

# EUROPEAN MONETARY INSTITUTE

## OPINION OF THE EUROPEAN MONETARY INSTITUTE

**on a consultation from the Council of the European Union under Article 109f(6) of the Treaty establishing the European Community (the Treaty) and Article 5.3 of the Statute of the EMI; on an amended Commission proposal for a European Parliament and Council Directive on the reorganisation and winding up of credit institutions**

(98/C 332/04)

CON/96/2

1. The present consultation was initiated by means of a letter from the President of the Council of the European Union, received on 30th January 1996 and relates to the proposal for a Directive, prepared by the Commission, (COM(88) 4 final) and to the text of the Directive as it stands following the discussions in the Council working group (SN 4582/95). It is noted that the text contained in document SN 4582/95 is merely a preparatory document and that Member States' delegations have not agreed its terms.

It is understood that some further changes have been made to the text of the proposal since document SN 4582/95. The present consultation was expressly limited to the Council of the European Union to document SN 4582/95, and does not extend to cover any subsequent documents. However, where the EMI understands that changes have been made to the text since document SN 4582/95, and where such changes may impact on comments made in this opinion, this is noted.

References to Article numbers in this opinion refer to Article numbers in document SN 4582/95 (not (COM(88) 4 final)).

2. The main purpose of the proposal is to ensure the recognition throughout the Community of reorganisation measures and winding-up procedures applicable in the home Member State of a credit institution according to the principles of unity and universality. Other provisions within the proposal relate to coordination between competent authorities, public information on the initiation of such measures and procedures, and non-discrimination between creditors based on residence.

3. The EMI considers that it is competent to give an opinion in relation to the proposal. Article 109f(6) of the Treaty and Article 5.3 of the EMI Statute provide for consultation of the EMI by the Council on any proposed Community Act which is within the field of competence of the EMI. The present proposal relates to several areas within the field of competence of the EMI: it will have a potential impact on the stability of financial institutions and the financial markets (Article 4.1, fourth indent of the EMI Statute); it relates to the supervision of credit institutions, which is an area which falls within the competence of a number of national central banks (Article 4.1, fourth indent of the EMI Statute); and, it relates to the level of efficiency of cross-border payment systems (Article 4.2, fourth indent of the EMI Statute).

Additionally, by providing for recognition of home state reorganisation and winding-up procedures, the proposal will introduce a greater degree of certainty as to which procedures will be applied to EU credit institutions. This will be very valuable to members of the ESCB, in common with other participants in the financial markets, to allow them to assess the risks of dealing with credit institutions. Comments are also, therefore, made in this opinion which relate to this issue.

4. The EMI welcomes this proposal. Any additional level of certainty which can be achieved in the context of the reorganisation and winding up of any types of entities with branches in a number of jurisdictions will be of significant benefit: the proposal is likely to assist greatly in achieving certainty and clarity as to which jurisdiction will apply relevant proceedings, in the context of a given situation. Due to the obvious potential of credit institutions to impact on the stability of the financial markets, such

clarity and certainty, in turn, is likely to have beneficial effects on levels of stability among financial markets and institutions. Such proposals are also likely to have a positive impact on the single market due to the added confidence available in relation to cross-border financial contracts. In turn, the EMI notes that the issue of multi-jurisdictional proceedings, which are already important, are likely to become increasingly relevant to the banking sector with an increasing trend towards branching throughout the Community having been facilitated through the single market measures in the banking field.

Therefore, the proposal is particularly welcome at this time. As noted in Paragraph 3, the additional certainty expected to result from this proposal will also be of benefit to the ESCB in managing its risk when effecting monetary policy through entering into contractual arrangements with credit institutions. Finally, the EMI welcomes that the proposal will, in principle, bring in line the winding-up and reorganisation procedures with the principle of home-country control adopted for the supervision of credit institutions.

5. The EMI does not consider that it would be appropriate for it to make comments on the drafting of the proposal. However, several points are made in the opinion which, if taken, might necessitate some amendment to the current drafting in order to make the intent of particular provisions within the proposal clearer.
6. The scope of the proposal, specifically relating as it does to credit institutions, is noted. It is also noted that agreement has now been reached on the EU Bankruptcy Convention, which covers most EU incorporated legal persons but specifically excludes from its scope not only credit institutions but also insurance undertakings, investment undertakings which provide services involving the holding of funds or securities for third parties and collective investment undertakings. The EMI notes that all of the types of entity which are excluded from the scope of the Convention have a significant potential impact on the stability of financial institutions and markets and that therefore it is important to devise suitable proposals covering all such types of entity.

In this regard, the EMI is aware of the parallel project concerning insurance undertakings and understands that there is the intention, declared by the EU Council and the Commission, to elaborate separately legislation concerning the other types of entities which fall outside the scope of the Bankruptcy Convention. These initiatives are welcome. The EMI, while noting the necessity of restricting the current proposal, would therefore encourage continued work to frame additional directives covering those entities outside the scope of both the Convention and the present proposal (particularly financial institutions) as a matter of priority.

From a central banking perspective, the EMI would particularly welcome any further proposal providing additional certainty in relation to the reorganisation and winding up of any entity which may be a counterparty to the European Central Bank and/or any national central bank in relation to the pursuance of monetary policy. This may, in stage three of EMU, extend to cover non-credit institution investment firms within the scope of the Investment Services Directive (93/22/EEC), Article 18(1), second indent of the Statute of the ESCB and ECB referring to the '... conduct of credit operations with credit institutions and other market participants ...'

7. The EMI further notes that there is an increasing trend for suppliers of financial services in Europe to diversify into a number of finance-related activities. For regulatory and business reasons, this diversification is often effected through establishing separate subsidiaries which may, or may not, be incorporated in the same jurisdiction as the parent, only some of these entities being credit institutions. In view of the significant intra-group exposure which generally exists within such groups, it is usually the case that the need to reorganise or wind up one of the entities in such a group will require similar measures to be taken in respect of all other members of the group. Failure of a number of entities in such a multidisciplinary financial group has the potential to have an even greater impact on the stability of financial institutions and the financial markets as a whole than the failure of a single entity whose activities may be more narrowly defined and constrained. In view of this phenomenon, and being aware of the efforts to enhance the regulatory framework concerning financial conglomerates, the EMI encourages all

further proposals for directives relating to the reorganisation and winding-up of non-credit institution financial entities to take this point into account with due regard to the specific problems that financial conglomerates may raise for the stability of financial institutions and markets.

8. Various Articles of the proposal provide for the competent authorities referred to, respectively, in Annex I or II to provide information on proceedings to the authorities competent to supervise credit institutions. Examples include Articles 5,6,9 and 12. The rationale of such provisions is to allow relevant supervisors of credit institutions to take appropriate steps in relation to supervisees at an early stage. Although Council Directive 95/26/EC will give the possibility of a flow of information between supervisory authorities and central banks and payment overseers, the EMI believes that, in view of the pivotal role of central banks and, where this function is effected through a separate organisation, overseers of payment systems in ensuring the continued stability of the financial markets, it would also be appropriate that information on reorganisation and winding-up procedures should be directly communicated to these entities within those jurisdictions where the relevant credit institution has a presence. However, any requirement imposed to pass on information to central banking authorities must not delay action being taken or orders being granted in relation to the reorganisation or winding-up of credit institutions. The EMI therefore recommends extending the information flows from the competent authorities referred to respectively in Annexes I and II by provisions which ensure that central banks, in their function as overseers of payment systems and liquidity providers, are informed when a branch in their jurisdiction is affected by the measures, