for capital on its own merits in compliance with relevant regulatory requirements.[28]

The business reorganisation plan has to set out measures aiming to restore the long-term viability of the bank, its parent company, or parts of its business within a reasonable timescale.[29] These measures may, for example, include the reorganisation of the bank's activities, changes to the operational systems and infrastructure, the withdrawal from loss-making activities, restructuring of existing activities, and the sale of assets or business lines.[30] The long-term viability of a bank is deemed restored following resolution if, at the latest by the end of the reorganisation period, the bank or banking

27 Laitenberger 2016, p. 4.
28 Restructuring Communication, point 13.
29 Article 53(4) BRRD.
30 Article 52(4) and (6) BRRD.

group is capable of fulfilling its internal capital adequacy assessment process, and all the relevant prudential and other regulatory requirements on a forward-looking basis, and that it has a viable business model that is also sustainable in the long-term.[31]

Both the State aid regime for the banking sector and the resolution framework hence impose measures on the bank to restore its long-term viability. The assessment whether this is restored is, however, different under the State aid regime for the banking sector and the resolution framework. The restoration of long-term viability under the resolution framework focusses on the fulfilment of prudential requirements in addition to having a viable business model, while having a viable business model seems to be the main element of long-term viability under the State aid regime for the banking sector. As a result, the measures included in the restructuring plan may differ in focus from the measures included in the business reorganisation plan.

> The recitals of Delegated Regulation (EU) 2016/1400 state that the guidelines and communications adopted by the Commission in relation to its State aid assessment may provide useful reference for elaboration of the business reorganisation plan, even where no State aid has been granted, since, they share the objective of restoring the bank's long-term viability.[32]

In addition to the measures to restore the long-term viability of the bank, a restructuring plan also needs to contain measures to limit the distortion of competition. This is not a requirement for the business reorganisation plan.

Furthermore, the restructuring plan needs to contain monitoring arrangements. This requirement does not apply to business reorganisation plans. However, the management body or the person or persons appointed by the resolution authority has to submit a report to the resolution authority at least every six months on progress in the implementation of the plan.[33]

Lastly, restructuring under the resolution framework requires the replacement of management, except where retention of management is appropriate and necessary to achieve the resolution objectives. Under the State aid

31 Recital (6) Delegated Regulation (EU) 2016/1400.
32 Recital (2) Delegated Regulation (EU) 2016/1400.
33 Article 52(10) BRRD. Article 6 Delegated Regulation (EU) 2016/1400.

regime for the banking sector, any entity relying on State aid for its restructuring or winding up in an orderly manner should normally replace the CEO, as well as other board members, if appropriate, if recourse to State aid could have reasonably been averted through appropriate and timely management action.[34]

7.2.3.3 Added value of *ex ante* restructuring under the resolution framework

Table 11 showed that the resolution framework introduced the possibility of *ex ante* restructuring, that is before the bank experiences financial difficulties. In the author's view, the possibility for resolution authorities to enforce *ex ante* restructuring on the basis of the recovery and resolution plans has a true added value compared to restructuring under the State aid regime, which always takes place on an *ex post* basis. As stated by Laprévote and Coupé, the Commission's powers under Article 107 and 108 TFEU are limited to assessing (and authorizing) State aid granted by Member States, and not to prevent this aid being granted in the first place. Absent of any State aid measure, the Commission does not have regulatory powers to enforce preventative measures.[35] The resolution framework could therefore be seen as being complementary to the State aid regime in so far it enables resolution authorities to enforce *ex ante* restructuring, even outside the situation in which State aid is granted. The resolution framework could however also be seen as forestalling the State aid regime, since banks that get in the situation where they require State aid are already the subject of a recovery and resolution plan. The cooperation between the Commission and the resolution authorities is therefore important in order to ensure an efficient restructuring process, as further discussed in section 7.3.2.

7.3 The authorities in the restructuring process of a failing bank

This section describes the competences of the different authorities involved in the restructuring process of a failing bank under the State aid regime for the banking sector and the resolution framework. It also discusses the cooperation between these authorities.

34 2013 Banking Communication, point 37.
35 Laprévote and Coupé 2017, p. 140.

7.3.1 Competences of the authorities

Which authorities are competent in the restructuring process of a failing bank depends on the applicable framework.

7.3.1.1 Competences in restructuring under the State aid regime for the banking sector

As discussed in section 3.7, under the State aid regime, the exact nature and scope of the required restructuring under the State aid regime for the banking sector is discussed between the Commission, the Member State involved, and (unofficially) the beneficiary bank, its shareholders and its competitors.[36] This is a political game that is not transparent for outsiders. The starting point is the restructuring plan (or winding up or integration plan) submitted by the Member State to the Commission. In case an integration plan has to be submitted, the buyer is also involved in preparing the plan.

It is therefore in principle the Member State that decides on the scope and nature of the measures, in consultation with the beneficiary bank and other parties involved. The Commission however has a decisive influence on the nature and scope of restructuring requested from the bank, taking into account that the Commission has the exclusive power to authorize the State aid measure.

7.3.1.2 Competences in restructuring under the resolution framework

As discussed in section 7.2, two forms of restructuring can be distinguished under the resolution framework. The first entails the restructuring on the basis of the business reorganisation plan when the bail-in tool is applied. The business reorganisation plan is drawn up by the bank and assessed by the resolution authority in agreement with the competent authority. If the resolution authority and the competent authority are satisfied that the plan would restore the long-term viability of the bank, the resolution authority approves the plan. If the resolution authority is not satisfied that the plan would restore the long-term viability of the bank, it can require amendments to be made.[37]

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36 Gray and De Cecco 2017, p. 39.
37 Article 52(1), (7) – (10) BRRD.

Within the SRM, the objectives and minimum content of the business reorganisation plan are established within the resolution scheme.[38] The national resolution authority submits the business reorganisation plan that it receives from the management body or appointed person(s) to the SRB. The SRB subsequently assesses within one month from the date of submission of the business reorganisation plan, the likelihood that the plan, if implemented, will restore the long term viability of the bank. The assessment is completed in agreement with the national competent authority or the ECB, where relevant. When the SRB is satisfied that the plan will achieve that objective, it allows the national resolution authority to approve the plan. Otherwise, it instructs the national resolution authority to notify the management body or person(s) appointed of its concerns and that it requires amendment. The management body or person(s) appointed subsequently have two weeks to amend the plan in order to obtain the required approval.[39] In case of 'less significant' banks and banking groups that are not directly supervised by the ECB or are not pan-European banking groups, no endorsement from the SRB is required.[40] The national resolution authorities however closely coordinate with the SRB.[41]

The second form of restructuring entails the *ex ante* restructuring as discussed in section 7.2.1.3. The competent authority, whether this is the national competent authority or the ECB (within the SSM), can direct a bank to take certain measures in case a revised recovery plan does not adequately remedy the deficiencies or potential impediments identified and a bank fails to make changes in that respect.[42]

In addition, the national resolution authority can take alternative measures to remove impediments to resolvability.[43] Within the SRM, the national resolution authority acts on the instruction of the SRB unless it concerns 'less significant' banks and banking groups that are not directly supervised by the ECB or are not pan-European banking groups.[44]

38 Article 27(1), paragraph 2, sub (c) SRMR.
39 Article 27(17) SRMR.
40 See section 4.5.1.1 for the division of tasks between the different authorities.
41 Article 7(3) SRMR.
42 Article 6(6) BRRD. Article 4(1)(i) SSMR.
43 Article 17(4)-(6) BRRD.
44 Article 10(10)-(13) SRMR. See section 4.5.1.1 for the division of tasks between the different authorities.

7.3.1.3 A combination of competences

Table 13 summarises the competences of the different authorities involved in restructuring under the State aid regime for the banking sector and the resolution framework. The term competent authority and resolution authority both cover the ECB/SRB and the national competent and resolution authorities, unless indicated otherwise.

Table 13: Overlapping of competences

	Bank / Member State	**Competent authority**	**Resolution authority**	**Commission**
Ex ante restructuring				
Restructuring on basis of the recovery plan	The recovery plan is drawn up by the bank.	The recovery plan is assessed by the competent authority. The competent authority may as an *ultimum remedium* direct the bank to take any measures it considers necessary and proportionate.	The resolution authority may examine the recovery plan with a view to identifying any actions in the recovery plan which may adversely impact the resolvability of the bank and make recommendations to the competent authority with regard to those matters.	

Restructuring on the basis of the resolution plan	The bank provides input for the resolution plan.	The resolution authority consults the competent authority.[45]	The resolution plan is drawn up by the resolution authority. Where the resolution authority assesses in the resolvability assessment that there are substantive impediments to the resolvability of a bank, it shall request the bank to propose possible measures. If these do not effectively reduce or remove the impediments, the resolution authority has to require the bank to take alternative measures (where applicable, on the instruction of the SRB).	
Ex post restructuring				
Business reorganisation plan	The business reorganisation plan is drawn up by the bank.	The business reorganisation plan is assessed by the competent authority and the resolution authority.	The resolution authority approves the business reorganisation plan (where applicable, with the endorsement of the SRB).	

45 See critically Bierens *Ondernemingsrecht* 2017, p. 6.

Restructuring plan	The restructuring plan is drawn up by the Member State that intends to award restructuring aid. The bank is normally (informally) involved in the preparation of the restructuring plan.			The restructuring plan is approved by the Commission.
Capital raising plan	The capital raising plan is drawn up by the Member State that intends to award the aid in cooperation with the bank.	The capital raising plan is assessed in close collaboration with the competent authority.[46]		The capital raising plan is approved by the Commission.

7.3.2 Cooperation between the authorities

The concurrence of the restructuring processes under the State aid regime for the banking sector and the resolution framework inevitably requests cooperation between the different authorities involved. The competent authority and resolution authority can, for example, require a bank to restructure on the basis of an assessment of the recovery and/or resolution plan, while it is still financially sound. The bank may request for State aid at a later stage. Another example can be found in the obligation for a bank to draw up the business reorganisation plan when the bail-in tool is applied for recapitalisation purposes. This plan is assessed by the resolution authority in agreement with the competent authority. When the application of the bail-in tool is accompanied by the award of State aid, the Commission is also involved. This section takes a further look into the cooperation between the resolution authority and the Commission.

46 2013 Banking Communication, point 8, 29.

7.3.2.1 Cooperation in resolution

In the 2013 Banking Communication, it is acknowledged that exercising State aid control for the financial sector sometimes interacts with responsibilities of the supervisory authorities in Member States. For example, in certain cases, supervisory authorities might require adjustments in matters such as corporate governance and remuneration practices which for banks benefitting from State aid are often also set out in restructuring plans. In such cases, whilst fully preserving the Commission's exclusive competence in State aid control, coordination between the Commission and the competent supervisory authorities is of importance. Given the evolving regulatory and supervisory landscape in the EU and, in particular, in the Eurozone, the Commission will liaise closely – as it currently does – with supervisory authorities to ensure a smooth interplay between the different roles and responsibilities of all the authorities involved.[47] Although the 2013 Banking Communication does not specifically refer to the resolution authorities, it may be safe to presume that this premise of close liaison also applies in respect of resolution authorities. The 2013 Banking Communication does not, however, provide any further substantiation of such cooperation.

The resolution framework provides some guidance as to the situation in which both a business reorganisation plan and a restructuring plan need to be drafted, e.g. in relation to timelines and contents of the plan.[48] It does not, however, provide any guidance as to the cooperation between the resolution authority and the Commission in that respect. The resolution framework does not provide for a role of the Commission in the preparation or assessment of the business reorganisation plan. In addition, there is no requirement for the Commission and the relevant resolution authority to discuss the contents of the business reorganisation plan and restructuring plan.

The EBA has provided further guidance in its Guidelines on the minimum criteria to be fulfilled by a business reorganisation plan. Pursuant to these Guidelines, the business reorganisation plan should be consistent with any business plans prepared by the bank and submitted to any other authority (e.g. competition or securities and markets authorities) following regulatory or legal obligations. Where the Union State aid framework is

47 2013 Banking Communication, point 14.
48 Article 52 BRRD.

applicable, the resolution authority and the competent authority, when assessing the business reorganisation plan, should cooperate with the Commission on the assessment and viability analysis, which is an objective of both the business reorganisation plan and the restructuring plan.[49] Other than that, there is no guidance on how the authorities should cooperate when a bank in resolution is faced with restructuring under the State aid regime and the resolution framework.

> Title III of the EBA Guidelines contains specific provisions for coordination between resolution and competent authorities. Unfortunately, it does not contain any provisions for coordination with the Commission being the State aid authority.[50]

7.3.2.2 Cooperation outside of resolution

Restructuring of a bank can also take place outside of resolution. For example, if a bank is the subject of precautionary recapitalisation, the restructuring obligations under the State aid regime for the banking sector are triggered. Although no business reorganisation plan is required to be drawn up in such a situation, the resolution authority could still be involved in the restructuring process because of the periodical (at least annual) evaluation of the resolution plan.[51] For example, if a bank is the subject of precautionary recapitalisation, this may be a reason for the resolution authority to evaluate the resolution plan and to require any restructuring on that basis. Cooperation between the resolution authority and the Commission in respect of restructuring outside of resolution is however again a topic that has not received any attention in the resolution framework.

> An example of a restructuring process of a bank subject to precautionary recapitalisation, is the restructuring of MPS. The Commission and the Italian authorities agreed on a far-reaching restructuring plan for MPS with the purpose of ensuring MPS's viability in the long term. On the basis of the public information available on the restructuring of MPS, it is not clear whether the resolution authority was involved in the restructuring process and whether the resolution plan has been updated following the precautionary recapitalisation.

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49 EBA Guidelines on the minimum criteria to be fulfilled by a business reorganisation plan, par. 4.1-4.2.

50 EBA Guidelines on the minimum criteria to be fulfilled by a business reorganisation plan, Title III.

51 Article 10(6) BRRD.

7.3.3 Judicial protection against decisions of authorities

Under the State aid regime for the banking sector, the judicial protection against decisions in respect of restructuring is pretty straight forward. If a beneficiary bank is unhappy with the restructuring obligations as part of the State aid approval, it can challenge the Commission's decision in the EU Courts.[52]

Judicial protection has become more complicated with the introduction of the resolution framework, as new authorities with decision-making powers in respect of the restructuring of a bank have been introduced as a result thereof. First, these are the authorities that have decision-making powers in respect of the decision to put the bank in resolution. These are under the SRM: (i) the ECB, in respect of the assessment whether a bank is failing or likely to fail (FOLTF), (ii) the SRB, in respect of the assessment whether the bank should be put in resolution and if so, in respect of the adoption of the resolution scheme, (iii) the national resolution authorities, in respect of the implementation of the resolution scheme, and (iv) the Commission and the Council, in respect of endorsement of the resolution scheme. When resolution takes place within the SRM, but in respect of those 'less significant' banks and banking groups that are not directly supervised by the ECB or are not pan-European banking groups, the national competent authorities make the FOLTF assessment and the national resolution authorities assess whether the bank should be put in resolution and, if so, adopt and implement the resolution decision (unless the resolution involves the use of the SRF).[53] The national resolution authorities closely coordinate with the SRB when taking these measures. Outside the SRM, the decisions are also made by the national competent authorities and resolution authorities. In that case, there is no involvement of the SRB or the ECB. The Commission is only involved as State aid authority.

In addition, the resolution framework provides for authorities that have decision-making powers in respect of the restructuring process that follows when the bail-in tool is applied as a going concern solution. Within the SRM, the business reorganisation plan is approved by the national resolution authorities, where applicable with the endorsement of the SRB.[54]

52 See section 3.9.2.1.
53 See section 4.5.1.1 for the division of tasks between the different authorities.
54 Article 27(16) SRMR.

Outside the SRM, the business reorganisation plan is approved by the national resolution authorities, without any involvement of the SRB.[55]

The resolution framework also provides for authorities that have decision-making powers in respect of *ex ante* restructuring. The competent authority, whether this is the national competent authority or the ECB, can direct a bank to take certain measures in case a revised recovery plan does not adequately remedy the deficiencies or potential impediments identified and a bank fails to make changes in that respect. In addition, the national resolution authority, where applicable on the instruction of the SRB, can take alternative measures to remove impediments to resolvability.

As a result of all these authorities with decision-making powers in respect of the restructuring process of a bank, the bank can be faced with numerous decisions, both from national and European decision makers. If a bank is unhappy with its restructuring process, it may therefore be necessary to start legal proceedings, both at national and European level.

At European level, this is only possible where these decisions are reviewable acts within the meaning of Article 263 TFEU.[56] Recital (88) BRRD states that decisions taken by the resolution authorities should be subject to a right of appeal. In the case of ABLV Bank, the GC judged that the FOLTF assessment made by the ECB is considered to be a preparatory measure which does not change the bank's legal status. The FOLTF assessment is considered a factual assessment conducted by the ECB as to whether the bank is failing or likely to fail, which is in no way binding but which constitutes the basis for the adoption by the SRB of resolution schemes, or decisions establishing that resolution is not in the public interest.[57] As a result, the FOLTF assessment cannot be challenged – independently of any SRB decision – before the EU Courts. In the author's view, this judgment, although it may channel legal actions, deserves a critical attitude from a judicial protection perspective. At the time of writing this dissertation, it is still to be seen whether this judgment will be upheld by the ECJ.[58]

55 Article 52(7) BRRD.

56 Pursuant to Article 263, fourth paragraph TFEU a natural or legal person may challenge only measures the legal effects of which are binding on, and capable of affecting the interests of, the applicant by bringing about a distinct change in his legal position.

57 GC, 6 May 2019, T-281/18, ECLI:EU:T:2019:296 (*ABLV Bank v ECB*), par. 49.

58 ABLV Bank has brought an appeal against the judgment of the GC (ECJ, C-551/19 P, Action brought on 17 July 2019 (*ABLV Bank v ECB*).

In respect of the decision of the competent authority to take measures in respect of a recovery plan, the BRRD states that this decision should be subject to a right of appeal.[59] In respect of the decision to impose alternative measures, the BRRD also provides that this decision should be subject to a right of appeal.[60] In addition, the SRMR provides that the decision of the SRB to instruct a national resolution authority to take alternative measures is subject to review by the Appeal Panel of the SRB.[61]

In respect of the business reorganisation plan, the resolution framework does not provide any guidance as to the judicial protection against the decisions by the SRB and the national resolution authorities. The question is whether this SRB decision is a reviewable act. In the author's view, this decision should be considered a reviewable act as it produces legal effects that are binding on and capable of affecting the interests of the individual bank subject to the restructuring measures included in the business reorganisation plan. It may, however, be that the endorsement of the business reorganisation plan is considered a preparatory step towards adoption of the resolution scheme. In that case it may be that the endorsement itself is not considered a reviewable act. Whether or not claims from individual banks against reviewable acts are admissible before the EU Courts depends on whether the relevant decision is addressed to them and, if not, whether they meet the requirements of Article 263(4) TFEU.

Whether or not judicial protection is available against decisions taken by national authorities depends on the national procedural formalities, albeit that the BRRD requires Member States to provide for this in certain cases.

Table 14 provides a summary of the different authorities that can take decisions and the (potential) judicial protection that is available.

59 Article 6(7) BRRD.
60 Article 17(6)(c) BRRD.
61 Article 85(3) SRMR in conjunction with Article 10(10) SRMR.

Table 14: Judicial protection against decisions of authorities in respect of the restructuring process of a bank

Authority	**Decision**	**(Potential) judicial protection**
Within the SRM – SRB authority		
Commission	Approval of State aid award	EU Courts
	Endorsement of resolution scheme	EU Courts
ECB	FOLTF assessment	N/A (no reviewable act according to GC)
	Decision to take measures in respect of a recovery plan	EU Courts
SRB	Assessment of resolution conditions (decision establishing that resolution is not in the public interest)	EU Courts
	Adoption of resolution scheme	EU Courts
	Endorsement of decision to approve business reorganisation plan	EU Courts
	Decision to instruct national resolution authorities to take alternative measures	Appeal Panel of the SRB
National resolution authorities[62]	Implementation of resolution scheme	National courts
	Approval of business reorganisation plan following the endorsement of the SRB	National courts
	Take alternative measures on instruction of the SRB	National courts
Within the SRM – SRB no authority		
Commission	Approval of State aid award	EU Courts
National competent authorities	FOLTF assessment	National courts (no reviewable act according to GC)
	Decision to take measures in respect of a recovery plan	National courts

62 See also section 4.9.1.4.

National resolution authorities[63]	Assessment of resolution conditions (decision establishing that resolution is not in the public interest)	National Courts
	Adoption and implementation of resolution decision	National courts
	Approval of business reorganisation plan	National courts
	Decision to take alternative measures	National courts
Outside the SRM		
Commission	Approval of State aid award	EU Courts
National competent authorities	FOLTF assessment	National courts (no reviewable act according to GC)
	Decision to take measures in respect of a recovery plan	National courts
National resolution authorities	Assessment of resolution conditions (decision establishing that resolution is not in the public interest)	National courts
	Adoption and implementation of resolution decision	National courts
	Approval of business reorganisation plan	National courts
	Decision to take alternative measures	National courts

7.4 Burden-sharing

The restructuring of a bank does not only involve the bank, but also its shareholders and creditors. They can be required to contribute to the costs of the bank failure. This is also referred to as 'burden-sharing'. This section aims to shed more light on the concept of burden-sharing and the development thereof after the introduction of the resolution framework.

> Although, burden-sharing may be the topic that receives most attention, the other powers that the resolution authorities have under the resolution framework to interfere in the contractual relationship between a bank and is shareholders/creditors are also noteworthy and

63 See also section 4.9.1.4.

> new with reference to the State aid regime for the banking sector. These powers have been discussed in section 4.8. This section focuses on burden-sharing.

7.4.1 Burden-sharing under the State aid regime

Under the State aid regime for the banking sector, the burden-sharing principle is applied by the Commission as an assessment criterion in its assessment of State aid awards.

7.4.1.1 Burden-sharing cascade

Application of the burden-sharing principle normally entails that losses are first absorbed by equity, after which contributions are made by hybrid capital holders and subordinated debt holders. Hybrid capital and subordinated debt holders must contribute to reducing the capital shortfall to the maximum extent. The Commission does not require a contribution from senior debt holders (in particular from insured deposits, uninsured deposits, bonds and all other senior debt) as a mandatory component of burden-sharing. State aid must not be granted before equity, hybrid capital, and subordinated debt have fully contributed to offset any losses.[64]

> Where the capital ratio of the bank, that has an identified capital shortfall, remains above the EU regulatory minimum, the bank should normally be able to restore the capital position on its own, in particular through capital raising measures as set out above. If there are no other possibilities, including any other supervisory action, such as early intervention measures or other remedial actions to overcome the shortfall as confirmed by the competent or resolution authority, then burden-sharing measures must be taken.
>
> In cases where the bank no longer meets the minimum regulatory capital requirements, subordinated debt must always be converted or written down, in principle before State aid is granted.

64 2013 Banking Communication, point 41-44.

7.4.1.2 Triggers for burden-sharing

In terms of burden-sharing, a distinction should be made between rescue, restructuring, and liquidation aid. Only in the restructuring and liquidation phase is burden-sharing by shareholders and subordinated debt holders required.[65] Rescue aid in the form of funding guarantees and liquidity support does not require burden-sharing. For rescue recapitalisations and rescue asset relief measures, burden-sharing must be complied with, either as part of the rescue aid, or the aid must be arranged in a manner that allows for implementation of the burden-sharing measures in the restructuring or liquidation phase. In the rescue phase, the focus lies on the remuneration of the aid measures.

> Sections 3.5.4 to 3.5.6 discuss the assessment criteria for rescue, restructuring and liquidation aid in more detail.

7.4.1.3 Deviations from burden-sharing cascade

An exception to the burden-sharing principle could be made, if complying with this principle endangers financial stability or leads to disproportionate results. This exception could cover cases where the aid amount to be received is small in comparison to the bank's risk weighted assets, and the capital shortfall has been reduced significantly in particular through capital raising measures. Disproportionate results or a risk to financial stability could also be addressed by reconsidering the sequencing of measures to address the capital shortfall.[66] In addition, the NCWO principle applies.

7.4.2 Burden-sharing under the resolution framework

Burden-sharing under the resolution framework takes place through the exercise of the PONV conversion power and the application of the bail-in tool by the resolution authority.

7.4.2.1 Burden-sharing cascade

While the resolution authorities have discretion to select the most appropriate method of resolution and to apply any of the resolution tools, including the bail-in tool, the resolution framework does not afford discretion

65 2013 Banking Communication, point 19.
66 2013 Banking Communication, point 45. See also section 3.7.1.2.

as to the application of the burden-sharing cascade when exercising the PONV conversion power and applying the bail-in tool.[67]

The burden-sharing cascade entails that losses are sequentially allocated through write-down and conversion of claims of (a) holders of CET 1 instruments, followed by (b) holders of AT 1 instruments, and (c) holders of Tier 2 instruments, followed by (d) other subordinated creditors in accordance with the hierarchy of claims in normal insolvency proceedings, and (e) the rest of eligible liabilities in accordance with the hierarchy of claims in normal insolvency proceedings.[68]

Within eligible liabilities, a further distinction should be made on the basis of the BRRD. Deposits of natural persons and micro, small and medium-sized enterprises exceeding coverage levels of the deposit guarantee schemes and deposits that would be eligible deposits if they were not made through branches outside the EU of banks established within the EU, enjoy priority over ordinary liabilities, but are subordinated to covered deposits and deposit guarantee schemes subrogating in their position.

The burden-sharing cascade can be influenced by means of subordination. Subordination of instruments issued by banks can take place in several ways, such as contractual subordination (including a subordination clause in contractual documentation governing the issuance of debt) or statutory subordination (subordination by law).[69] BRRD II bis has provided for further harmonization in that respect by introducing a new type of 'senior', unsecured, non-preferred debt, which is subordinated to other types of ordinary senior debt in the insolvency hierarchy, but preferred to subordinated debt, following the French Tier-3 approach.[70]

> As a result of the amendment of Article 108 BRRD under BRRD II bis, ordinary unsecured claims have a higher ranking than unsecured claims resulting from debt instruments that (a) have a contractual maturity of at least one year, (b) do not embed derivatives and

67 Hadjiemmanuil, 2015, p. 237.

68 Article 48 BRRD. Grünewald introduces a loss ranking based on the instrument of loss absorption (Grünewald 2014, p. 59).

69 Resti 2016, p. 13. Ramos Muñoz 2017, p. 272. Maragopoulos discusses the option of structural subordination (Maragopoulos 2016, p. 51-52). Gleeson 2018, p. 78.

70 France chose a mixed approach by creating a specific type of 'Tier 3' debt which is subordinated to operational debt, provided it includes a specific subordination clause. IMF Country Report 2018, p. 26. The IMF also discusses the approaches of other Member States.

are no derivatives themselves, and (c) are covered by contractual documentation and, where applicable, a prospectus that explicitly refers to the lower ranking.

As a result of BRRD II bis, banks can structure their liabilities in such a way, that they consist of (a) regulatory capital, (b) subordinated debt that does not qualify as regulatory capital, (c) 'senior', unsecured, non-preferred debt, which is subordinated to ordinary senior debt but preferred to subordinated debt (senior non-preferred debt), and (d) other bail-inable debt that is in scope of the bail-in tool, but preferably not bailed-in (ordinary senior debt). By including extra layers of subordinated and senior non-preferred debt, ordinary senior debt holders are protected, as it is less likely that a bail-in will extend to this senior debt.

> Protection of senior debt can also be achieved if the regulator compels banks to issue a sufficiently high amount of contingent capital instruments (CoCo bonds). An important feature of CoCo bonds and similar instruments is their potential to kick-in relatively remote from resolution. If they define an early trigger-event, they allow a substantial contribution to a fragile bank's recapitalisation before and independent of a subsequent workout, thereby protecting senior debt.[71] In addition, high-trigger CoCo bonds could also prevent a bank from getting into a pro-cyclical spiral of getting weaker as a result of which it is harder and more expensive to get funding, as a result of which they get (again) weaker.[72]

7.4.2.2 Triggers for burden-sharing

The triggers for burden-sharing under the resolution framework depend on the burden-sharing technique applied.

The PONV conversion power has to be exercised by the resolution authority:

1. when the determination has been made that conditions for resolution have been met, before any resolution action is taken;
2. when the appropriate authority determines that unless the PONV conversion power is exercised, the bank or the banking group will no longer be viable; or

71 Tröger 2018, p. 9.
72 Avgouleas and Goodhart *JFR* 2015, p. 20. Tröger 2017, p. 21-22.

3. when EPFS is required by the bank or banking group, except in the case of precautionary recapitalisation. [73]

Application of the bail-in tool when a bank is put in resolution is not a given, contrary to the use of the PONV conversion power.[74] For each resolution case, the resolution authority should assess whether the bail-in tool is the most appropriate resolution tool to apply taking into account the resolution objectives. There is, however, one situation in which the bail-in tool *has* to be applied. This is the situation in which EPFS is used to assist in the resolution process, with the exception of contributions by national resolution funds or the SRF, other than when used for loss absorption or recapitalisation.[75]

In addition, the resolution framework has introduced a threshold for burden-sharing when certain public funding sources are used in the resolution phase.[76] A bail-in of 8% of total liabilities and own funds of the bank has to take place when:

1. the national resolution funds or SRF is used for loss absorption or recapitalisation; [77]
2. the GFST are used; [78] or
3. the ESM DRI is used. [79]

In addition, all unsecured, non-preferred liabilities, other than eligible deposits, have to be written down or converted in full when:

1. the ESM DRI is used; [80] or
2. alternative financing sources are used. [81]

73 Article 59(3) BRRD. See section 4.5.2.1.
74 Tröger 2018, p. 19.
75 See section 5.3.5.2 for the conditions under which the SRF and the national resolution funds can contribute to loss absorption or recapitalisation.
76 See also Grünewald 2017, p. 289.
77 Article 44(5) BRRD. Article 27(7) SRMR.
78 Article 37(10)(a) BRRD. See also section 5.3.5.4 on the scope of the burden-sharing requirement in respect of GFST.
79 Article 8 ESM DRI Guideline.
80 Article 8 ESM DRI Guideline.
81 Article 44(7) BRRD. Article 27(9) SRMR. This may be more far-reaching than compliance with the requirement to bail-in 8% of total liabilities, including own funds of the bank in resolution. This bail-in requirement applies when the national resolution funds or the SRF are used to cover any losses or to recapitalise the bank.

There is no bail-in threshold in relation to resolution financing by deposit guarantee schemes. Deposit guarantee schemes can, however, only absorb losses that would have otherwise been suffered by covered depositors.[82]

7.4.2.3 Deviations from burden-sharing cascade

The resolution framework does not provide for an exception to the burden-sharing requirement, if applying this requirement endangers financial stability or leads to disproportionate results. It does however provide that certain eligible liabilities are excluded from the scope of the bail-in tool, including covered deposits, but, e.g. also operational liabilities.[83]

> The deposit guarantee schemes contribute to the resolution for the amount of covered deposits that would have been in scope of the bail-in tool, if these were not excluded.[84]

In addition, in exceptional circumstances the resolution authorities may (partially) exclude other liabilities where certain conditions are met.[85] Lastly, the NCWO principle applies when the bail-in tool is used. As a result, creditors may not incur greater losses than they would have incurred in an insolvency situation.[86]

7.4.3 Co-existence of burden-sharing requirements

As stated by Gardella, the legal discipline of burden-sharing pertains both to the resolution framework, as it affects its financing side and the principle of internalization of losses, and to the State aid regime, given the potential involvement of public support measures. Prior to the adoption of the resolution framework, the burden-sharing criteria were shaped by the State aid regime under the application of the burden-sharing principle. This principle was subsequently transposed in a hard law requirement

82 Article 109(1)(a) BRRD.
83 Article 44(2) BRRD. Article 27(3) SRMR. See also section 4.5.3.4. It is at this point that the BRRD may interfere with the hierarchy in normal insolvency proceedings. See Ramos Muñoz 2017, p. 265-266.
84 Article 109(1) BRRD. Article 79(1) SRMR. Article 109(5), last paragraph BRRD. Article 79(5) SRMR. See also section 4.5.3.4.
85 Article 44(3) BRRD. Article 27(5) SRMR.
86 See also section 4.5.5.

under the resolution framework, as this was conceived to be insufficient by the Member States (in particular, Germany). After the adoption of the resolution framework, the coexistence of the two frameworks requires their interaction to be examined with a view to assessing the internal consistency of EU law and to come to a clear understanding of the procedure to be followed by the resolution authorities,[87] especially when public funding is involved. This section therefore sheds further light on the co-existence of the burden-sharing requirements under the State aid regime for the banking sector and the resolution framework further to the discussion thereof in sections 7.4.1 and 7.4.2.

> Grünewald describes that the shift towards privately-funded bank resolution not only followed the international trend, it also became an actual 'game changer' in the negotiations on the European Banking Union, as it alleviated Member States' fears of heightened fiscal transfers.[88]

7.4.3.1 Different triggers, scope and authorities

With the introduction of the resolution framework, there are currently three burden-sharing requirements that may be applicable when a bank is failing: the exercise of the PONV conversion power, the application of the bail-in tool, and the application of the burden-sharing principle under the State aid regime for the banking sector.[89] These requirements all have different triggers, a different scope and are applied by different authorities, as summarised in Table 15.

87 Gardella 2015, p. 376-377.
88 Grünewald 2017, p. 287-289.
89 Burden-sharing requirements applied in normal insolvency proceedings are outside the scope of this dissertation.

Table 15: Burden-sharing requirements under the resolution framework and the State aid regime

Burden-sharing requirement	**Triggers**	**Scope**	**Decision-maker**
Exercise of PONV conversion power	1. when the determination has been made that conditions for resolution have been met, before any resolution action is taken; 2. when the appropriate authority determines that unless the PONV conversion power is exercised the bank or the banking group will no longer be viable; or 3. when EPFS is required by the bank or banking group except in the case of precautionary recapitalisation.	Relevant capital instruments (CET 1, AT 1 and Tier 2 instruments)	Resolution authority (FOLTF assessment is made by the national competent authority/ECB)
Application of bail-in tool	1. when the resolution authority determines that the bail-in tool is the tool that best achieves the resolution objectives that are relevant in the circumstances of the case; or 2. where resolution action involves the use of EPFS, with the exception of contributions by national resolution funds or the SRF, other than when used for loss absorption or recapitalisation.	Eligible liabilities (except for excluded liabilities, such as covered deposits and operational liabilities)	Resolution authority (FOLTF assessment is made by the national competent authority/ECB)
Application of burden-sharing principle under the State aid regime	where a Member State awards restructuring or liquidation aid	Share capital and subordinated debt[90]	Member State with the approval of the Commission

90 Subordinated debt may also refer to debt that is not eligible as Tier 2 instrument.

7.4.3.2 A closer look at public funding as trigger for burden-sharing

The three burden-sharing requirements have in common that they are triggered when public funding (State aid and/or EPFS) is used. Table 16 makes a further distinction between the different forms of public funding in the recovery, resolution and insolvency phase and the burden-sharing requirement that it triggers. It shows that the burden-sharing requirements differ depending on the type of public funding source that is used.

Table 16: Application of the burden-sharing requirements in case of public funding

Public funding source	**Exercise of PONV conversion power**	**Application of bail-in tool**	**Application of burden-sharing principle under the State aid regime**
Recovery phase			
ELA	N/A	N/A	N/A[91]
DGS support (alternative measures)	N/A[92]	N/A[93]	Application of burden-sharing principle, if in the form of restructuring aid[94]
Precautionary guarantees	Exercise of PONV conversion power	N/A	N/A
Precautionary recapitalisation	N/A	N/A	Application of burden-sharing principle
Resolution phase			
NRF/SRF	Exercise of PONV conversion power	**Only** when the NRF/SRF is used for loss absorption or recapitalisation: Bail-in of 8% of total liabilities and own funds of the bank[95]	Application of burden-sharing principle

91 Based on the assumption that ELA does not qualify as State aid.
92 See however section 5.3.4.
93 See however section 5.3.5.3.
94 Based on the assumption that alternative measures qualify as State aid. See however section 3.1.3.
95 Article 44(5) BRRD. Article 27(7) SRMR. See section 5.3.5.2 for the conditions under which the SRF and the national resolution funds can contribute to loss absorption or recapitalisation.

DGS (resolution financing)	Exercise of PONV conversion power	There is no bail-in threshold in relation to resolution financing by deposit guarantee schemes. Deposit guarantee schemes can however only absorb losses that would have otherwise been suffered by covered depositors[96]	Application of burden-sharing principle
GFST	Exercise of PONV conversion power	Bail-in of 8% of total liabilities and own funds of the bank[97]	Application of burden-sharing principle
ESM DRI	Exercise of PONV conversion power	Bail-in of 8% of total liabilities and own funds of the bank SRF has to contribute 5% of the total liabilities including own funds of the bank in resolution All unsecured, non-preferred liabilities, other than eligible deposits, have to be written down or converted in full[98]	Application of burden-sharing principle
Alternative financing sources	Exercise of PONV conversion power	National resolution funds or SRF have to contribute up to 5% of total liabilities All unsecured, non-preferred liabilities, other than eligible deposits, have to be written down or converted in full[99]	Application of burden-sharing principle

96 Article 109(1)(a) BRRD.
97 Article 37(10)(a) BRRD. See also section 5.3.5.4 on the scope of the burden-sharing requirement in respect of GFST.
98 Article 8 ESM DRI Guideline.
99 Article 44(7) BRRD. Article 27(9) SRMR. This may be more far-reaching than compliance with the requirement to bail-in 8% of total liabilities, including own funds of the bank in resolution. This bail-in requirement applies when the national resolution funds or the SRF are used to cover any losses or to recapitalise the bank.

Insolvency phase			
Liquidation aid	N/A	N/A	Application of burden-sharing principle
DGS (pay-out function and other use)	N/A	N/A	N/A

7.4.3.3 Deviation from the burden-sharing requirement

The State aid regime for the banking sector and the resolution framework provide for certain deviations from the burden-sharing requirements. These deviations and the consequences thereof for burden-sharing are summarised in Table 17.

Table 17: Deviation from burden-sharing requirements

Burden-sharing requirement	**Deviation**	**Results of deviation for burden-sharing**
Exercise of PONV conversion power	The exercise of the PONV conversion power is not triggered in case of precautionary recapitalisation	The burden shifts towards Member States for the benefit of the holders of share capital and eligible liabilities. However, the burden-sharing principle under the State aid regime does apply.
Use of bail-in tool	1 The application of the NCWO principle. 2. Certain eligible liabilities are excluded from the scope of the bail-in tool. 3. The resolution authority can exclude eligible liabilities from the scope of the bail-in tool; and 4. The deposit guarantee schemes contribute to the resolution for the amount of covered deposits that would have been in scope of the bail-in tool, if these were not excluded. 5. The national resolution funds and the SRF can be used without triggering a bail-in, unless they are used for loss absorption or recapitalisation.	1. The burden shifts towards the resolution funds for the benefit of the holders of eligible liabilities. 2. The burden shifts to holders of eligible liabilities that are not excluded. 3. The burden shifts to holders of eligible liabilities that are not excluded or towards the resolution funds for the benefit of holders of eligible liabilities that are excluded from the scope of bail-in. 4. The burden shifts towards the deposit guarantee funds for the benefit of holders of covered deposits. 5. The burden shifts towards the resolution funds for the benefit of holders of eligible liabilities.

Application of burden-sharing principle under the State aid regime	1. The application of the NCWO principle. 2. The burden-sharing principle can be deviated from when implementing burden-sharing measures would endanger financial stability or lead to disproportionate results. [100]	1. The State aid regime for the banking sector does not specify what the consequences are of the application of the NCWO principle. The author assumes that this leads to a shift of the burden to the Member State. 2. The burden shifts towards Member States for the benefit of holders of share capital and/or subordinated debt.

7.4.3.4 Synopsis

When comparing the burden-sharing requirements under the State aid regime for the banking sector and the resolution framework, it turns out that these are not fully aligned.[101] The following differences can be distinguished:

1. Under the State aid regime for the banking sector, the burden-sharing principle applies as part of the assessment by the Commission of the State aid measure as proposed by the Member State. Under the resolution framework, the resolution authorities can (or have to, depending on the circumstances) exercise the PONV conversion power and/or apply the bail-in tool to impose the burden-sharing requirement (sections 7.4.1, 7.4.2 and 7.4.3.1);
2. Burden-sharing under the resolution framework can include senior debt, while this is restricted to share capital and subordinated debt under the State aid regime for the banking sector (sections 7.4.1.1, 7.4.2.1 and 7.4.3.1);[102]
3. The resolution framework requires a bail-in of 8% of total liabilities and own funds of the bank when certain public funding sources are used. When the ESM DRI or alternative financing sources are used, all unsecured, non-preferred liabilities, other than eligible deposits, have to be written down or converted in full. The State aid regime does not set any thresholds for burden-sharing (sections 7.4.2.2 and 7.4.3.2);

100 See section 3.7.1.2.
101 Babis *LFMR* 2016, p. 168.
102 Grünewald calls this the crucial discrepancy between burden-sharing under the State aid regime on the one hand and bail-in in resolution on the other hand (Grünewald 2017, p. 288-289).

4. It is possible to deviate from the burden-sharing requirement under the State aid regime for the banking sector when burden-sharing measures would endanger financial stability or lead to disproportionate results. The resolution framework does not provide for this possibility (sections 7.4.1.3, 7.4.2.3 and 7.4.3.3).

<u>Ad 2: Bail-in of senior debt</u>

The introduction of the possibility to bail-in senior debt under the resolution framework has had the effect that the layer of subordinated debt is increased and a further distinction is made within senior debt instruments. As a result, burden-sharing under the State aid regime for the banking sector and burden-sharing under the resolution framework may converge to the extent that there is practically no difference between the two, since bail-in of ordinary senior debt becomes a theoretical possibility. In that respect, it is still relevant whether the senior non-preferred debt (within the meaning of Article 108 BBRD II bis) falls within the scope of the burden-sharing principle under the State aid regime for the banking sector. Taking into account that these instruments are specifically issued with a cushion function, it seems to be reasonable to extend the bail-in under the State aid regime to these instruments. Does this make the bail-in tool under the resolution framework superfluous? In the author's view, this question should be answered with no, since the fear – or commercial unattractiveness – of bail-in of senior debt may lead banks to change the liabilities side of their balance sheet in such a way that this is avoided to the greatest extent possible. If banks can ensure their resolvability by increasing the layers of subordinated debt and senior non-preferred debt, while protecting senior debt, this would, in the author's view, serve the purposes of the resolution framework. Secondly, the bail-in requirements under the State aid regime only apply when there is an award of State aid. The resolution framework makes it possible to apply the bail-in tool also outside the situation in which State aid is awarded.

<u>Ad 4: Financial stability exemption</u>

The Commission may make an exception to the burden-sharing principle under the State aid regime for the banking sector, where that is justified by reasons of financial stability or in case of disproportionate results. The resolution framework does not provide for this exception. According to Iftinchi, it is therefore no longer possible to apply this exception in so far this would obstruct the exercise of the PONV conversion power or the application of the bail-in tool when EPFS is involved.[103] The author agrees with this view. The exception could in that case only still be used when the burden-sharing requirements under the resolution framework in relation to the use of EPFS are complied with.[104] In other words, if a Member State proposes an aid measure for a bank in resolution without the required burden-sharing under the State aid regime because of reasons of financial stability, the Commission should in its assessment take into account whether this violates intrinsically linked provisions of the resolution framework.[105] As set out in Recital 57 BRRD, the minimum loss absorption requirement of 8% for the use of GFST is such an intrinsically linked provision.[106]

7.5 Restructuring of a failing bank after the introduction of the resolution framework

This section discusses the impact of the resolution framework on the restructuring process of a failing bank. It also discusses the challenges that can be identified in respect of this process as a result thereof.

7.5.1 Impact of the resolution framework on the restructuring process of a failing bank

The previous sections have shown that the restructuring process of a failing bank has been impacted at numerous levels by the resolution framework. First, section 7.2 discussed that the resolution framework introduced its own restructuring process besides the restructuring process under the State aid regime, where the bail-in tool is applied as a going concern solution. This restructuring process can even take place simultaneously with the restructuring process under the State aid regime, namely, in case the bail-in tool is applied as a going concern solution and the resolution involves the award of State aid. In addition, the resolution framework has introduced the possibility for competent and resolution authorities to impose *ex ante* restructuring measures. Secondly, section 7.3 discussed that with the introduction of the resolution framework, a new 'restructuring

103 Iftinchi 2017, p. 78.
104 See section 7.4.2.
105 See section 6.3.2.
106 It seems therefore reasonable to assume that the burden-sharing requirements in relation to other forms of EPFS also qualify as intrinsically linked provisions.

authority' is introduced, in the form of the resolution authority, besides the Commission. Thirdly, section 7.4 discussed the impact of the resolution framework on the obligations of shareholders/creditors in respect of burden-sharing. The impact of the resolution framework on the restructuring process of a failing bank is summarized in Table 18.

Table 18: Impact of resolution framework on the restructuring process of a failing bank

Impact level	**Situation under State aid regime for the banking sector**	**Impact of resolution framework**
Restructuring process	- When rescue aid is not reimbursed within two months and/or more structural aid (restructuring aid) is required a bank becomes subject to the restructuring process set out in the State aid regime for the banking sector. - The starting point for restructuring is the restructuring plan (or winding up or integration plan) submitted by the Member State to the Commission for its approval, as preceded or accompanied by the capital raising plan.	- The resolution framework only provides for a restructuring process when the bail-in tool is used as a going concern solution. In that case a business reorganisation plan has to be drafted by the bank and assessed by the competent authority and resolution authority. In none of the cases in which State aid was awarded after the introduction of the resolution framework was a restructuring process triggered under the resolution framework. This restructuring was, in all cases, covered by the State aid regime for the banking sector. - The resolution framework introduced *ex ante* restructuring measures.

Competences of authorities	- It is the Member State that decides on the scope and nature of the restructuring, in consultation with the beneficiary bank. The Commission however has a decisive influence on the nature and scope of restructuring that is requested from the bank, taking into account that the Commission has the exclusive power to authorize the State aid measure. - If a beneficiary bank or its shareholders/creditors are unhappy with the requested restructuring, they can challenge the decision from the Commission at the EU Courts.	- The resolution framework introduced the resolution authority as restructuring authority. - The resolution framework introduced the possibility for competent authorities and resolution authorities to impose ex ante restructuring measures. - If a beneficiary bank or its shareholders/creditors are unhappy with the requested restructuring, they may have to challenge multiple decisions from multiple authorities, both at national and EU level.
Contribution of shareholders/ creditors	- The burden-sharing principle applies as part of the assessment by the Commission of the State aid measure. - Burden-sharing is restricted to share capital and subordinated debt. - It is possible to deviate from the burden-sharing requirement under the State aid regime for the banking sector when burden-sharing measures would endanger financial stability or lead to disproportionate results.	- The resolution authorities can (or have to, depending on the circumstances) exercise the PONV conversion power and/ or apply the bail-in tool to impose the burden-sharing requirement. - Burden-sharing can include senior debt. - Certain eligible liabilities are excluded from the scope of the bail-in tool or may be excluded by the resolution authority. - The resolution framework requires a bail-in of 8% of total liabilities and own funds of the bank when certain public funding sources are used. When the ESM DRI or alternative financing sources are used, all unsecured, non-preferred liabilities, other than eligible deposits, have to be written down or converted in full.

7.5.2 *Challenges at the level of the restructuring processes*

This section describes the challenges at the level of the restructuring process itself.

7.5.2.1 Divergence in restructuring processes

Firstly, a bank put in resolution with the aid of State aid can be confronted with diverging restructuring processes as a result of colliding competences, as referred to in section 7.5.3.1. In addition, a bank can be faced with restructuring obligations under the State aid regime for the banking sector, while there are no restructuring obligations under the resolution framework. For example, the resolution framework does not provide for a restructuring process in the case of precautionary recapitalisation. As a result, the restructuring process in case of precautionary recapitalisation is solely governed by the State aid regime for the banking sector; there is no role for the resolution authority in that respect. Also, in all resolution cases, besides the application of the bail-in tool as a going concern solution, restructuring obligations are solely imposed under the State aid regime for the banking sector, even if resolution involves the award of State aid. The only exception being the removal or replacement of the management body and senior management.

7.5.2.2 Lack of clarity on 'going concern' solutions

As discussed in section 7.2.1.1, the resolution framework only sets out the criteria for the restructuring process of a bank in resolution, when the bail-in tool is applied with the objective of restoring the capital of the failing bank to enable it to continue to operate as a *going concern*. The reason behind this may be that the bail-in tool is the only resolution tool considered a 'going concern' tool.

However, if the application of the bridge bank tool or sale of business tool leads to the transfer of all shares in the failing bank to a bridge bank or third party, respectively, this could also be seen as a 'going concern' solution in the author's view. The bank itself will, after all, not be impacted by the share transfer, although its new shareholder(s) may want to reorganize the bank. It is not clear whether, in that situation, restructuring of the bank in resolution is triggered under the resolution framework.

For example, on 7 June 2017, the SRB transferred all shares of Banco Popular to Banco Santander. According to a press release on the website of the SRB, this means that "*Banco Popular continued to operate under normal business conditions as a solvent and liquid member of the Santander Group with immediate effect*".[107] Although the exercise of the PONV conversion power led to the write down of all shares, the conversion of the AT 1 capital instruments into shares and the subsequent write down thereof, no other restructuring obligations can be derived from the resolution of the Spanish resolution authority (the FROB).[108] The SRB decision mentions that the FROB is entitled to remove and replace the management body, but the FROB does not seem to have exercised this power.[109] No State aid was involved, so no restructuring obligations were imposed from that angle. The transfer of the shares in Banco Popular to Banco Santander also constituted a concentration within the meaning of Article (3)(1)(b) of the Merger Regulation[110] and was therefore also assessed by the Commission in its role as competition authority.[111] Also from that perspective, no restructuring obligations were imposed.

In addition, the resolution framework does not provide any guidance in relation to the application of the asset separation tool. For example, the asset separation tool could be applied to transfer impaired assets from a failing bank to an AMC, while the critical functions remain with the failing bank. In that case, the application of the asset separation tool has to be accompanied by the bail-in tool[112], taking into account that the asset management tool cannot be used as a stand-alone resolution tool. It is not clear whether the bail-in tool can, in that case, only be used to convert to equity or reduce the principal amount of claims or debt instruments transferred to the AMC, *or* that it can also be used to recapitalise the failing bank.

107 SRB, The Single Resolution Board adopts resolution decision for Banco Popular, 7 June 2017.
108 FROB resolution 2017, p. 14.
109 SRB, Decision of 7 June 2017 concerning the adoption of a resolution scheme in respect of Banco Popular Español, S.A., SRB/EES/2017/08, non-confidential version, p. 24.
110 Regulation No 139/2004.
111 EC, 8 June 2017, C(2017) 5659 final (M.8553 – Banco Santander/Banco Popular). See also Grünewald 2014, p. 116-121; Barata and Smoleńska 2017, p. 8.
112 It is not possible that the asset separation tool is accompanied by the bridge institution or sale of business tool in this case, since in the event of a partial transfer of assets of a bank under resolution to a private purchaser or to a bridge bank, the residual part of the bank under resolution should be wound up in normal insolvency proceedings (Recital (50) BRRD).

Article 43 BRRD does not seem to exclude the bail-in tool being used in that case to recapitalise the failing bank. It seems to be logical that,, in both cases, the failing bank has to restructure, since it will remain active on the market. The resolution framework however only requires restructuring when the bail-in tool is used to recapitalise the failing bank.[113]

> An example in which the asset separation tool was used as a going concern solution is the case of MKB Bank, see section 6.4.4.4. Taking into account that the resolution of MKB Bank took place prior to the introduction of the bail-in tool, this was not used. However, the shareholder of MKB Bank (the Hungarian State) was fully diluted. There were no subordinated debt-holders.

The situation is different if the asset separation tool is used to transfer the impaired assets to an asset management vehicle and subsequently sold or liquidated, while the critical functions are transferred under the sale of business tool or bridge bank tool, after which the residual entity is liquidated. In such a case, the asset separation tool is used as a gone concern solution.

7.5.2.3 Loss of proportionality in restructuring

As discussed in section 3.7.1, the Commission conducts a proportionate assessment of the long term viability of banks under the State aid regime for the banking sector, taking full account of elements indicating that banks could be viable in the long term without the need for significant restructuring. As a result, banks can benefit from a complete or partial exemption from restructuring under the State aid regime for the banking sector.

The proportionality principle also applies under the resolution framework. The competent and resolution authorities are permitted to apply different or significantly reduced recovery and resolution planning and information requirements on an institution-specific basis, and at a lower frequency for updates than one year. For a small bank with little interconnectedness and complexity, a recovery plan could be reduced to basic information on its structure, triggers for recovery actions, and recovery options. If a bank could be permitted to go insolvent, then the resolution plan could be reduced.[114] The competent authorities and, where relevant, resolution

113 Article 51(1) BRRD.
114 Recital (14) BRRD. Recital (21) BRRD.

authorities, even have the option to waive the requirements relating to the preparation of the recovery and resolution plans on a case-by-case basis in the limited cases specified in the BRRD.[115] Although the proportionality principle is applied in relation to the recovery and resolution planning, this is absent in respect of the business reorganisation plan. Delegated Regulation (EU) 2016/1400 sets strict requirements as to the contents of the business reorganisation plan, without providing any basis for proportional application thereof.

> It is interesting in that respect, that the proportionality of the recovery and resolution plan is a hot topic, while no attention at all is paid to the business reorganisation plan.[116] This may be explained by the fact that there has not yet been a case in which the bail-in tool is applied as a going concern solution.

7.5.2.4 Loss of transparency in restructuring

Although the restructuring process under the State aid regime is a political game not transparent to outsiders, the (non-confidential) versions of the decisions from the Commission in relation to State aid awards are published.[117] In addition, the commitments by the Member States in relation to the restructuring process are published as annexes to these decisions. In this way, it is possible to get a certain insight in the restructuring that the beneficiary bank is subject to. This may be helpful for third parties confronted with such restructuring process (e.g., shareholders of which shares are written down).

Under the resolution framework, transparency of the restructuring process seems to have lost ground.[118] It can be read in Recital (86) BRRD that the fact that information on the contents and details of recovery and resolution plans and the result of any assessment of these plans may have far-reaching effects, in particular on the undertakings concerned, must be taken into account. Any information provided in respect of a decision before it is taken, be it on whether the conditions for resolution are satisfied,

115 Recital (27) BRRD.
116 EC Report on application and review resolution framework 2019, p. 8.
117 When State aid is granted on the basis of an aid scheme and there is no individual notification obligation, no such decision is taken by the Commission. In that case, the award of State aid to an individual bank and any restructuring of such bank takes place out of public sight.
118 See also Lehmann *Bruegel Blog Post* 2019.

on the use of a specific tool, or of any action during the proceedings, must be presumed to have effects on the public and private interests concerned by the action.

However, information that the resolution authority is examining a specific institution could be enough for there to be negative effects on that institution. It is therefore necessary to ensure that there are appropriate mechanisms for maintaining the confidentiality of information, such as the content and details of recovery and resolution plans and the result of any assessment carried out in that context. The contents of recovery and resolution plans are therefore not publicly available. Furthermore, the business reorganisation plan is not publicly available.

As a result, the restructuring process of a bank put in resolution without the use of EPFS is less transparent than that of a bank put in resolution with the use of State aid. In the latter case, the Commission has to publish (the non-confidential version of) its decision in respect of the award of restructuring aid and the commitments of the Member State in respect of the restructuring of the bank.[119] Taking into account that also the recovery and resolution plans of banks are not published, it would contribute to the understanding and acceptance of the resolution of a bank, if a (non-confidential version of the) business reorganisation plan is made publicly available (in so far this does not impede financial stability).[120]

> The resolution framework does provide that the resolution authority shall publish or ensure the publication of a copy of the order or instrument by which the resolution action is taken, or a notice summarising the effects of the resolution action, and in particular the effects on retail customers and, if applicable, the terms and period of suspension or restriction referred to in Articles 69, 70 and 71 BRRD. This does however not provide further insight in any restructuring of the bank.[121] At the time of writing this dissertation, transparency of resolution is a much debated – and litigated – topic in relation to the resolution of Banco Popular.

119 EC, State aid transparency: Why? What? When? Where? How?, Competition policy brief, 2016(4).

120 See also on (the lack of) transparency in the resolution framework: De Serière and Milione *JIBLR* 2019, p. 82-83.

121 Article 83(4) BRRD.

7.5.3 Challenges at the level of competences

This section describes the challenges at the impact level of competences of the authorities involved in the restructuring of a failing bank.

7.5.3.1 Colliding competences

As a result of the resolution framework, a number of 'restructuring authorities' play a role in the restructuring process of a bank. These are the Commission, the competent authorities, and the resolution authorities. Member States also play a role in the restructuring process of a failing bank under the State aid regime for the banking sector. Having multiple authorities with their own competences being involved in the same process may trigger a number of questions should these competences not be fully aligned.

One of these questions is whether the Member States and the Commission, when discussing a restructuring plan under the State aid regime, are in any way bound to the measures set out in the recovery and the resolution plan. In that respect, it may be relevant that the resolution framework sets out that when taking resolution actions, resolution authorities should take into account and follow the measures provided for in the resolution plans unless resolution authorities assess, taking into account the circumstances of the case, that resolution objectives will be achieved more effectively by taking actions which are not provided for in the resolution plans.[122] The resolution framework therefore provides for the possibility for resolution authorities to deviate from the resolution plan in resolution. It seems logical that the Member State involved and the Commission can take any recovery or resolution plan, insofar they have access thereto, into account when discussing the restructuring plan under the State aid regime, without being legally bound to the measures set out therein. This is notwithstanding the fact that the State aid decision may not violate intrinsically linked provisions of the resolution framework.

Another question is whether the Commission can desire further-going restructuring measures from Member States than provided for in the resolution plan or set out in the business reorganisation plan. In finding an answer to this question, it should be recognised that the resolution framework and the State aid regime have different objectives. While the

122 Recital (54) BRRD.

Commission is responsible for protecting competition, limiting moral hazard, and avoiding excessive bailouts, the resolution authority is primarily responsible for guaranteeing financial stability.[123] In addition, the Commission and the resolution authority have different roles. While the resolution authority decides on the resolution path and manages the respective national resolution fund (or the SRF, if the resolution authority is the SRB), the Commission acts more as a referee and provides a dispute-prevention mechanism, both for Member States and for banks receiving aid and their competitors.[124] Taking into account these different objectives and roles and in the absence of any further guidance, it seems arguable that the Commission can impose different restructuring obligations than the resolution authority. Thus a bank put in resolution with the assistance of EPFS may be confronted with different restructuring obligations in simultaneous restructuring processes.

> The business reorganisation plan, for example, does not require any measures to limit the distortion of competition, while these are required by a restructuring (or winding up or integration) plan.

7.5.3.2 Lack of cooperation provisions

Taking into account that there are multiple authorities involved in the restructuring process of a bank as a result of the introduction of the resolution framework, the cooperation between these authorities is important in order to ensure a smooth and efficient restructuring process. As discussed in section 7.3.2, this cooperation is however not a topic covered by the resolution framework or the State aid regime for the banking sector, other than the (likely) premise of close liaison. Some guidance is also given in respect of the business reorganisation plan. The resolution framework does, however, not provide for a role of the resolution authority in the restructuring of a bank that is subject to precautionary recapitalisation. In addition, it does not provide for any cooperation procedures.

Providing a clearer picture of the cooperation between the different actors in the restructuring process seems to be desirable, as any flaws in cooperation could negatively impact the efficiency of the restructuring process.

123 Dewatripont et al *Bruegel Policy Contribution* 2010, p. 6.
124 Dewatripont et al *Bruegel Policy Contribution* 2010, p. 6.

> Dewatripont noted in relation to the resolution authority that it should make sure that in its decisions it embeds the State aid control principles – relating to viability, the sharing of the restructuring costs with the incumbent owners, and other measures to remedy competitive distortions. This, as it would always be possible for the Commission to challenge *ex post* a decision of the resolution authority to bail out a particular institution, either on its own initiative or following a complaint of unfair competition by another bank.[125] This is indeed correct, taking into account the exclusive competence of the Commission to act as the State aid authority. It is however only possible for the Commission to challenge the decision of the resolution authority when State aid is involved. In cases where State aid is not involved, the State aid control principles do not play a role. It would then only be on the basis of the competition rules in Articles 101 to 106 TFEU that the Commission could act. The resolution of Banco Popular forms an example.

7.5.3.3 Impediments to effective judicial protection

As a result of the introduction of the resolution framework, numerous authorities can take decisions that influence the restructuring process that a bank and its shareholders/creditors are subject to. Taken into account that such a restructuring process can have a far reaching impact on the bank and its shareholders/creditors, effective judicial protection is important. It is exactly this judicial protection that is jeopardized by the resolution framework, since it may now be necessary to start legal proceedings against multiple authorities at multiple courts.[126] This is not only very costly, but also time consuming, while large stakes are often at risk.[127] According to Tegelaar and Haentjens, public policy considerations regarding the stability of the financial system seem to have been given priority over considerations of individual justice.[128]

> An interesting example in that respect, is the case of the resolution of BES.[129] Subordinated creditors holding Lower Tier 2 Bonds started legal proceedings in order to annul the decision from the Commission

125 Dewatripont et al *Bruegel Policy Contribution* 2010, p. 6-7.
126 Tegelaar and Haentjens 2019, p. 261-262.
127 Another interesting issue is the (lack of a) procedure for verification of disputed claims in resolution, as discussed by Binder (Binder 2019, p. 11-16).
128 Tegelaar and Haentjens 2019, p. 287.
129 This resolution case is discussed in more detail in section 4.4.2.2.

and more specifically the commitment by Portugal that no claim of a shareholder or holder of subordinated debt or any hybrid instrument may be transferred to the bridge bank that was set up. The creditors argued that they have an interest in bringing proceedings before the GC, because they have brought an action before the national court of Portugal against the decision of the Portuguese resolution authority to put BES in resolution in the context of which the possible annulment of the contested decision before the EU Courts is capable of benefiting the creditors. The GC concluded that the applications did not have any legal interest in bringing proceedings for annulment of the Commission's decision.[130] The ECJ however set aside the judgment of the GC. It held that the GC erred in law in holding that, given that the proceedings before it and the national proceedings did not have the same subject matter, the possible annulment of the contested decision would have no effect on those latter proceedings and would therefore not benefit the appellants, within the meaning of the relevant case-law.[131]

The complexity of judicial protection is also illustrated by the fact that of the 76 appeals received by the Appeal Panel of the SRB in the aftermath of the resolution of Banco Popular, 54 were declared inadmissible since the decision of the SRB is not appealable at the Appeal Panel.[132] This shows that it was not clear for most plaintiffs that they used the incorrect legal process, as a result of which they may have spent time and money without any result.

7.5.4 *Challenges at the level of obligations of shareholders/creditors*

This section discusses the challenges at the level of the obligations of the shareholders/creditors of a failing bank.

7.5.4.1 Undesirable outcomes of burden-sharing allocation

Section 7.4 described the concept of burden-sharing and the development thereof after the introduction of the resolution framework. Although burden-sharing takes place in the bankruptcy or liquidation of each and every

130 GC, 19 July 2017, T-812/14, ECLI:EU:T:2017:560 (*BPC Lux 2 Sarl c.s. v Commission*), par. 27-37.
131 ECJ, 7 November 2018, C-544/17 P, ECLI:EU:C:2018:880 (*BPC Lux 2 Sarl c.s. v Commission*), par. 57.
132 See section 4.9.2.1.

corporation, burden-sharing is special in relation to failing banks, taking into account the specific role they play in our society.[133] The burden is therefore not shared by the usual suspects in a normal insolvency situation. Moreover, with the introduction of a range of new funding resources, answering the question of who has to bear the losses has become even more complex.[134] These funding resources may range from the bank itself, its shareholders, creditors, and the whole banking sector (through contributions from the national resolution funds or the SRF and the deposit guarantee schemes), to the national central banks and the Member States.

With the introduction of new parties that can assist when a bank fails (such as the national resolution funds or SRF, but also senior debt holders), the burden-sharing allocation among the parties that carry the burden has also been impacted.[135] Burden-sharing allocation seems unavoidable without favouring one party over another party. If a Member State does not provide the necessary means to ensure the return to long-term viability of a bank or to protect the critical functions, these means must be provided by another party, be it a shareholder, creditor, or the banking sector through contributions from the national resolution fund or the SRF.[136]

> De Serière notes that burden-sharing has been an issue that has never been resolved due to politics and the complexities surrounding the issue.[137] Although it seems fair that investors in a bank are exposed to investment risks, the nature of these investors can make it a – socially and politically – unacceptable decision to have them contribute to the losses of a failing bank. See, for example, section 7.5.4.2 in respect of the treatment of retail investors. A disadvantage of a taxpayer bailout is, however, that this allocates the costs of a bank failure in one Member State, while the bank is most likely active in multiple Member States and even outside the EU. This issue can be solved by the introduction of supranational funding instruments, but this comes at the cost of giving up fiscal sovereignty.

133 This role is also referred to as 'too-big-to-fail' or 'too-connected-to-fail'. See, *inter alia*, Cunliffe *EE* 2016, p. 63-64 and Bouyon *ECRI Commentary* 2014, p. 1.
134 Cunliffe *EE* 2016, p. 59.
135 See also Grünewald 2014, p. 52.
136 See also Avgouleas and Goodhart *JFR* 2015, p. 16-17.
137 Haentjens and Wessels 2014, ch. 8, par. 5.

> In addition, Schoenmaker states that burden-sharing may have a different effect depending on the bank to which it is applied. He states that bail-in of large banks might add to–instead of dampen–financial panic.[138] Wojcik also states that bail-ins will be most effective when applied to non-systemic, smaller domestic banks.[139] Binder, however, sees a risk in the application of the resolution toolbox (including the bail-in tool) to small or even medium-sized institutions taking into account that the resolution action should be proportionate to one or more resolution objectives and winding up of the bank in normal insolvency proceedings would not meet the resolution objectives to the same extent. He takes the stance that this could normally not be said about cases involving smaller or even medium-sized institutions.[140]

In the author's view, there is no 'one size fits all' approach when it comes to burden-sharing allocation when a bank fails. The resolution framework however defines a standard burden-sharing cascade, which may include senior debt, and a mandatory bail-in threshold when certain public funding sources are used. This has already led to artifices of Member States to deal with an (both financial and political) undesirable outcome thereof. As a result, burden-sharing has not only become controversial, but also conveys the impression of arbitrariness. This is pressing, as Wojcik mentions the predictability and the stability of the legal result produced by a bail-in as two of the most important criteria to make bail-in effective.[141]

> According to Nicolaides, special consideration should be given to the fact that many banks that have received State aid since 2007 and have not been liquidated are partly or even wholly owned by a Member State. This means that in case these banks need extra capital and cannot raise it on the market, the State as a shareholder will have to be bailed-in. As a result, tax payers will still ultimately bear the burden. This could – and should, in the author's view – be changed by requiring the SRF or the national resolution funds to step in when a Member State has to be bailed-in.[142] This, however, requires amending the resolution framework.

138 Schoenmaker *IF* 2018, p. 41.
139 Wojcik *CML Rev*. 2016, p. 130.
140 Binder *ECFR* 2016, p. 595.
141 Wojcik *CML Rev*. 2016, p. 137-138.
142 Nicolaides *Maastricht J*. 2017, p. 347.

7.5.4.2 Restrictions in the ability of the bail-in tool to perform as intended

Ringe and Patel discuss that the more interconnected banks become, the more likely it is that the authorities will resort to a bail-out rather than a bail-in resolution. This is because both the investor and the issuing bank, in any bank interconnection, are less likely to be bailed in if doing so creates further systemic risk.[143] In that respect, the type of counterparties are paramount for the purposes of bail-in. Bail-in powers may actually be increasing systemic risk, particularly systemic risk that arises from banking interconnections. This is because the regulatory framework is inadept of a fundamental concern: the counterparties to banking capital. This creates relative advantages for banks that invest in other banks, because the bail-in framework does not internalise the systemic risk costs that arise out of counterparty selection.[144]

Götz and Tröger argue that the ability of the bail-in tool under the resolution framework to perform as intended may be restricted as long as (i) investors do not understand the risk of bail-in and are therefore not able to charge adequate risk premiums and thus exert meaningful market discipline on banks, and (ii) investors do not have sufficient loss-bearing capacity to incur a loss when their debt is bailed-in, and (iii) a bail-in endangers the health of other banks because these are the holders of the 'bail-inable' debt. Holders of bail-inable debt are ideally sophisticated investors outside the banking sector whose assets and liabilities are matched with regards to their maturity (e.g. insurance companies, pension funds or high net-worth individuals).[145]

> CRR II provides for an MREL cross-holdings' deductions regime that provides for cross-holding deductions for banks holding bail-inable debt issued by another bank.[146] This seems to be a more proportionate solution than excluding banks from the eligible potential buyers of bail-inable debt.

Private households and bank retail customers are less suited as holders of bail-inable debt, since national governments may feel compelled to compensate these parties in case of a loss due to a bail-in. There is however no restriction in selling bail-inable debt to these parties, despite the fact

143 Ringe and Patel 2019, p. 15.
144 Ringe and Patel 2019, p. 37.
145 Götz and Tröger 2016, p. 6.
146 CRR II, Article 72b(2)(b).

that there are already numerous examples of additional complications to burden-sharing where financial instruments used to finance the bank have been mis-sold to unsophisticated retail investors unable to properly understand the riskiness and the complexity of these financial products.[147] According to Asimakopoulos, this impinges on the credibility of the resolution framework.[148]

> Mis-selling and precautionary recapitalisation
>
> In the case of MPS, subordinated bonds were sold to retail investors who were not adequately informed about potential risks when they decided to invest in the financial instruments. The Italian government had to step in and introduce the possibility of compensating the retail investors by converting their subordinated bonds into equity and buying this equity with more secure senior instruments. The financing of the compensation involved the award of State aid which was approved by the Commission. The Commission assessed that this is an entirely separate consideration to burden-sharing under the State aid framework.
>
> Mis-selling and resolution
>
> Also in the case of Banca Marche, Banca Etruria, Carife, and Carichieti, subordinated bonds were mis-sold to unsophisticated retail investors. In this case, the Italian Government introduced an arbitration procedure to allow them to recover the invested amount. It can be argued that even if such a political strategy is understandable, it may be considered a circumvention of the State aid framework.[149]
>
> Mis-selling and liquidation
>
> In the case of Veneto Banca and Banca Popolare di Vicenza, resolution was avoided and liquidation took place with the assistance of State aid as a result of which the burden-sharing requirements under the resolution framework were not triggered, and any potential mis-selling towards retail investors remained without consequences.[150]

147 Götz and Tröger 2016, p. 6.
148 Asimakopoulos *ECLJ* 2018, p. 157-158.
149 Olivares-Caminal and Russo 2017, p. 14.
150 Hellwig 2017, p. 17.

These examples of mis-selling show that improving the position of retail investors is important for the ability of the bail-in tool to work as intended,. Certain initiatives have already been taken. Under MiFID II, further investor protection has been introduced, including in relation to bail-inable debt. For example, bail-inable debt instruments have been classified as a 'complex instrument' as a result of which this debt cannot be sold to retail investors without conducting an appropriateness test.[151] In addition, the ESMA and EBA published a statement on the treatment of retail holdings of debt financial instruments subject to the BRRD on 30 May 2018.

> It can be derived from the analysis made by the ESMA and EBA, that banks in Italy have by far the largest amount of retail-held debt issuance, followed by Germany and France.[152]

In this statement, the ESMA urges institutions to convey the information on the effects of the BRRD on retail clients holdings through the means of a specific written communication, both in relation to existing holdings and new issuances.[153] In addition, resolution authorities are encouraged to pay attention to any material presence of retail investors as holders of debt liabilities in their resolution planning and resolvability assessment. They should for example consider whether additional MREL-eligible liabilities should be issued in order to create an additional buffer of subordinated liabilities, which may help make the risk that retail debt holders would be bailed-in more remote.[154] The ESMA and EBA emphasize that making use of the discretionary exemption from the bail-in scope should only be used in exceptional cases.[155] Besides this restricted use, it should be noted that this exemption does not exist in relation to the exercise of the PONV conversion power. If capital instruments are held by retail investors, they can only be protected if the investor protection requirements under MiFID II are violated. In the author's view, the resolution framework could therefore have benefitted from providing the resolution authority the

151 ESMA, Guidelines on complex debt instruments and structured deposits, ESMA/2015/1787, 4 February 2016 p. 9.

152 Statement of the EBA and ESMA on the treatment of retail holdings of debt financial instruments 2018, p. 6.

153 Statement of the EBA and ESMA on the treatment of retail holdings of debt financial instruments 2018, p. 2. See also Article 41 of Delegated Regulation (EU) No 2017/565.

154 See also Tröger 2017, p. 20-21.

155 Statement of the EBA and ESMA on the treatment of retail holdings of debt financial instruments 2018, p. 3, 18-19.

(transitional) power to exclude liabilities from the exercise of the PONV conversion power for the same reasons set out in relation to the bail-in tool.

> Article 44a BRRD II introduces the requirement for Member States to ensure that a seller of eligible liabilities – which meet all conditions referred to in Article 72a CRR II except for point (b) of Article 72a(1) and paragraphs 3 to 5 of Article 72b CRR II – sells these liabilities to a retail client only where all the following conditions are met: (a) the seller has performed a suitability test in accordance with MiFID II, (b) the seller is satisfied on the basis of this test that the eligible liabilities are suitable for the retail client, and (c) the seller documents the suitability. Member States may provide that the conditions also apply to sellers of other instruments qualifying as own funds or bail-inable liabilities. Where the financial instrument portfolio of the retail client does not, at the time of the purchase, exceed EUR 500,000, the seller also has to ensure that the retail client does not invest an aggregate amount exceeding 10% of its portfolio in the eligible liabilities and the initial investment amount is at least EUR 100,000. In certain circumstances, Member States may lower this threshold to EUR 50,000 or only apply this threshold as condition for investment by a retail client. Article 44a BRRD II only applies to liabilities issued after 27 December 2020. It is, in the author's view, remarkable that BRRD II has introduced this obligation, since MiFID II is the directive that covers investor protection in case of the provision of investment services.[156] It is even more remarkable that the obligation to carry out a suitability test applies when 'selling' the eligible liabilities. This implies that this test should also be conducted when no portfolio management or advisory services are provided (in deviation from MiFID II).

Besides the restrictions in the ability of the bail-in tool to perform as intended due to retail holdings, Asimakopoulos mentions that the EU authorities and, most prominently, the ECB are still hesitant to wipe-out senior debt holders due to contagion concerns.[157] As discussed in section

156 Recital (16) BRRD II mentions that "*This requirement is not sufficiently covered in Directive 2014/65/EU and should therefore be enforceable under Directive 2014/59/EU and should be without prejudice to investor protection rules provided for in Directive 2014/65/EU.*"

157 Asimakopoulos *ECLJ* 2018, p. 157.

7.4.3.4, these concerns may however have led to the increase of other layers of eligible liabilities that can be used for bail-in.

7.5.4.3 The (in)compatibility of burden-sharing and financial stability

Burden-sharing has been developed as a general principle of State aid control that contributes, in particular, to limiting distortions of competition between banks and across Member States in the internal market, and to addressing moral hazard.[158] An exception to the burden-sharing principle can be made where implementing burden-sharing measures would endanger financial stability or lead to disproportionate results. Under the resolution framework the objective of burden-sharing is explained as ensuring that systemic banks can be resolved without jeopardising financial stability. In addition, the application of the burden-sharing requirement should give shareholders and creditors of banks a stronger incentive to monitor the health of a bank under normal circumstances.[159]

While the resolution framework therefore starts from the premise that burden-sharing contributes to financial stability, the State aid regime allows deviation from the burden-sharing principle if applying this principle endangers financial stability. This difference in approach in relation to the contribution of burden-sharing towards financial stability, can perhaps be explained taking into account that the resolution framework is more focused on the failure of an individual bank (idiosyncratic shock), while the State aid regime for the banking sector is developed in the midst of a systemic crisis.[160] Idiosyncratic shocks and systemic crises can call for different approaches. It should be acknowledged that the GFC created exceptional circumstances in which the bankruptcy of one bank, even a bank of small size, could undermine trust in the financial system at large, both at national and international level.[161]

> In other words, even a small bank can have systemic importance during a systemic crisis. The assessment whether a bank has systemic importance is therefore not static, but can depend on the prevailing market conditions.

158 2013 Banking Communication, point 15. See also Lo Schiavo *EBOLR* 2018, p. 596.
159 Recital (67) BRRD.
160 IMF Country Report 2018, p. 6.
161 EC, 29 June 2012, C(2012) 4427 final (SA.34445 – FIH), par. 49.

Avgouleas and Goodhart conclude that imposing haircuts on general bank creditors during a systemic event is a sure way to accelerate the panic. In fact, contagion: a flight of creditors from other institutions may be uncontainable.[162] They therefore focus on the clean-up of bank balance sheets, for example through setting up a Euro-AMC. Cleaning up bank balance sheets from NPLs would free up capital for new lending which would boost economic recovery in the periphery of the Eurozone.[163] Tröger also states that bank resolution without injection of public funds poses a problem if it occurs in the middle of a systemic crisis. In fact, he notes that financial history teaches us that a tough stance of governments who refuse to backstop the financial system aggravates the impact of the event.[164] While burden-sharing may hence contribute to financial stability in case of an idiosyncratic shock, this may be different when the whole banking sector fails. Requiring a bail-in of 8% of total liabilities and own funds of the bank to have access to public funding may not be realistic in that situation.

7.6 Conclusion

This chapter discussed the restructuring process that takes place after a bank is put in resolution, with or without the assistance of public funding. Not all banks put in resolution go through a restructuring process; this depends on the resolution tool applied by the resolution authority and whether or not public funding is involved. The transfer tools normally involve the disappearance of the bank as an autonomous entity, while the bail-in tool aims at preserving the bank when used for recapitalisation purposes. The resolution framework only provides for a restructuring process when the bail-in tool is applied for recapitalisation purposes. In that case, a business reorganisation plan has to be prepared by the bank. In none of the cases of State aid awards after the introduction of the resolution framework has a restructuring process been triggered under the resolution framework. Restructuring is, in all cases, solely covered by the State aid regime for the banking sector. This can be explained by the fact that at the time of writing this dissertation, the bail-in tool has not yet been applied as a going concern solution. In addition, the resolution framework does not provide for a restructuring process when a transfer tool is actually applied

162 Avgouleas and Goodhart *EE* 2016, p. 87.
163 Avgouleas and Goodhart *EE* 2016, p. 88.
164 Tröger 2018, p. 9.

as a going concern solution. An example can be found in the resolution of Banco Popular.

This chapter also discussed the new possibilities under the resolution framework to enforce *ex ante* restructuring on the basis of the recovery and resolution plans and their added value compared to restructuring under the State aid regime. Most notably, the resolution framework could be seen as being complementary to the State aid regime in so far it enables resolution authorities to enforce *ex ante* restructuring, even outside the situation in which State aid is granted.

It furthermore highlights the importance of the cooperation between the Commission and the resolution authorities in order to ensure an efficient restructuring process. With the introduction of the resolution framework, a new 'restructuring authority' was introduced, namely the resolution authorities. The cooperation between the Commission and the resolution authorities is, however, a topic that has not received a lot of attention. Although, there seems to be the premise of close liaison and some guidance is given in respect of the business reorganisation plan, uncertainty remains. For example, the resolution authority has no role in the restructuring of a bank subject to precautionary recapitalisation. In addition, no cooperation procedure is provided when both the restructuring process under the State aid regime for the banking sector and the resolution framework apply.

Lastly, the burden-sharing obligations of shareholders/creditors of a failing bank under the resolution framework have been compared with the obligations under the State aid regime for the banking sector. Although the State aid regime for the banking sector already provides for a burden-sharing principle, the resolution framework takes it one step further: it introduced the possibility to bail-in senior debt holders. In addition, it also introduced the requirement to bail-in 8% of total liabilities and own funds of a bank to have access to public funding in revolution, with some exceptions. The bail-in requirement under the resolution framework has met with great scepticism. The mandatory burden-sharing allocation may lead to undesirable outcomes that are both financially and politically untenable.[165] This ties into the fact that there (still) are restrictions in the ability of the bail-in tool to perform as intended, especially those that are caused by retail debt holdings. Finally, the resolution framework does not seem to cater for the situation of a systemic crisis in which the use of public funding may be inevitable.

165 Grünewald already mentioned that the difficulty lies in finding a balance between limiting political interference during the containment decision-making process and ensuring that, at the end of the day, the containment strategy enjoys political support and public trust (Grünewald *JBR* 2010, p. 77).

CHAPTER 8

CONCLUSION

> *"Men, it has been well said, think in herds; it will be seen that they go mad in herds, while they only recover their senses slowly, and one by one."*
>
> *Charles Mackay (1841)*

8.1 Introduction

This dissertation covers three areas of law: prudential regulations, State aid rules and the resolution framework. These areas of law are closely interlinked. If there are not sufficient capital instruments and eligible liabilities on its balance sheet, the resolution of a bank will be difficult to envisage without the use of public funding. As a result, there is a delicate interaction between the State aid regime for the banking sector and the resolution framework in regulating public funding of failing banks in the EU. The following threefold research question has been addressed in this dissertation in order to further understand this interaction:

How does the resolution framework impact the State aid regime for the banking sector? Which challenges can be identified in the co-existence of the resolution framework and State aid regime in regulating public funding of failing banks in the EU after the onset of the GFC? And which potential steps can be taken to address such challenges in order to contribute to an adequate and efficient institutional and regulatory framework for the banking sector?

This research question has been assessed along three lines of research: (i) the impact of the resolution framework on the access to public funding for failing banks, (ii) the impact of the resolution framework on the exercise of State aid control by the Commission and (iii) the impact of the resolution framework on the restructuring process of a failing bank. The terms 'public funding' and 'failing banks' have been introduced in this dissertation as neutral terms without any special connotation under the resolution framework or the State aid regime for the banking sector.[1]

This chapter starts with a retrospective on Part 1 of this dissertation (section 8.2). Sections 8.3, 8.4 and 8.5 subsequently discuss the impact assessments that have been made with respect to the three research lines (Part 2 of this dissertation). Section 8.6 discusses potential actions to address the gaps that have been identified in the impact assessments. Section 8.7 contains some thoughts on the further development of the regulation of public funding within the European Banking Union. Section 8.8 reflects on the contribution of the resolution framework to solving the inadequacies revealed by the GFC.

8.2 Moving towards resolvable banks

Chapter 2 started with taking a closer look at the definition of 'credit institution' in banking regulation in order to better understand the term 'bank'. Interestingly, this term is not as clear as one might expect. Due to a lack of clarification of certain elements of the definition of 'credit institution' at the EU level, there remains a degree of divergence between the Member States as to the interpretation of this term. A further complicating factor in understanding what a bank is, is the variety of activities and business models of banks within the EU. Although, ultimately, the purpose of banking intermediation is transforming short-term deposits into a stable and sustainable supply of long-term credit to the real economy, banks are involved in all kinds of activities. Some banks have such high amounts of total assets that they qualify as being global systemically important. Other banks have a more modest balance sheet.

While the business models and balance sheets of banks differ, they have in common that they all need to comply with the regulatory capital requirements and the MREL. As a result, each bank needs to maintain a certain composition of its balance sheet. This should guarantee that the reliance of

1 The reason behind this is that the resolution framework and the State aid regime for the banking sector both apply their own terminology for public funding (e.g. State aid, rescue aid, restructuring aid, liquidation aid, resolution aid, EPFS, ELA, GFST, SRF) and failing banks (e.g. failing or likely to fail, solvent, capital shortfall, significant deterioration of financial position), subject to specific legal interpretations. See section 1.3.1.

banks on short-term wholesale funding to finance the expansion of their balance sheets, together with the use of high leverage, supports economically useful banking activities that serve the general interest, while banks are resolvable when they are failing. The balance sheets of banks may, however, not be quite ready for that, because of challenges relating both to the MREL amount and the MREL composition. Banks have a financing need to meet the MREL. In addition, certain banks are characterized by the predominance of deposits covered by a deposit guarantee scheme or preferred retail deposits in the funding structure and limited or non-existent experience in issuing debt instruments. This affects these banks' abilities to meet the MREL and, in the end, also affects their resolvability.

If the level of own capital and eligible liabilities is insufficient to absorb losses and recapitalise a failing bank, other funding resources will be necessary to resolve the bank. These may involve public funding provided by Member States, national central banks, deposit guarantee schemes, national resolution funds, the SRF and/or the ESM. Taking into account that banks are currently still in the initial stage of implementing the MREL, it may be realistic to assume that it will be necessary to use alternative public funding resources in the resolution of banks – in any event, as long as the MREL has not been fully implemented. This brings us to the State aid regime.

Chapter 3 discussed that the EU is unique in having a State aid regime, under which Member States give up part of their sovereignty by requiring the Commission's approval of State aid awards. Not all public funding qualifies as State aid: public funding only comes within the remit of State aid control if it is assessed to be an intervention by a Member State or through Member State resources in any form whatsoever, which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods, and that affects trade between Member States. This assessment is made by the Commission and is subject to judicial review by the EU Courts.

The assessment by the Commission normally starts with the request of a Member State for approval of a State aid award. It remains for each Member State to determine the circumstances in which it wishes to grant State aid and the beneficiaries to whom this aid is to be granted. The Member States design the aid measure in liaison with the bank. In the end, however, it is the Commission that has to approve the aid as being compatible with the internal market, which makes the process of designing the aid measure more of a trialogue. Third parties, such as the shareholders and creditors of a bank, also play their part when State aid is awarded. Sometimes far-reaching restructuring of the bank is necessary, which may include the dilution, cancellation or conversion of capital instruments, the write-off of debts, the replacement of management and/or divestment. Shareholders' and creditors' rights do not remain untouched in that case.

The Commission makes use of soft law instruments to inform Member States how it assesses State aid awards. The urgency, the interdependence of financial markets and the extraordinary size of the subsidies committed by Member States to save national banks during the GFC, led the Commission to modify its ordinary decision-making practices and to adopt a new set of soft laws for the banking sector, consisting of the Crisis Communications, on the basis of Article 107(3)(b) TFEU. While the contours of the European Banking Union were given shape, the Commission started with its review of the Crisis Communications This led to the publication of the 2013 Banking Communication on 13 July 2013, still on the basis of Article 107(3)(b) TFEU. The 2013 Banking Communication forms the basis of the State aid regime for the banking sector as we know it today. The Commission continues to assess whether State aid awards in the banking sector are appropriate for remedying a serious disturbance in the economy of a Member State. The temporality of this regime, although advocated by the Commission, therefore seems to no longer be a reality.

With the introduction of the resolution framework, as described in Chapter 4, the question whether the State aid regime for the banking sector is still fit for the purpose of identifying and controlling State aid to banks have become more imperative. The resolution framework was introduced because the GFC showed that general corporate insolvency procedures may not always be appropriate for banks, as they may not always ensure sufficient speed of intervention, the continuation of the critical functions of institutions and the preservation of financial stability. This formed the justification to take away the power to determine resolution from courts and confer this on administrative authorities, the resolution authorities. With the introduction of the BRRD, procedures for resolving banks were harmonised at EU level, in order to submit resolution authorities to the same principles and to provide them with the same set of tools in order to achieve the resolution objectives. With the introduction of the SRM, not only harmonisation, but also centralisation of the resolution process at supranational level took place within the European Banking Union, with the introduction of the SRB and the SRF.

Although the resolution framework has successfully been established, the devil is – as always – in the detail. The resolution framework is, mainly due to its dual structure, both on Eurozone and national level, at some points hard to read and fathom. In addition, the complexity of resolution, both in terms of involvement of the number of actors, and the procedural outline of resolution, renders the concept of resolution difficult to grasp, not only for the bank itself, but also for its shareholders and creditors. At the same time, this resolution can have far-reaching consequences. The case of Banco Popular, the first resolution case in which the SRB took the lead, shows that shareholders and subordinated debt holders can be confronted with a situation in which their shares and other capital instruments are written down without any compensation.

The resolution framework has already been subject to revision, although it has barely seen its first practical applications. With the further development of its practicalities over the coming years, there will undoubtedly be many more causes for revisions of this framework. Any amendments have to be carefully considered, however, in light of the cohesion with other legal frameworks, including the State aid regime for the banking sector.

8.3 The access to public funding for failing banks

This section summarises the assessment that has been made in Chapter 5 with respect to the impact of the resolution framework on the access to public funding for failing banks.

8.3.1 Impact of the resolution framework

Under the resolution framework, access to public funds is restricted and is determined according to which phase (recovery, resolution or insolvency) and under which legal instrument (BRRD or SRMR) the public funds are proposed to be used.

Access restriction

Within the resolution framework, the terms EPFS and ELA have been introduced to regulate the access to public funding for failing banks. Only, if public funding is captured by the definition of EPFS or ELA, can the resolution framework impact the access to such public funding. This means, for example, that public funding in the form of liquidation aid and interventions by Member States on market terms are not impacted by the resolution framework. The same applies to the payout function of the deposit guarantee schemes of Member States, while it is disputable for intervention by deposit guarantee schemes when taking alternative measures (section 5.2).

If public funding qualifies as EPFS or ELA, access thereto is restricted in several ways under the resolution framework: (a) through the resolvability assessment, (b) in the recovery and resolution plans, (c) by making EPFS a trigger for the exercise of the PONV conversion power, (d) by making EPFS a trigger for resolution, and (e) by making the access to EPFS subject to compliance with certain access criteria, including the application of a mandatory threshold for bail-in with respect to EPFS that is granted in resolution. With respect to ELA, a separate assessment framework applies that provides for access criteria (sections 5.3 and 5.4).

The access restrictions that are included in the resolution framework do not all restrict the access to public funding in the same way. Some of the access restrictions contribute to minimizing the total amount of public funds necessary to assist failing banks (*absolute restriction*), such as the mandatory bail-in of shareholders and creditors that apply with respect to certain forms of EPFS that are granted in resolution. Other access restrictions are more directed towards introducing a certain 'public funding cascade' in which taxpayers' money (that is, Member State resources) is used as a last resort (*relative restriction*). For example, the use of national resolution funds and the SRF do not impede resolvability (section 5.5.1.1).

Access differentiation

The access restrictions that apply under the resolution framework differ depending on whether it concerns the availability of public funding within or outside of resolution. The resolution framework therefore not only provides for access restriction, but also for access differentiation. The access differentiation that is created by the resolution framework can be explained by the different purposes that public funding may have. Public funding can be geared more towards addressing liquidity issues (liquidity support) or solvency issues (solvency (or capital) support). As a result, a distinction can be made between public funding that is available in the recovery phase, the resolution phase and the insolvency phase. This distinction furthermore differs depending on whether the public funding is available for banks and banking groups in the Eurozone (in scope of the SRMR) or banks and banking groups outside the Eurozone (in scope of the BRRD) (section 5.5.1.2).

8.3.2 Hurdles

Although the resolution framework restricts the access to EPFS and ELA, depending on in which phase (recovery, resolution or insolvency) and under which legal instrument (BRRD or SRMR) the public funds are used, there are still some hurdles in restricting such access.

First, the concepts of EPFS and ELA need further refinement in order to limit uncertainty and mitigate unintended consequences. An example is the (potential) qualification of alternative measures taken by deposit guarantee schemes as EPFS, as a result of which resolution is triggered, while alternative measures are only available outside of resolution (section 5.5.2.1). Secondly, public funding that addresses liquidity issues (liquidity support) is not sufficiently available for banks in resolution (section 5.5.2.2). Thirdly, both the State aid regime and the resolution framework prioritise maintaining financial stability above protecting public funds in a last resort situation. This means that sometimes taxpayers have to contribute to the losses of banks, in order to avoid any further – potentially catastrophic – losses and to ensure financial stability (section 5.5.2.3). Fourthly, there is a lack of backstops to public funding resources that are *not* provided by the Member States. The standing of a banking system depends on the strength and credibility of the backstop of the available resources, especially in the case of a full-blown systemic crisis. As long as this backstop is provided by the Member States, it will still be the Member States that will ultimately carry the burden of failing banks (section 5.5.2.4). Fifthly, it is still the prerogative of Member States to decide whether or not to grant State aid to a bank. The SRB and national resolution authorities cannot prevent a Member State from providing State aid to a failing bank. Only the Commission can order the repayment of unlawful aid in accordance with Article 108(2) TFEU. The resolution framework does, however, restrict this prerogative by setting access criteria with respect to certain forms of public funding, such as the GFST, precautionary guarantees and precautionary recapitalisation (section 5.5.2.5).

8.4 The exercise of State aid control by the Commission

This section summarises the assessment that has been made in Chapter 6 with respect to the impact of the resolution framework on the exercise of State aid control by the Commission.

8.4.1 *Impact of the resolution framework*

The State aid regime for the banking sector has not changed as a result of the introduction of the resolution framework. The Commission still assesses State aid awards to failing banks on the basis of the 2013 Banking Communication. This does not, however, mean that the resolution framework has not had its impact on the exercise of State aid control by the Commission.

At the institutional level
With the introduction of the resolution framework, the role of the Commission as State aid authority has been extended to the assessment of supranational EPFS, namely the use of the SRF. The resolution framework provides for the analogue application of State aid control to the SRF. Moreover, the resolution framework regulates the relation between the SRB and the Commission, as a result of which the SRB has to comply with similar obligations as the Member States when the SRF is used. Similar provisions apply with respect to the ESM DRI on the basis of the ESM Treaty and the ESM DRI Guideline (section 6.2.1).

In addition, with the introduction of the resolution framework, the Commission has acquired the new role of co-resolution authority within the SRM. This entails that the assessment of the discretionary aspects of the resolution decisions taken by the SRB is exercised by the Commission (together with the Council). The Commission has also been empowered to adopt delegated acts to specify further criteria or conditions to be taken into account by the SRB in the exercise of its different powers. Moreover, as an observer of the SRB's meetings, the Commission checks on an ongoing basis that the resolution scheme adopted by the SRB complies fully with the SRMR, balances appropriately the different objectives and interests at stake, respects the public interest and that the integrity of the internal market is preserved (section 6.2.2).

Lastly, the resolution framework has introduced the authority for the Commission to make an assessment when certain liabilities are excluded from the application of the bail-in tool under the BRRD or the SRMR. This is without prejudice against or for the assessment by the Commission under the State aid regime (section 6.2.3).

At the procedural level
Since the introduction of the resolution framework, the Commission has to apply the State aid regime for the banking sector on aid granted in resolution (resolution aid). This term is not included in the 2013 Banking Communication. It is not clear how the concept of resolution aid fits within the concepts of rescue, restructuring and liquidation aid. It seems, based on an assessment of the decisions from the Commission, that resolution aid can take the form of all three types of aid (section 6.3.1).

As a result of the fact that the 2013 Banking Communication does not include the concept of resolution aid, it is not clear which framework applies to the assessment by the Commission of this aid. Chapter 6 discusses the elements that can be established based on the Commission's decision practice with respect to the assessment by the Commission of resolution aid when notified by a Member State that it intends to grant resolution aid, both on an *ad hoc* basis and under a resolution aid scheme (sections 6.4.1 to 6.4.6).

In addition, the Commission has to assess State aid granted in the banking sector, not only on compatibility with the internal market, but also on compliance with intrinsically linked provisions of the resolution framework. This obligation of the Commission is in line with the jurisprudence of the EU Courts. It is not indicated in the resolution framework which provisions qualify as 'intrinsically linked' (section 6.3.2). [2] It can be read in the decisions taken by the Commission that it has considered a number of provisions to be intrinsically linked provisions, depending on the specifics of the resolution aid measure. In all of its decisions, the Commission assessed that these intrinsically linked provisions were not violated by the proposed aid measures without going into much detail (section 6.4.7).

State aid can also still be granted outside of resolution, in the form of precautionary guarantees, precautionary recapitalisation and liquidation aid. The Commission's decisions assessing precautionary guarantees and precautionary recapitalisation show that the access criteria set with respect thereto under the resolution framework are considered by the Commission to qualify as intrinsically linked provisions of the resolution framework. Liquidation aid is granted outside the scope of the resolution framework, as a result of which there are no intrinsically linked provisions

2 With the exception of Recital (57) BRRD.

of the resolution framework that impact the assessment of liquidation aid under the State aid regime for the banking sector. One exemption in that respect is that winding up in normal insolvency proceedings is only possible if resolution is not in the public interest (section 6.5).

8.4.2 Tensions

The institutional and procedural changes that the Commission faces as a result of the introduction of the resolution framework have created certain tensions for the Commission in its exercise of State aid control.

At the institutional level

There can be certain tensions between the different roles that the Commission fulfils, since, on the one hand it is involved in the decision to put a bank in resolution within the SRM – thereby restricting the access to EPFS –, while on the other hand it has to assess the compatibility of the proposed State aid measures with the internal market on the basis of the State aid regime for the banking sector. This tension is particularly clear when the decision is taken that resolution is not in the public interest, while the award of State aid is subsequently justified by the Commission to remedy a serious disturbance in the economy of a Member State. Chapter 6 has researched several root causes for this tension:

1. The Commission does not have the power to endorse the decision by the SRB concerning the assessment of the conditions for resolution without such a resolution scheme being adopted (section 6.6.1.1).
2. The cooperation between the Commission and the SRB has not been crystallized yet (section 6.6.1.2).
3. Retail investor protection may be the underlying rationale for the decision not to put a bank in resolution (section 6.6.1.3).
4. Resolution and State aid control may serve different purposes (section 6.6.1.4).
5. DG COMP and DG FISMA may have different priorities as a result of which the involvement of the Commission as co-resolution authority is not necessarily completely aligned with the involvement of the Commission as State aid authority. However, any service preparing a Commission decision or proposal must take account of the fact that the Commission as a whole will bear responsibility for the measure in question and must act accordingly, i.e. in conjunction with other services as appropriate (section 6.6.1.5).

At the procedural level
Another potential for tension is created by the fact that two sets of rules may have to be taken into account by the Commission, when assessing State aid measures in the banking sector. These sets of rules are not always coherent, as could be seen in Chapter 6 in the example of precautionary guarantees and the exercise of the PONV conversion power. In section 6.6.2.1, it is argued that there is no hierarchy between the State aid regime for the banking sector and the resolution framework and that measures adopted by Member States and EU institutions should be consistent with both the State aid regime and the resolution framework. This means that if there is any inconsistency between these rules, either the State aid regime or the resolution framework should be amended (section 6.6.2.1). This tension is intensified by the fact that the 2013 Banking Communication has not been updated since its introduction (section 6.6.2.2) and exacerbated by the lack of harmonisation of the national insolvency regimes (section 6.6.2.3).

8.5 The restructuring process of a failing bank

This section summarises the assessment that has been made in Chapter 7 with respect to the impact of the resolution framework on the restructuring process of a failing bank.

8.5.1 Impact of the resolution framework

The restructuring process of a failing bank has been impacted at three different levels by the resolution framework.

At the level of the restructuring process
The first impact is at the level of the applicable restructuring process. The resolution framework has introduced its own restructuring process besides the restructuring process under the State aid regime, but only in case the bail-in tool is applied as a 'going concern' solution (that is, for recapitalisation purposes). When resolution involves the use of another resolution tool, the resolution framework does not provide for a restructuring process (section 7.2.1.1). The resolution framework also does not provide for a restructuring process outside of resolution (e.g. in the case of precautionary recapitalisation) (section 7.2.1.2). The restructuring processes under the State aid regime for the banking sector and the resolution framework can take place simultaneously, namely, in case resolution involves the award

of State aid and the bail-in tool is used for recapitalisation purposes. This may be the case when the GFST are used. At the time of writing this dissertation, there have been no examples yet of cases where the restructuring processes under the State aid regime for the banking sector and the resolution framework take place simultaneously (section 7.2.3.1). If the restructuring processes apply simultaneously, this may cause friction since these are not completely aligned (section 7.2.3.1 and 7.2.3.2).

In addition, the resolution framework has introduced the possibility for competent authorities and resolution authorities to impose *ex ante* restructuring measures on the basis of the recovery and resolution plans. These restructuring measures can be imposed before a bank experiences financial difficulties. This has a true added value compared to restructuring under the State aid regime, which always takes place on an *ex post* basis (sections 7.2.1.3 and 7.2.3.3).

At the level of competences
The second impact is at the level of the competences of the authorities involved in the restructuring. With the introduction of the resolution framework, a new 'restructuring authority' – besides the Commission – is introduced in the form of the resolution authority (section 7.3.1.2). As a result of the resolution framework, the Commission has to work together with the resolution authorities and *vice versa* in order to ensure an efficient restructuring process. Although it may be presumed that the premise of close liaison applies with respect to the cooperation between the Commission and the resolution authorities, the resolution framework and the State aid regime for the banking sector do not provide for any specific guidance with respect to it (section 7.3.2).

In addition, the introduction of the resolution framework has significantly increased the number of decisions that a bank can be faced with, with respect to its restructuring process. These decisions can be both from national and European decision makers, which may make it necessary for the bank (or its shareholders or creditors) to start legal proceedings both at national and European levels (section 7.3.3).

At the level of the obligations of shareholders/creditors of the failing bank
Lastly, the resolution framework introduces some changes with respect to burden-sharing. First, it introduces the power for the resolution authorities to exercise the PONV conversion power or to use the bail-in tool to impose a burden-sharing requirement (section 7.4.2). Secondly, burden-sharing

under the resolution framework can include senior debt (section 7.4.2.1). Thirdly, the resolution framework requires a bail-in of 8% of total liabilities and own funds of the bank when certain public funding sources are used. When the ESM DRI or alternative financing sources are used, all unsecured, non-preferred liabilities other than eligible deposits have to be written down or converted in full (section 7.4.2.2). Fourthly, the resolution framework does not provide for the possibility to deviate from the burden-sharing requirement when burden-sharing measures would endanger financial stability or lead to disproportionate results. However, certain eligible liabilities are excluded from the scope of the bail-in tool or may be excluded by the resolution authority (section 7.4.2.3).

8.5.2 Challenges

The introduction of the resolution framework has caused certain challenges in relation to the restructuring process of a failing bank.

At the level of the restructuring process

Firstly, a bank that is put in resolution with the assistance of State aid can be confronted with diverging restructuring processes as a result of colliding competences. In addition, a bank can be faced with restructuring obligations under the State aid regime for the banking sector, when there are no restructuring obligations under the resolution framework. For example, the resolution framework does not provide for a restructuring process in the case of precautionary recapitalisation. As a result, the restructuring process in case of precautionary recapitalisation is solely governed by the State aid regime for the banking sector. There is no role for the resolution authority in that case (section 7.5.2.1).

In addition, the resolution framework only sets out the criteria for the restructuring process of a bank in resolution when the bail-in tool is applied with the objective of restoring the capital of the failing bank to enable it to continue to operate as a *going concern*. The reason behind this may be that the bail-in tool is the only resolution tool that is considered a 'going concern' solution. In the author's view, there are also, however, other situations in which the application of a resolution tool could be qualified as a 'going concern' solution. For example, the application of the bridge bank tool or sale of business tool may lead to the transfer of all shares in the failing bank to a bridge bank or third party. The resolution framework currently does not provide for a restructuring process in that respect. In addition, the asset separation tool (accompanied by the bail-in tool) could be applied to transfer impaired assets from a failing bank to an asset management vehicle, while the critical functions remain with the failing bank. In that case, the bank is only subject to a restructuring process, if the bail-in tool is applied for recapitalisation purposes (section 7.5.2.2).

Furthermore, the resolution framework does not provide for proportional application of the requirements as to the contents of the business reorganisation plan, while this is provided for with respect to the restructuring plan under the State aid regime for the banking sector (section 7.5.2.3).

Lastly, the resolution framework does not provide for transparency of the business reorganisation plan. As a result, the restructuring process of a bank that is put in resolution without the use of EPFS is less transparent than the restructuring process of a bank that is put in resolution with the use of State aid (section 7.5.2.4).

At the level of competences
The State aid regime for the banking sector and the resolution framework both lack provisions that govern the cooperation between the Commission and the resolution authorities with respect to the restructuring process of a failing bank. This may be detrimental to an efficient and orderly restructuring process (section 7.5.3.1), especially because it is not clear how the competences of the Commission and the resolution authorities relate. For example, a question that may arise is whether the Member States and the Commission, when discussing a restructuring plan under the State aid regime, are in any way bound to the measures set out in the recovery and the resolution plan. Another question may be whether the Commission can desire more far-reaching restructuring measures from Member States than provided for in the resolution plan or set out in the business reorganisation plan (section 7.5.3.2). Lastly, effective judicial protection may be jeopardized by the resolution framework, since it may now be necessary to start legal proceedings against multiple authorities at multiple courts. This is not only very costly, but also time consuming while normally large stakes are at risk (section 7.5.3.3).

At the level of the obligations of shareholders/creditors of the failing bank
The resolution framework defines a standard burden-sharing cascade, which may include senior debt, and a mandatory bail-in threshold when certain public funding sources are used. There is, however, no 'one size fits all' approach when it comes to burden-sharing allocation when a bank fails. This has already led to artifices of Member States to deal with an

(both financial and political) undesirable outcome, as a result of which, burden-sharing has not only become controversial, but also conveys the impression of arbitrariness (section 7.5.4.1). This effect is reinforced by the fact that the ability of the bail-in tool under the resolution framework to perform as intended is restricted as long as (i) investors do not understand the risk of bail-in and are therefore not able to charge adequate risk premiums and thus exert meaningful market discipline on banks, (ii) investors do not have sufficient loss-bearing capacity to incur a loss when their debt is bailed-in, and (iii) a bail-in endangers the health of other banks, because these are the holders of the bail-inable debt (section 7.5.4.2).

In addition, the resolution framework is more focused on the failure of an individual bank (idiosyncratic shock), while the State aid regime for the banking sector is developed in the midst of a systemic crisis. Idiosyncratic shocks and systemic crises can call for different approaches. While burden-sharing may contribute to financial stability in case of an idiosyncratic shock, this may be different when the whole banking sector fails. Requiring a bail-in of 8% of total liabilities and own funds of the bank to have access to public funding may not be realistic in that situation (section 7.5.4.3).

8.6 Potential steps to address challenges

This section discusses the potential steps that can be taken to address the hurdles, tensions and challenges that have been identified in the impact assessments, as summarised in the previous sections. Some steps will be easier to implement than others. Where proposed steps are more abstract or dependent on political consensus, they are meant to stir the discussion and point towards further development of regulation of public funding to failing banks within the EU.

8.6.1 Further refinement of concepts of EPFS and ELA

In order to ensure that the concepts of EPFS and ELA are correctly used, and also taking into account the consequences that are attached under the resolution framework to the qualification of public funding as EPFS or ELA, the author suggests to make the following amendments to the resolution framework:

1. Clarify that ELA does not qualify as EPFS, unless it qualifies as State aid, taking into account the conditions set out in the 2013 Banking Communication.
2. Supplement the objective of EPFS with "*or to resolve the bank or its group by applying resolution tools and powers*" in order to clarify that the use of the national resolution funds and the SRF always qualifies as EPFS.
3. Provide that alternative measures taken by deposit guarantee schemes in accordance with Article 11(3) DGS Directive do not qualify as an FOLTF indicator, similar to precautionary guarantees and precautionary recapitalisation and independent of their qualification as State aid.
4. Introduce a definition of solvency in relation to precautionary recapitalisation and guarantees. As soon as Eurosystem Resolution Liquidity (ERL) is available, it may in addition be possible to use the same definition of solvency, both in relation to ELA and ERL.

8.6.2 Introduction of an inclusive funding profile

It is the author's view that it is more important to find the right balance between financial stability and the protection of public funds than to restrict the use of public funds against all costs. This view fits the interpretation that the objective of protecting public funds aims at introducing a public funding cascade in order to protect taxpayers' money. The exact structure of this public funding cascade can differ per bank, depending, *inter alia*¸ on the financial difficulties that the bank faces and the legal instrument (BRRD or SRMR) under which the public funds are applied.

In the author's view, it would be beneficial if banks were required to prepare a public funding cascade as part of their funding profile (hereinafter referred to as an inclusive funding profile). This inclusive funding profile should not only describe the private funding resources, but also the public funding resources that are available when a bank gets into financial difficulties, both as a result of an idiosyncratic shock and systemic crises. It should not be restricted to the resolution phase, but also discuss the funding resources that are available in the recovery and insolvency phase. An assessment of the access criteria for the different public funding resources should also be part of the inclusive funding profile, so that banks are prepared for and aware of the different steps that may have to be taken to gain access to the respective public funding resource.

Although the author by no means argues, that banks should assume reliance on public funding sources, drafting an inclusive funding profile may contribute to an efficient and smooth use of funds available to restore the financial position of the bank or to wind up this bank in an orderly manner. Already, the resolution plan needs to include an explanation by the resolution authority as to how the resolution options could be financed. In addition, the recovery plan needs to set out the range of capital and liquidity actions required to maintain or restore the viability and financial position of the bank. This, however, excludes the use of EPFS, such as resolution financing by the deposit guarantee schemes or precautionary guarantees and recapitalisation in the recovery phase. In addition, any public funding resources required for the winding up of a bank in an orderly manner in normal insolvency proceedings are beyond scope of these plans.

If all banks were to prepare an inclusive funding profile, this would give better insight into the appeal that banks might make to public funding resources. This may contribute to ensuring that these public funding resources are sufficient and may give input that can be used for the further development of the public funding cascade.

8.6.3 Preparation of a permanent State aid regime for the banking sector

Taking into account that it is highly likely that banking crises will continue to take place in the future, it is the author's view that the establishment of a permanent State aid regime for the banking sector will contribute to the objective of financial stability while enhancing the legal certainty. Already the European Parliament called on the Commission to assess the recovery and resolution of banks in the light of State aid rules, to examine regulation in the light of the BRRD and to propose transparent application of the rules on State aid in relation to the BRRD.[3] Below, the author addresses the elements that should, in her view, form part of such a permanent regime for the banking sector.

The legal basis for the State aid assessment

Creating a permanent regime can in the author's view not take place without changing the legal basis for the State aid assessment in the banking sector. The Commission has always emphasised that the application of Article 107(3)(b) TFEU remains possible only as long as the crisis situation persists, creating genuinely exceptional circumstances where financial

3 EP Annual Report Resolution 2018, under 26.

stability is at risk. The European Parliament also recalls the strict requirements for this application.[4] As discussed in section 5.3.2.2 and section 6.6.1.4, the Commission is struggling with these requirements, as it asseses that Article 107(3)(b) TFEU can also be used when aid is necessary to *avoid* (instead of remedy) a serious disturbance in the *regional economy* (instead of the whole economy) of a Member State. The Commission seems to stretch the scope of Article 107(3)(b) TFEU contrary to the strict interpretation of the EU Courts.

A shift back to Article 107(3)(c) TFEU, however, seems undesirable. First, although this is more a technical concern, the resolution framework is currently based on the assumption that the legal basis for the State aid assessment is Article 107(3)(b) TFEU. An example thereof can be found in the access criteria for precautionary guarantees and recapitalisation. If the legal basis for the State aid assessment shifts to Article 107(3)(c) TFEU, precautionary guarantees and recapitalisation may no longer be available. This could, however, be solved by amending the resolution framework at this point. Secondly, and more importantly, the public policy objective that underlies Article 107(3)(c) TFEU (that is, facilitation of the development of certain economic activities or of certain economic areas) does not fit the public policy objective that is pursued with aid measures in the banking sector (that is, to safeguard financial stability by preventing spillover effects on other banks and on the real economy via the lending channel).

As Article 107(3)(b) TFEU seems to give insufficient leeway to the Commission for its assessment and the public policy objective underlying Article 107(3)(c) TFEU is a mismatch, the only solution seems to be the creation of a special exception under Article 107(3) TFEU for aid measures in the banking sector. The Council can create such a specific exception on a proposal from the Commission.[5] Creating a specific exeption for the State aid assessment by the Commission in the banking sector would provide the possibility to further align the State aid regime with the resolution framework, in particular with respect to the ‘public interest’ test.

The assessment framework

The new exception under Article 107(3) TFEU could form the basis of a sectoral policy expressing the coherence between the framework of State aid control and the supervisory and regulatory framework for the banking

4 EP Annual Report Resolution 2018, under 28.
5 See section 3.4.1.1.

sector. In this assessment framework, the distinction can be made between aid granted in resolution (resolution aid) and aid granted outside of resolution (precautionary guarantees, precautionary recapitalisation and liquidation aid). Within the concept of resolution aid, many different aid measures are captured. The specifics of these aid measures and the resolution procedure should be taken into account in the new assessment framework. Additionally, the development towards centralised public funding resources (supranational EPFS) should be striven for in the new assessment framework.

In addition, it would be helpful if the assessment framework addresses the assessment that is made by the Commission whether aid measures violate intrinsically linked provisions of the resolution framework. Inconsistencies between the State aid regime and the resolution framework could be resolved in the revision of the State aid regime, unless this is better addressed in a revision of the resolution framework. This concerns in particular the burden-sharing requirements, but also, for example, the valuations.

Procedural arrangements
Time pressure is no exception, but the rule when a bank fails. State aid procedures can take a long time due to the negotiations between the Commission and the Member State. This may lead to an exaggeration of the financial difficulties that a bank faces.[6] It is therefore of the essence that a new regime for State aid control in the banking sector sets sharp timelines. This may even be a reason to replace the *ex ante* assessment by the Commission with an *ex post* assessment in certain circumstances.

8.6.4 Harmonisation of normal insolvency proceedings

According to the SRB, the harmonisation of insolvency regimes and their improvement from a resolution perspective remains essential to increase the effectiveness of the resolution regime. Currently, the SRM framework is faced with 19 or more different insolvency procedures in the European Banking Union.[7] The SRB also states that recent cases highlighted the prevailing need for an eventual harmonisation of national insolvency laws. The failing or likely to fail (FOLTF) assessment does not automatically link to the criteria for insolvency/liquidation. Similarly, the assessment regarding the NCWO principle uses insolvency as the counterfactual scenario.

6 Hellwig 2017-1, p. 17-18.
7 SRB, Work Programme 2019, p. 4.

Only by establishing harmonised standards in this regard can identical outcomes in all Member States be ensured of these evaluations.[8]

> In its review of the resolution framework, the Commission already announced that it launched a study to get a better understanding of the issues and identify potential policy options for harmonisation.[9] In addition, BRRD II introduces a new Article 32b which requires Member States to ensure that a bank in relation to which the resolution authority considers that the resolution conditions, besides the public interest condition, are met, should be wound up in an orderly manner in accordance with the applicable insolvency law.

8.6.5 Distinction between rescue and restructuring resolution

Currently, the resolution framework provides for precautionary guarantees and precautionary recapitalisation. Through these, it is possible for Member States to provide State aid without triggering resolution, including a mandatory threshold for bail-in. Since this takes place outside of resolution, the resolution authorities are not involved in cases where banks are assisted through precautionary guarantees or precautionary recapitalisation. In the author's view, it would be better to include precautionary guarantees and precautionary recapitalisation in the resolution process. This means that precautionary guarantees and precautionary recapitalisation will no longer be excluded as a trigger for resolution, and the resolution authority will be involved in the decision-making process, including the implementation of the guarantees or recapitalisation.

In order to do this, it will be necessary to make a further distinction between the funding needs of the bank and the applicable burden-sharing requirements. The State aid regime for the banking sector can be taken as an example. Within this regime, a distinction is made between the assessment of rescue and restructuring aid. No burden-sharing requirement applies with respect to rescue aid, unless the aid cannot be reimbursed within two months. In that case, the rescue aid should be followed up by restructuring or winding up in normal insolvency proceedings, as part of which a burden-sharing requirement applies. Within the resolution framework a same distinction could be created between 'rescue resolution' and 'restructuring

8 König 2018.
9 EC Report on application and review resolution framework 2019, p. 9. See also EP Liquidation In-Depth Analysis 2019, p. 14-21 on the question whether the EU needs a harmonised liquidation regime.

resolution'. The rescue resolution would cover the 'precautionary guarantee and precautionary recapitalisation tools', while the restructuring resolution would cover the use of the resolution tools.

> In case of rescue resolution in the form of a precautionary guarantee, no burden-sharing requirement (in the form of the exercise of the PONV conversion power) should apply, unless the aid is not reimbursed within two months. In that case, the rescue resolution should be followed by a restructuring resolution which triggers the burden-sharing requirement (in the form of the exercise of the PONV conversion power and, potentially, the application of the bail-in tool) or winding up in normal insolvency proceedings. In case of rescue resolution in the form of precautionary recapitalisation, the burden-sharing requirement should be applied conform the guidance that has been published by the Commission with respect to rescue recapitalisations,[10] unless the precautionary recapitalisation takes place in the form of restructuring aid. In that case, it should be seen whether the burden-sharing requirement under the resolution framework should be alleviated, taking into account that the bank is still solvent.[11]

8.6.6 Business reorganisation plan for all 'going concern' solutions

The restructuring process under the resolution framework could in the author's view be improved by providing that a business reorganisation plan is not only required in case the bail-in tool is applied for recapitalisation purposes, but also when a transfer tool is applied as a 'going concern' solution (e.g., when this tool is used to transfer all shares in a bank to a new shareholder, or when the asset separation tool is used, while the failing bank remains on the market). In that situation, the bank will also remain on the market as an autonomous entity, which in the author's view justifies the restructuring of that bank (where applicable, in cooperation with the purchaser). Imposing the requirement to prepare a business reorganisation plan for all 'going concern' solutions may contribute to a level playing field, since this ensures that the restructuring takes place along the same lines.

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10 See section 3.5.4.2. For rescue recapitalisations and rescue asset relief measures, burden-sharing must be complied with either as part of the rescue aid or the aid must be arranged in a manner that allows for the implementation of the burden-sharing measures in the restructuring or liquidation phase.

11 See also section 3.7.1.2.

In the author's view, competition concerns can arise when a bank in resolution continues as an autonomous entity, even if no State aid is involved. When a bank is put in resolution, the resolution authorities can exercise powers that interfere in the relations that banks have with third parties, such as their shareholders and creditors. Banks that are not put in resolution cannot interfere in the same way in the relations that they have with their third parties. This may create distortions in the level playing field. These competition concerns should be addressed by the resolution authorities, preferably in a business reorganisation plan.[12]

Requiring a business reorganisation plan for all 'going concern' solutions may also contribute to a level playing field in another way. The business reorganisation plan is drafted with the purpose of restoring the long-term viability of the bank. The restructuring plan that needs to be prepared when State aid in the form of restructuring aid is granted has the same purpose. Requiring a business reorganisation plan for all 'going concern' solutions ensures that competition concerns are addressed when a bank in resolution continues as an autonomous entity – also when no State aid is involved and therefore no restructuring plan is prepared.

In the author's view, it would be an improvement if the resolution framework also provides for a restructuring process of a bank that is subject to precautionary recapitalisation. In this case, it should, however, be possible to apply the restructuring obligations proportionally, similar to the State aid regime for the banking sector.

8.6.7 The creation of an integrated restructuring process when EPFS is involved in resolution

When a bank is put in resolution with the assistance of EPFS (e.g. in case the bail-in tool is applied as a 'going concern' solution, but see also section 8.6.6) it is confronted with the restructuring process and obligations under the State aid regime for the banking sector and the restructuring process and obligations under the resolution framework. This brings up the question whether it would be possible to apply one integrated restructuring process when a bank is put in resolution with the assistance of EPFS. Taking into account that the business reorganisation plan and the restructuring plan both have the objective of restoring the long-term viability of the bank, it may be possible to combine both plans into one plan. This

12 See also Article 6(2) SRMR.

integrated restructuring plan could then cover the measures to restore the long-term viability of the bank, the measures to limit the distortion of competition and the monitoring arrangements. In addition, as part of the plan, the management body and senior management of the bank should be replaced, except when the retention thereof is considered necessary for the achievement of the resolution objectives. By integrating the restructuring obligations these may be streamlined, while the administrative and regulatory burdens of banks may be alleviated.

If one integrated restructuring plan can be prepared, this also triggers the question whether it would be possible to appoint one authority as the appropriate authority to assess and monitor this plan. In the author's view, this authority could be the resolution authority (the SRB or the national resolution authorities) or the Commission. While the Commission has extensive experience with the restructuring of banks as a result of its State aid decisions, the resolution authorities have access to the resolution tools and powers. When State aid is involved in the restructuring, this integrated restructuring plan will have to be assessed by the Commission to ensure compliance with the State aid regime for the banking sector. In the author's view, this assessment could, however, be limited to a check on how the distortion of competition is being prevented, while the resolution authorities will be responsible for the assessment whether the long-term viability of the bank is restored.[13] The monitoring could be done by a person or persons appointed by the resolution authority and the Commission together.

8.6.8 Refinement of burden-sharing requirements

In the author's view, burden-sharing should not take place against all costs. In practice, it has already been seen that this is not desirable and leads to destructive[14] behaviour among Member States. Nonetheless, it is the author's view that burden-sharing requirements under the resolution framework and State aid regime for the banking sector should be streamlined in such a way that the State aid regime for the banking sector requires similar burden-sharing as the resolution framework.[15]

13 As a result, the Commission's approach to State aid in the banking sector may – finally – no longer be 'industrial policy in disguise' (Lannoo 2010, p. 40-42).

14 See also Donnelly and Asimakopoulos *JCMS* 2019, who refer to a 'willingness to bend and even break EU rules' (p 4).

15 See also IMF Country Report 2018, p. 21.

At the same time, certain correction mechanisms should be introduced or refined within the resolution framework. First, the principles and safeguards that apply when the bail-in tool is used should also apply when the PONV conversion power is exercised, whether this is in resolution or outside it; especially taking into account that BRRD II and SRMR II introduce a new definition of eligible liabilities, as a result of which the scope of the PONV conversion power is extended.

Secondly, a financial stability exemption for the banking sector, as we know it under the State aid regime, should be introduced, allowing for discretion in the exercise of the PONV conversion power and the use of the bail-in tool.[16] This makes it possible for the resolution authority to exempt certain liabilities from the scope of the burden-sharing requirement when this would endanger financial stability or lead to disproportionate results: for example, in case the failure of the bank is caused by or contributes to a systemic crisis. This exemption should be accompanied by certain safeguards, such as the NCWO principle.[17]

Thirdly, the burden-sharing requirement should not apply when the SRF or national resolution funds step in to cover losses or recapitalise a bank. This will reduce the hurdle to make use of the SRF or national resolution funds.

Fourthly, a distinction should be made between solvency and liquidity support. As discussed in section 8.6.5, application of the burden-sharing requirement in case of liquidity support, such as precautionary guarantees, is not line with the State aid regime for the banking sector. This form of support is considered less distortive than solvency support, as a result of which burden-sharing may not offset the consequences thereof for the shareholders and creditors. Instead of requiring burden-sharing, more attention could be paid towards remuneration, collateral and the temporality of the liquidity support.

16 IMF Country Report 2018, p. 30.

17 Some authors argue that even the exemption under the State aid regime for the banking sector is too narrow. (Babis *LFMR* 2016, p. 170).

8.7 Towards further centralisation of public funding (regulation) within the European Banking Union

This section discusses how the regulation of public funding to failing banks could be further centralised within the European Banking Union. This is a logical, but – unfortunately – highly controversial step in completing the European Banking Union. Outside the European Banking Union, the Member States, while guided by the Commission as the State aid authority, will have to continue regulating public funding in the absence of political consensus to further centralise this regulation.

8.7.1 Centralisation of public funding

As long as Member States remain necessary for the provision of public funding to failing banks, it remains within the remit of the Member States to award this funding. In the author's view, this is undesirable, because it makes banks dependent on their Member States. The author therefore argues that public funding should be centralised within the European Banking Union (see this section), while the SRB becomes the authority that decides on the use of this public funding with the approval of the Commission (see section 8.7.2).

Steps have already been taken to create centralised public funding within the European Banking Union. One could think of the SRF, with the ESM DRI being transformed into its future backstop, the potential development of ERL and the intended introduction of the EDIS. There are, however, some further steps that could be taken.

First, ELA could be provided by the ECB instead of the national central banks. Should ERL be established in the form of a liquidity facility that can be provided by the ECB in resolution, centralisation of ELA may help to best coordinate the provision of liquidity. Since ELA prevents a bank from needing to be resolved due to only a temporary liquidity shortage, it regulates the access to ERL. It therefore makes sense that both ELA and ERL are overseen by the ECB. Also Mario Draghi, the President of the ECB, clearly called for a change of the existing ELA rules in the Eurosystem, saying, "*I personally have argued several times toward a centralization of ELA. This is a remnant of a past time*".[18]

18 EP Financing Arrangements Briefing 2018, p. 12.

In addition, a facility could be introduced to provide public funding for precautionary recapitalisation and guarantees within the European Banking Union. This could potentially be the SRF. In that case, the SRB can decide on the use of the precautionary guarantee and precautionary recapitalisation tools, instead of the Member States. This would also contribute to the introduction of 'rescue resolution' (as described in section 8.6.5), as the Member States would no longer be involved in providing the funding that is required for the 'precautionary guarantees and precautionary recapitalisation tools'.

Lastly, a facility could be introduced for the insolvency phase that can assist in the winding up of a bank in an orderly manner– or the integration of the economic activities of the bank in the organisation of a buyer as part of the winding up process. Currently, the Member States provide this assistance, also in the absence of harmonised insolvency proceedings in the EU. If a bank liquidation tool is introduced (see section 8.7.4), creating a central insolvency facility could be part of that.

8.7.2 Designation of the SRB as centralised public funding authority

A further step would be to centralise the decision-making powers with respect to the use of public funding resources within the European Banking Union, other than ELA and ERL, at the SRB. This would go hand in hand with the further centralisation of public funding resources within the Eurozone as discussed in the previous section. If the SRB is designated as an independent EU institution, similar to the ECB,[19] this would eliminate the need for the involvement of the Commission in the decisions of the SRB. This would be helpful in the further development of the tasks and responsibilities of the SRB.

> It is questionable whether such a designation will take place soon, as the Commission indicated in its review of the resolution framework that there are not sufficient elements at this stage to suggest changes in the legal status of the SRB given its recent creation and limited practical experience.[20] In addition, a complication in that respect is the involvement of national resolution authorities in the resolution of less significant banks or banking groups that are not directly supervised

19 See IMF Country Report 2018, p. 27. See also Véron 2019, p. 19-20.
20 EC Report on application and review resolution framework 2019, p. 12.

by the ECB or that are not pan-European banking groups, unless it is provided that the SRB always is the competent resolution authority where resolution involves the use of public funding.[21]

In the author's view, the Commission should be the authority that assesses whether the centralised public funding means do not violate distortion of competition between the Member States, most notably between Member States in and outside the European Banking Union. There are, however, also other views. According to the IMF, consideration should be given to paring back procedures for State aid oversight for resolution decisions taken by the SRB, given the lower risk of distorting competition for national interest.[22]

Hellwig argues that, because financial stability, systemic risk and costs to taxpayers are not the primary focus of State aid control, there is a danger that measures undertaken in State aid control may sometimes be too strict and sometimes too lenient.[23] In addition, he mentions that the State aid procedure takes time. During this time, the situation of the banks may worsen, the recapitalisation needs may become larger and the bail-in-able creditors may run.[24] In the author's view, these risks will be mitigated if the Commission focuses on preventing the distortion of competition, while the SRB focuses on the financial stability and systemic risk assessment, in cooperation with the ECB and national competent authorities. The Commission can even use this assessment by the SRB to balance the positive effects of State aid against the distortion of the competition, which could in turn also contribute to the further alignment of the 'public interest' test and the State aid assessment. Costs to the taxpayers is a topic that needs to be addressed in the assessment by both the Commission and the SRB from their respective angles. With respect to the time delay, the Commission has already shown during the GFC that it is willing to deviate

21 See Article 7(3), second paragraph, SRMR in respect of the use of the SRF.

22 IMF Country Report 2018, p. 21. The IMF mentions that this could be achieved by introducing a new exemption under Article 107(3)(e) TFEU. This does not, however, exempt the Commission from making an assessment; that could only be achieved through extending the scope of the General Block Exemption Regulation (GBER) to include aid granted in case a resolution decision is taken by the SRB. Taking into account the distortive nature of resolution aid, however, this would not be desirable; although the author does concur with the IMF that a new exemption should be created under Article 107(3)(e) TFEU (see section 8.6.3), there should still be an assessment by the Commission.

23 Hellwig 2017, p. 24.

24 Hellwig 2017, p. 20.

from the procedural outline set out in the Procedural Regulation and can act swiftly. It is therefore the author's view that the Commission would be the most appropriate authority to assess centralised public funding within the European Banking Union, while the SRB would be the most appropriate authority to decide on the use of such public funding.

8.7.3 Elimination of the role of Member States in the restructuring process

Section 8.6.7 discussed the possibility of creating an integrated restructuring process when EPFS is involved in resolution. A complicating factor in that respect is the role of the Member States: while they play a role in the restructuring process under the State aid regime, they have no role in the restructuring process under the resolution framework. The question is, however, whether the Member States within the European Banking Union should still have a role in the restructuring process of a bank. It may make more sense to make the resolution authority responsible for preparing the integrated restructuring plan with the assistance of the competent authority and the bank, thereby following the division of competences under the SRM and SSM.

> If a further centralisation of public funding sources takes place, as discussed in section 8.7.1, this will also lead to further elimination of the role of Member States.

8.7.4 Introduction of a bank liquidation tool

The IMF recommends including an administrative bank liquidation tool for all banks within the SRB's remit and banks considered systemic at the time of their failure.[25] This recommendation requires harmonisation of the national insolvency proceedings followed by centralisation of insolvency powers at the level of the SRB. This is however not expected to happen in the foreseeable future. Introduction of a bank liquidation tool for the SRB would solve the issue of the 'public interest' test under the resolution framework, as the SRB would have the power to decide over the future of a failing bank both inside and outside of resolution. After all, the 'public interest' test not only determines whether or not a bank should be put in resolution, but currently also determines whether the power to decide over the future of a failing bank rests with the SRB (when the bank is put in resolution) or the Member State (when the bank is wound up in normal insolvency proceedings).[26]

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25 IMF Country Report 2018, p. 22-23, 30.
26 Binder 2018, p. 8.

When resolution is not in the 'public interest', the failing bank will have to be wound up in normal insolvency proceedings. These proceedings sometimes do not even differ that much from the resolution proceedings in terms of the outcome. They do, however, establish the decision-making powers at national level and leave room for the Member States to award State aid without the application of the mandatory bail-in threshold. The introduction of an administrative bank liquidation tool for the SRB could potentially contribute to the purity of the 'public interest' test, as it would remove the political charge from the test. However, if insolvency powers are also centralised at the level of the SRB, besides resolution powers, it may be necessary to rethink necessary checks and balances in order to ensure the sound exercise of these combined powers.

8.8 Reflection and final thoughts

This dissertation started with the observation that the GFC revealed inadequacies in the institutional and regulatory framework for the banking sector to safeguard the stability of domestic financial markets and the single financial market as a whole; to break the link between Member States and banks; and to limit the risks of moral hazard. Although the previous sections described how the resolution framework impacted the State aid regime for the banking sector, what challenges exist as a result of the co-existence of the resolution framework and the State aid regime, and what potential steps can be taken to address these challenges, it left the key question unaddressed: Did the resolution framework contribute to solving the inadequacies that the GFC revealed? The answer to that question is still difficult to give, considering that the resolution framework is still relatively young and unused. However, certain observations can already be made.

> Most cases of failing banks since the introduction of the resolution framework have been solved outside resolution. In the author's view, however, this is not a sign that the resolution framework is not efficient. Sometimes, the preventive and dissuasive effect can already achieve the desired behaviour. The author proposes that the possibility to bail-in senior debt is an example.

8.8.1 Breaking the link between banks and Member States

One of the author's working assumptions was that the promise that the resolution framework avoids taxpayers losses is empty without a Fiscal Union being in place. Through the research the author conducted for this dissertation, she came to the conclusion that the resolution framework is used as a tool to take steps towards a Fiscal Union, just like State aid policy led to resolution harmonisation across the EU.

The resolution framework has not changed that it is the prerogative of Member States to decide whether or not to grant State aid to a bank, even though this is restricted by State aid control and by the agreements set out in the Fiscal Compact Treaty. The SRB or the national resolution authorities cannot prevent a Member State from providing State aid to a failing bank. The current resolution framework does, however, restrict the prerogative of the Member States to award State aid, as a result of which the link between banks and Member States has become weaker. First, it has introduced conditions that the Member States have to comply with when awarding State aid. Examples thereof are the conditions that have to be met in order to have access to GFST and precautionary recapitalisation. If Member States do not comply with these conditions when awarding these forms of State aid, they would be violating the resolution framework. This differs from the conditions set out in the State aid regime for the banking sector: under this regime it is possible for Member States to notify to the Commission aid measures that they consider to be compatible with Article 107(3)(b) TFEU *without* meeting the conditions set out in the State aid regime for the banking sector, and the Commission may authorise this in exceptional circumstances.

Secondly, the resolution framework introduced the SRF, a supranational form of funding. The Member States do not play a role in the decision whether or not to use the SRF, since the relevant decision-maker in that case is the SRB.[27] During the GFC, 'taxpayers' money' was the main source of funding for failing banks, because access to other funding resources was not secured. There were no supranational funds available, such as the SRF or the ESM. The only other funding resources that were available at the time of the GFC were ELA awarded by the national central banks and contributions from national deposit guarantee schemes, notwithstanding the lack of a uniform regime within the EU.

27 The use of large amounts from the SRF, however, requires a decision taken by the SRB in its plenary session. See also Busch, Van Rijn and Louisse *EBLR* 2019, p. 593.

Thirdly, a link has been created between the award of public funding and the resolution procedure,[28] with the result that the resolution authority is involved when a Member State intends to award State aid. When said authority is the SRB,[29] this may safeguard that national interests cannot be pursued at the expense of the general interest. However, as long as the SRB still has to deal with Member States, both regarding the availability of public funding and regarding the applicability of normal insolvency proceedings, the resolution framework will not be able to fully live up to its promise.

8.8.2 Addressing moral hazard

Whether the resolution framework sufficiently addresses moral hazard is a controversial topic.[30] It is often mentioned that the moral hazard risk is mitigated by ensuring that each bank can fail. After the introduction of the resolution framework, winding up a bank through normal insolvency proceedings is considered the default option.[31] As long as Member States can use their insolvency proceedings to award State aid to banks without triggering the bail-in requirements under the resolution framework, the moral hazard risk will, however, still be present.

In addition, the resolution framework seems to focus on limiting the risk of 'moral hazard' not the level of the bank, but at the level of the shareholders and creditors of a bank, since they are the ones that can now be forced to contribute to a failing bank.[32] Under the State aid regime for the banking sector, shareholders and creditors of banks cannot be forced by the Commission to contribute to failing banks. The Commission can only disapprove of the State aid award by the Member State. As a result, any measures taken in relation to third parties needed either to be implemented in cooperation between the bank and its stakeholders, or to be imposed by the Member State through national legislation. This is different under the resolution framework, since the resolution authorities can

28 With the exception of precautionary guarantees and precautionary recapitalisation!
29 Within the European Banking Union, this is the SRB, where it concerns significant banks and banking groups directly supervised by the ECB as well as other pan-European banking groups.
30 Avgouleas and Goodhart 2019, p. 4, 9.
31 König 2017.
32 Avgouleas and Goodhart mention specifically large shareholders as one out of the two constituents (the other being the bank management) whose opportunistic behaviour is the key source of moral hazard (Avgouleas and Goodhart 2019, p. 7).

interfere in contractual relationships of a bank.[33] The resolution authorities can exercise the PONV conversion power and apply the resolution tools. In addition, the resolution authorities have the resolution powers, under which they can cancel or modify contractual terms, suspend payment and delivery obligations and suspend termination rights. The measures that the resolution authorities can take with respect to the failing bank itself – such as removing or replacing the management board of the bank, enforcing caps on remuneration and preventing banks from paying dividends or coupons –could already be imposed on banks as part of the State aid award process. The resolution framework has not, therefore, substantially altered the measures that could already be imposed under the State aid regime for the banking sector with respect to the failing bank itself.

8.8.3 Safeguarding financial stability

With respect to the inadequacies that were revealed to safeguard the stability of the single financial market, it is the author's view that mainly the preparatory phase under the resolution framework brings relief. In the preparatory phase, recovery and resolution plans are drafted and the MREL is set. In addition, the resolution framework introduced the possibility of *ex ante* restructuring, that is, before the bank experiences financial difficulties. In the author's view, the possibility for competent authorities and resolution authorities to enforce *ex ante* restructuring on the basis of the recovery and resolution plans has a true added value compared to restructuring under the State aid regime, which always takes place on an *ex post* basis. The resolution framework could therefore be seen as being complementary to the State aid regime insofar as it enables resolution authorities to enforce *ex ante* restructuring, even outside the situation in which State aid is granted. Preventing financial difficulties from arising is in the author's view the best way to safeguard financial stability.

When financial difficulties do arise, time is of the essence. Processes should be unambiguous and straightforward. The involvement of many different authorities may complicate and delay the process. As long as there is a lack of clarity on how the roles between national treasuries, the ESM, the SRB and the ECB are divided in bank resolution, the European Banking Union remains incomplete. This creates financial instability.[34] Further centralisation of the public funding sources within the European Banking Union and

33 See also Ventoruzzo and Sandrelli 2019, p. 29.
34 Demertzis and Wolff *Bruegel Blog Post* 2018.

the decision-making powers with respect to the use of these sources, while clearly defining the mandates of the authorities involved, would contribute to efficiently resolving a bank, whether it is in resolution or in normal insolvency proceedings.

8.8.4 Synopsis

Overall, it is the author's view that the introduction of the resolution framework did contribute to solving the inadequacies revealed by the GFC. There are still, however, significant flaws in that respect. Further alignment of the State aid regime for the banking sector and the resolution framework will be a valuable step in creating a sound, integrated framework for regulating public funding of failing banks in the EU. This requires a true understanding of both the resolution framework and the State aid regime for the banking sector, so as to see how they can further complement each other, instead of contradicting or duplicating each other. That being said, the output that can be expected from such an enhanced framework for public funding of failing banks cannot be seen separately from the political stakes that are at risk. The author's original thought was that the resolution framework would lead to a system that would be more objective, more transparent and less political, which would be an improvement compared to the State aid regime.[35] Studying the resolution framework, however, shows that there still is plenty of room for political considerations. This not only concerns political decisions at Member State level, but also policy choices at the level of the European institutions involved. Rather than denying that resolution involves political decisions, the author believes it would be better if discretion in dealing with political stakes is catered for and made more transparent in the resolution framework.[36] This will not only contribute to the credibility of the resolution framework, but also to the democratic accountability.[37]

35 See also Bacon 2017, p. 16.
36 See also Binder 2019 (p.2) and De Serière and Milione *JIBLR* 2019, p. 76.
37 See also Teixeira *EBOLR* 2017, p. 561.

SUMMARY

The subject of this dissertation is the regulation of public funding of failing banks in the EU. Three areas of law are involved in this regulation: prudential regulations, State aid rules and the resolution framework. If the level of own capital and eligible liabilities is insufficient to absorb losses and recapitalise a failing bank, the resolution thereof will be difficult to envisage without the use of public funding. As a result, there is a delicate interaction between the State aid regime for the banking sector and the resolution framework for failing banks. The following threefold research question is at the heart of this dissertation:

1. *How does the resolution framework impact the State aid regime for the banking sector?*
2. *Which challenges can be identified in the co-existence of the resolution framework and State aid regime in regulating public funding of failing banks in the EU after the onset of the GFC?*
3. *Which potential steps can be taken to address such challenges in order to contribute to an adequate and efficient institutional and regulatory framework for the banking sector?*

This dissertation has eight chapters. *Chapter 1* presents the research question and contextualises it. *Chapter 2* discusses the funding profile of banks in order to gain a better understanding on how the State aid regime and resolution framework interact. It takes a closer look at the definition of credit institution in banking regulation. It describes the variety of activities and business models of banks within the EU and elaborates on the balance sheet of a bank. While business models and balance sheets of banks differ, they have in common that they all need to comply with the regulatory capital requirements and the MREL. This should safeguard that the reliance of banks on short-term wholesale funding to finance the expansion of their balance sheets, together with the use of high leverage, supports economically useful banking activities that serve the general interest, while banks are resolvable when they are failing. If the level of own capital and eligible liabilities is insufficient to absorb losses and recapitalise a failing bank, other funding resources will be necessary to resolve the bank. These may be provided by private market parties, but also by Member States, national central banks, deposit guarantee

schemes, national resolution funds, the SRF and/or the ESM. Taking into account that banks are currently still in the initial stage of implementing the MREL, it may be realistic to assume that it will be necessary to use alternative resources in the resolution of banks, in any event, as long as the MREL has not been fully implemented. The MREL requirement is still developing in terms of the minimum required MREL. In addition, although competent authorities have a full set of powers available when regulatory capital requirements are (likely to be) breached, this still needs to evolve in relation to the MREL requirement.

Chapter 3 discusses the State aid regime for the banking sector. The EU is unique in having a State aid regime under which Member States give up part of their sovereignty by requiring the approval by the Commission of State aid awards. While the application of the State aid rules in the banking sector was often neglected prior to the GFC, this completely changed when Member States started to award mind-blowing amounts of State aid to their banking sectors in order to keep them alive after the fall of Lehman Brothers in 2008. It is thanks to the exercise of State aid control by the Commission that a certain level playing field could be protected within the internal market during the GFC. Not all public funding qualifies as State aid. Public funding only comes within the remit of State aid control, if it is assessed to be an intervention by a Member State or through Member State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods and that affects trade between Member States. Aid measures in the banking sector already led to many discussions between the Member States and the Commission about the qualification as State aid. By exercising State aid control in the banking sector, the Commission had – and still has – to balance the necessity and the proportionality of an aid measure in achieving an EU objective versus the distortion of competition brought about it. The Commission has continuously stressed that financial stability is the overriding goal of State aid policy in the banking sector, whilst ensuring that State aid and distortions of competition between banks and across Member States are kept to the minimum. To find the right balance between the two is key to the State aid regime for the banking sector.

Chapter 4 discusses the resolution framework for the banking sector. The term 'resolution' has a new meaning as of 1 January 2015, when the BRRD entered into force. From that date on, it is commonly used to explain the situation that a bank is failing or likely to fail, but, instead of being wound up in normal insolvency proceedings, it is 'resolved' through administrative, non-judicial procedures while preserving insured deposits and other services essential for maintaining financial stability, such as payment services. The primary objective of resolution is to maintain financial stability and minimise losses for the society, in particular taxpayers. For this reason, certain critical stakeholders and functions (such as depositors and payment systems) need to be protected and maintained as operational, while other parts, which are not considered key to financial stability, may be allowed to fail in the normal way. Resolution is not available for each and every bank. Only, if the resolution authority decides that there is a 'public interest' to put a bank in resolution this can take place. The BRRD harmonised procedures for resolving banks at EU level, in order to submit resolution authorities to the same principles and to provide them with the same set of tools in order to achieve the resolution objectives. With the introduction of the SRB and the SRF in the SRMR, not only harmonisation, but also centralisation of the resolution process at supranational level took place within the European Banking Union. The resolution regime is still in its infancy. The different authorities involved in resolution scan the boundaries of their mandates and powers, the Member States try to find loopholes to comply with the resolution regime, while keeping the taxpayers satisfied, and the resolution framework itself faces an upgrade (through BRRD II, BRRD II bis and SRMR II).

Chapter 5 analyses and assesses the impact of the resolution framework on the access to public funding as a remedy for failing banks. This impact can be described as (the attempt to) restrict the access to and use of public funding by failing banks. The resolution framework introduced the terms EPFS and ELA to regulate access to public funding. Only, if public funding falls within scope of one of these concepts, is the access thereto regulated by the resolution framework. If public funding qualifies as EPFS or ELA, access thereto is restricted in several ways under the resolution framework: (a) through the resolvability assessment, (b) in the recovery and resolution plans, (c) by making EPFS a trigger for the exercise of the PONV conversion power, (d) by making EPFS a trigger for resolution, and (e) by making the access to EPFS subject to compliance with certain access criteria, including the application of a mandatory threshold for bail-in in respect of – certain forms of – EPFS granted in resolution. In respect of ELA, a separate assessment framework applies that provides for access criteria. The access restrictions included in the resolution framework do not all restrict access to public funding in the same way. Some contribute to minimising the total amount of public funds necessary to assist failing banks. Others are more directed towards introducing a certain 'funding cascade' in which taxpayers' money is used in the last instance. In addition, they differ depending on whether it concerns the availability of public funding in or outside of resolution. The resolution framework therefore not only provides for access restriction, but also for access differentiation. There are still some hurdles in restricting access to public funding. Abolition of these hurdles may further contribute to restricting the access to public funds, although finding the right balance between financial stability and the protection of public funds may be more important.

Chapter 6 analyses and assesses the impact of the resolution framework on the exercise of State aid control by the Commission. The State aid regime for the banking sector has not changed as a result of the introduction of the resolution framework. The Commission still assesses State aid awards to failing banks on the basis of the 2013 Banking Communication. This does not, however, mean that the resolution framework has not had an impact on the exercise of State aid control by the Commission. This impact has both an institutional and a procedural dimension. At an institutional level, the role of the Commission as State aid authority has been extended to the assessment of supranational EPFS. Furthermore, the Commission has acquired the new role of co-resolution authority within the SRM. This entails that the assessment of the discretionary aspects of the resolution decisions taken by the SRB is exercised by the Commission, together with the Council. At a procedural level, the resolution framework impacts the assessment by the Commission of State aid awards. Since the introduction of the resolution framework, the Commission has to apply the State aid regime for the banking sector on aid granted in resolution (resolution aid). This term is not included in the 2013 Banking Communication, as a result of which it is not clear which framework applies to the assessment by the Commission of this resolution aid. This chapter discusses the assessment criteria that can be established based on the Commission's decision practice in respect of resolution aid. In addition, the Commission has to assess State aid awards not only on compatibility with the internal market, but also on compliance with intrinsically linked provisions of the resolution framework. As a result, the Commission has to be aware of the dynamics of resolution procedures in its assessment, including the tight timelines. This is not without challenges. The Commission has to deal with tensions between its different roles, while taking the boundaries of its different mandates and the cooperation with the SRB into account. In addition, it has to deal with tensions between different sets of rules. Although the resolution framework acknowledges the priority of the State aid regime for the banking sector, the Commission cannot approve a State aid award if it violates intrinsically linked provisions of the resolution framework. Especially in the absence of a (much desired) revision of the State aid regime for the banking sector, it has become challenging to fully comprehend State aid control by the Commission in the banking sector without knowledge of both the State aid regime for the banking sector and the resolution framework.

Chapter 7 analyses and assesses the impact of the resolution framework on the restructuring process of a failing bank. After the resolution authority (the SRB or the national resolution authority) has put the bank in resolution, the resolution of the bank starts. This may trigger restructuring of the bank, but not necessarily so. The resolution framework only provides for a restructuring process when the bail-in tool is applied for recapitalisation purposes. In that case, a business reorganisation plan has to be prepared by the bank. In addition, the resolution framework introduced new possibilities to enforce *ex ante* restructuring on the basis of the recovery and resolution plans. When resolution involves the award of State aid, e.g. through the use of the GFST, the restructuring process under the State aid regime for the banking sector may also apply. As a result, the restructuring process of a failing bank has become multi-faceted after the introduction of the resolution framework. After all, a failing bank may not only be faced with the restructuring process under the State aid regime for the banking sector, but also under the resolution framework. Although these restructuring processes may be triggered at the same time, they may differ and impose different restructuring obligations on the bank. In addition, the resolution framework introduced a new 'restructuring authority', namely the resolution authorities. The cooperation between the Commission and the resolution authorities in restructuring is, however, a topic that has not received a lot of attention. Although, there seems to be the premise of close liaison and some guidance is given in respect of the business reorganisation plan, uncertainty remains. Lastly, this chapter compares the burden-sharing obligations of shareholders/creditors of a failing bank under the resolution framework with the obligations under the State aid regime for the banking sector. Although the State aid regime for the banking sector already provides for a burden-sharing principle, the resolution framework takes it one step further: it introduced the requirement to bail-in 8% of total liabilities and own funds of a bank to have access to public funding, in resolution, with some exceptions. In addition, it introduced the possibility to bail-in senior debt holders. The bail-in requirement under the resolution framework has met with great scepticism. The mandatory burden-sharing allocation may lead to undesirable outcomes that are both financially and politically untenable. This ties into the fact that there (still) are restrictions in the ability of the bail-in tool to perform as intended, especially those that are caused by retail debt holdings.

Chapter 8 contains the conclusion. It starts with a retrospective on Part 1 of this dissertation (Chapters 2, 3 and 4). Subsequently, it discusses the assessments that have been made in Part 2 with respect to the impact of the resolution framework on the access to public funding as a remedy for failing banks, the exercise of State aid control by the Commission and the restructuring process of a failing bank (Chapters 5, 6 and 7). It summarises the hurdles, tensions and challenges that are identified as part of these impact assessments. It also discusses potential steps to address these hurdles, tensions and challenges and presents some thoughts on the further development of the regulation of public funding within the European Banking Union. The chapter ends with a reflection on the contribution of the resolution framework to solving the inadequacies, as mentioned in Chapter 1, in the institutional and regulatory framework for the banking sector to safeguard the stability of domestic financial markets and the single financial market as a whole; to break the link between Member States and banks; and to limit the risks of moral hazard.

SAMENVATTING

Het onderwerp van dit proefschrift is de regulering van publieke financiering van falende banken in de Europese Unie. Drie rechtsgebieden dragen bij aan die regulering: prudentieel recht, staatssteunrecht en het afwikkelingsrecht. Indien een bank niet voldoende kapitaal- en schuldinstrumenten heeft uitgegeven om verliezen op te vangen en te kunnen herkapitaliseren, is het moeilijk om de afwikkeling te bewerkstelligen zonder publieke financiering. Als gevolg daarvan bestaat er een delicate wisselwerking tussen het staatssteunregime voor de bankensector en het afwikkelingskader voor falende banken. De volgende – drieledige – onderzoeksvraag staat centraal in dit onderzoek:

1. *Wat zijn de gevolgen van het afwikkelingskader voor het staatssteunregime voor de bankensector?*
2. *Welke uitdagingen zijn er in de samenloop tussen het afwikkelingskader en het staatssteunregime bij het reguleren van publieke financiering van falende banken in de EU na de uitbraak van de financiële crisis in 2007 (de GFC)?*
3. *Welke stappen kunnen worden gezet om deze uitdagingen op te pakken om zo bij te dragen aan een adequaat en efficiënt institutioneel en regulatoir kader voor de bankensector?*

Het proefschrift heeft acht hoofdstukken. In *Hoofdstuk 1* wordt de onderzoeksvraag gepresenteerd en in haar context geplaatst. *Hoofdstuk 2* bespreekt het financieringsprofiel van een bank om beter te begrijpen hoe het staatssteunregime en het afwikkelingskader op elkaar ingrijpen. Het begint met een uitleg van de definitie van kredietinstelling in de bankwetgeving. Het beschrijft de verschillende activiteiten en bedrijfsmodellen van banken in de EU en gaat in op de balans van een bank. Hoewel bedrijfsmodellen en balansen van banken van elkaar verschillen, zijn zij allemaal onderworpen aan de regulatoire kapitaaleisen en de MREL (*minimum requirement for own funds and eligible liabilities*). Deze eisen en de MREL dienen ervoor te zorgen dat de afhankelijkheid van banken van kortetermijnfinanciering om de expansie van de balans te bekostigen, in combinatie met het gebruik van een hoge *leverage*, economisch zinvolle activiteiten ondersteunt die het algemeen belang dienen, terwijl banken afwikkelbaar zijn als zij falen. Als banken niet voldoende kapitaal- en schuldinstrumenten hebben uitgegeven om verliezen op te vangen en te kunnen herkapitaliseren, zijn andere financieringsbronnen nodig om de bank af te wikkelen. Deze financiering kan beschikbaar worden gesteld door private marktpartijen, maar ook door lidstaten, nationale centrale banken, depositogarantiestelsels, nationale afwikkelingsfondsen, het SRF (*Single Resolution Fund*) en/of het ESM (*European Stability Mechanism*). Gelet op het feit dat banken momenteel nog in de initiële fase van de MREL-implementatie zijn, is een realistisch uitgangspunt dat het nodig zal zijn om gebruik te maken van alternatieve financieringsbronnen, in ieder geval zolang de MREL nog niet volledig is geïmplementeerd. Het minimum MREL-vereiste is momenteel nog in ontwikkeling. Daarnaast moet het handhavingsinstrumentarium ten aanzien van de MREL nog verder worden ontwikkeld om dit op gelijke voet te brengen met de bevoegdheden die de bevoegde autoriteiten hebben om overtredingen van regulatoire kapitaaleisen aan te pakken.

Hoofdstuk 3 bespreekt het staatssteunkader voor de bankensector. De EU is uniek met haar staatssteunregime als gevolg waarvan lidstaten een deel van hun soevereiniteit opgeven door de goedkeuring van de Europese Commissie te vereisen voor het verlenen van staatssteun. Hoewel de toepassing van de staatssteunregels in de bankensector werd verwaarloosd voorafgaand aan de GFC, brachten de enorme bedragen aan staatssteun, die door de lidstaten werden verstrekt om hun bankensector in leven te houden na de val van Lehman Brothers in 2008, daar verandering in. Het is dankzij de uitoefening van staatssteuncontrole door de Commissie dat een zeker *level playing field* werd bewaakt tijdens de GFC. Niet alle publieke financiering kwalificeert als staatssteun. Publieke financiering kwalificeert alleen als zodanig, indien het een interventie van een lidstaat, of door middel van lidstaatmiddelen, betreft, in welke vorm dan ook, die de mededinging verstoort of dreigt te verstoren door bepaalde ondernemingen of de productie van bepaalde goederen te bevoordelen en die de handel tussen lidstaten raakt. Steunmaatregelen in de bankensector hebben vaak geleid tot discussie tussen de lidstaten en de Commissie over de kwalificatie als staatssteun. In de uitoefening van staatssteuncontrole moest – en moet – de Commissie de balans weten te vinden tussen enerzijds de noodzakelijkheid en proportionaliteit van de steunmaatregel in het bereiken van een EU doelstelling en anderzijds de verstoring van de mededinging als gevolg daarvan. De Commissie heeft steeds benadrukt dat financiële stabiliteit de overheersende doelstelling is van het staatssteunbeleid in de bankensector, terwijl tegelijkertijd de omvang van de staatssteun en de verstoring van de mededinging tussen lidstaten tot een minimum beperkt moeten blijven. Het vinden van de juiste balans daartussen staat centraal in het staatssteunregime voor de bankensector.

Hoofdstuk 4 bespreekt het afwikkelingskader voor de bankensector. De term 'afwikkeling' heeft een nieuwe betekenis gekregen sinds 1 januari 2015, toen de BRRD (*Bank Recovery and Resolution Directive*) in werking trad. Vanaf die datum wordt de term gebruikt om de situatie aan te duiden waarin een bank faalt of waarschijnlijk zal falen, maar, in plaats van afgewikkeld te worden in normale insolventieprocedures, wordt afgewikkeld in administratieve, buitengerechtelijke procedures met behoud van gedekte deposito's en andere diensten die essentieel zijn voor het behoud van de financiële stabiliteit, zoals betaaldiensten. Het belangrijkste doel van afwikkeling is het behoud van financiële stabiliteit en het beperken van de verliezen voor de samenleving, in het bijzonder de belastingbetalers. Gelet hierop moeten kritieke stakeholders en functies (zoals depositohouders en betaalsystemen) worden beschermd en in stand blijven, terwijl andere onderdelen, die niet belangrijk zijn voor de financiële stabiliteit, op normale wijze kunnen falen. Afwikkeling is niet beschikbaar voor elke bank. Alleen indien de afwikkelingsautoriteit bepaalt dat afwikkeling in het algemeen belang is, kan een bank in afwikkeling worden geplaatst. De BRRD harmoniseert de procedures voor afwikkeling van banken op EU-niveau, om ervoor te zorgen dat afwikkelingsautoriteiten zich moeten houden aan dezelfde principes en dezelfde instrumenten tot hun beschikking hebben om de afwikkelingsdoelstellingen te realiseren. Binnen de Europese Bankenunie heeft de SRMR (*Single Resolution Mechanism Regulation*) geleid tot de introductie van de SRB (*Single Resolution Board*) en het SRF, als gevolg waarvan niet alleen sprake is van harmonisatie, maar ook van centralisatie van het afwikkelingsproces op supranationaal niveau. Het afwikkelingskader staat nog steeds in de kinderschoenen. De verschillende autoriteiten die betrokken zijn bij afwikkeling, onderzoeken de grenzen van hun mandaten en bevoegdheden, de lidstaten proberen de mazen te vinden in het afwikkelingskader om de belastingbetalers tevreden te houden en het afwikkelingskader zelf wordt op dit moment herzien (door BRRD II, BRRD II bis en SRMR II).

Hoofdstuk 5 analyseert en beoordeelt de impact van het afwikkelingskader op de toegang tot publieke financiering als een remedie voor falende banken. Deze impact kan worden beschreven als (de poging tot) het beperken van de toegang tot en het gebruik van publieke financiering door falende banken. Het afwikkelingskader heeft de termen EPFS (*extraordinary public financial support*) en ELA (*emergency liquidity assistance*) geïntroduceerd om de toegang tot publieke financiering te reguleren. Alleen indien publieke financiering als EPFS of ELA kwalificeert, wordt de toegang daartoe bepaald door het afwikkelingskader. Het afwikkelingskader beperkt de toegang tot EPFS en ELA op verschillende manieren: (a) door de afwikkelbaarheidsbeoordeling, (b) in de herstel- en resolutieplannen, (c) doordat EPFS een trigger is voor de uitoefening van de AFOMKI-bevoegdheden (*PONV conversion power*), (d) doordat EPFS een trigger is voor afwikkeling, en (e) door de toegang tot EPFS afhankelijk te maken van het voldoen aan bepaalde 'toegangscriteria', waaronder het naleven van een verplichte drempel voor bail-in, indien (bepaalde vormen van) EPFS worden gebruikt in afwikkeling. Voor ELA geldt een apart beoordelingskader met eigen toegangscriteria. De toegangscriteria in het afwikkelingskader beperken de toegang tot publieke financiering niet allemaal op dezelfde manier. Sommige criteria dragen bij aan het beperken van de totale omvang van publieke financiering die nodig is om falende banken te ondersteunen. Andere criteria zijn erop gericht om een bepaalde financieringswaterval te creëren waarbinnen belastinggeld pas in laatste instantie wordt gebruikt. De toegangscriteria verschillen daarnaast ook in en buiten afwikkeling. Het afwikkelingskader leidt daarom niet alleen tot beperking van de toegang tot publieke financiering, maar ook tot differentiatie in deze toegang. Er is nog steeds een aantal obstakels in het beperken van de toegang tot publieke financiering. Het wegnemen van deze obstakels kan ertoe leiden dat deze toegang verder wordt beperkt. Maar belangrijker is dat de juiste balans wordt gevonden tussen financiële stabiliteit en de bescherming van publieke financiering.

Hoofdstuk 6 bespreekt de impact van het afwikkelingskader op de uitoefening van staatssteuncontrole door de Commissie. Het staatssteunkader voor de bankensector is niet gewijzigd als gevolg van de introductie van het afwikkelingskader. De Commissie beoordeelt steunverlening aan falende banken nog steeds aan de hand van de 2013 Bankenmededeling. Dit betekent echter niet dat het afwikkelingskader geen impact heeft gehad op de uitoefening van staatssteuncontrole door de Commissie. Deze impact heeft zowel een institutionele als een procedurele dimensie. De rol van de Commissie als staatssteunautoriteit is uitgebreid met de beoordeling van supranationale EPFS. Daarnaast heeft de Commissie de nieuwe rol van co-afwikkelingsautoriteit binnen het SRM (*Single Resolution Mechanism*) gekregen. Dit betekent dat de Commissie, samen met de Raad van de Europese Unie, de discretionaire aspecten van een afwikkelingsbesluit van de SRB beoordeelt. Het afwikkelingskader heeft daarnaast ook procedurele gevolgen voor de beoordeling door de Commissie van staatssteunverlening. Sinds de introductie van het afwikkelingskader moet de Commissie het staatssteunkader toepassen om steun die is verleend in afwikkeling (afwikkelingssteun) te beoordelen. De term afwikkelingssteun is niet opgenomen in de 2013 Bankenmededeling. Hierdoor is niet duidelijk welk kader van toepassing is voor de beoordeling van dergelijke steun. Dit hoofdstuk beschrijft de beoordelingscriteria die kunnen worden afgeleid uit de beschikkingenpraktijk van de Commissie ten aanzien van afwikkelingssteun. Daarnaast moet de Commissie, sinds de introductie van het afwikkelingskader, staatssteunverlening niet alleen op verenigbaarheid met de interne markt beoordelen, maar ook op verenigbaarheid met 'intrinsiek gelinkte bepalingen van het afwikkelingskader'. Gelet hierop moet de Commissie in haar beoordeling rekening houden met de dynamiek van het afwikkelingskader, inclusief de strikte tijdslijnen. Dit leidt tot uitdagingen. De Commissie wordt geconfronteerd met spanning tussen haar verschillende rollen, terwijl zij tegelijkertijd de grenzen van haar mandaten en de samenwerking met de SRB in het oog moet houden. Daarnaast heeft de Commissie te maken met spanning tussen de verschillende sets van regelgeving. Hoewel het afwikkelingskader de voorrang van het staatssteunkader voor de bankensector erkent, kan de Commissie staatssteun niet goedkeuren, indien dit intrinsiek gelinkte bepalingen van het afwikkelingskader schendt. In het bijzonder door het ontbreken van een (zeer gewenste) herziening van het staatssteunkader voor de bankensector, is het uitdagend geworden om staatssteuncontrole door de Commissie volledig te doorgronden zonder kennis van zowel het staatssteun- als het afwikkelingskader.

Hoofdstuk 7 bespreekt de impact van het afwikkelingskader op het herstructureringsproces van falende banken. Nadat de afwikkelingsautoriteit (de SRB of een nationale afwikkelingsautoriteit) een bank in afwikkeling heeft geplaatst, gaat de afwikkeling van die bank van start. Dit betekent echter niet per definitie dat ook herstructurering van de bank plaatsvindt. Het afwikkelingskader voorziet alleen in een herstructureringsproces, indien het bail-in instrument wordt toegepast voor herkapitalisatiedoeleinden. In dat geval moet een bedrijfssaneringsplan (*business reorganisation plan*) worden voorbereid door de bank. Het afwikkelingskader heeft daarnaast nieuwe mogelijkheden geïntroduceerd voor *ex ante* herstructurering op basis van de herstel- en afwikkelingsplannen. Indien staatssteun wordt verleend in afwikkeling, bijvoorbeeld door middel van de GFST (*government financial stabilisation tools*), verplicht het staatssteunkader (mogelijk) ook tot herstructurering. Als gevolg daarvan kan het herstructureringsproces van een falende bank veelzijdig zijn. Een falende bank kan niet alleen worden geconfronteerd met een herstructureringsproces onder het staatssteunkader voor de bankensector, maar ook onder het afwikkelingskader. Hoewel deze processen tegelijkertijd van toepassing kunnen zijn, kunnen zij van elkaar verschillen en verschillende herstructureringsverplichtingen opleggen aan de bank. Het afwikkelingskader introduceert daarnaast een nieuwe 'herstructureringsautoriteit', in de vorm van de afwikkelingsautoriteiten. De samenwerking tussen de Commissie en de afwikkelingsautoriteiten in herstructurering is echter geen onderwerp dat veel aandacht krijgt. Hoewel men mag aannemen dat de Commissie en de afwikkelingsautoriteiten nauw zullen samenwerken, en er wel wat toelichting is gegeven ten aanzien van samenwerking in het kader van het bedrijfssaneringsplan, blijft de vormgeving van deze samenwerking voor het overige onduidelijk. Tot slot vergelijkt dit hoofdstuk de verplichtingen voor aandeelhouders en crediteuren van de bank om bij te dragen in tekorten van de bank (*burden-sharing*) onder het staatssteunkader en het afwikkelingskader. Hoewel het staatssteunkader al voorziet in een *burden-sharing* principe, gaat het afwikkelingskader een stap verder: het introduceert een verplichte bail-in van minimaal 8% van de totale passiva, met inbegrip van het eigen vermogen van de bank om toegang tot publieke financiering te krijgen in afwikkeling, een aantal uitzonderingen daargelaten. Het introduceert daarnaast de mogelijkheid van bail-in van *senior* schuldeisers. Het bail-in vereiste onder het afwikkelingskader is met veel scepsis ontvangen. De vereiste *burden-sharing* allocatie kan leiden tot uitkomsten die zowel financieel als economisch onhoudbaar zijn. Dit hangt samen met het feit dat het bail-in instrument nog niet kan worden ingezet zoals voorzien, in het bijzonder als gevolg van retail schuldeisers die aandelen of schuldinstrumenten in een bank houden.

Hoofdstuk 8 bevat de conclusie. Het start met een terugblik op het eerste deel van dit proefschrift (hoofdstuk 2 t/m 4). Het beschrijft daarnaast de analyses die zijn gemaakt in het tweede deel ten aanzien van de impact van het afwikkelingskader op de toegang tot publieke financiering voor falende banken, de uitoefening van staatssteuncontrole door de Commissie en het herstructureringsproces van een falende bank (hoofdstuk 5 t/m 7). Het beschrijft de geïdentificeerde obstakels in het beperken van de toegang tot publieke financiering, de spanningen in de uitoefening van staatssteuncontrole door de Commissie en de uitdagingen in het herstructureringsproces van een falende bank. Het stelt potentiële oplossingsrichtingen voor om om te gaan met deze obstakels, spanningen en uitdagingen. Het wijdt daarnaast enkele beschouwingen aan de verdere ontwikkeling van de regulering van publieke financiering binnen de Europese Bankenunie. Het hoofdstuk sluit af met een reflectie op de bijdrage van het afwikkelingskader aan de in Hoofdstuk 1 besproken tekortkomingen in het institutioneel en regulatoir kader voor de bankensector om de stabiliteit van de financiële thuismarkten van de lidstaten en de interne financiële markt binnen de EU te beschermen, de band tussen lidstaten en banken te breken en de risico's van *moral hazard* te beperken.

CURRICULUM VITAE

Marije Louisse was born on 31 December 1986 in Deventer. After obtaining her high school diploma at the Ashram College in Alphen aan den Rijn in 2004, she studied law at the University of Utrecht. She graduated cum laude for her Bachelor of Laws at the honours program of Utrecht Law College in 2008. In 2010, she graduated cum laude for the Law Master's Program Law & Undertaking at the University of Utrecht.

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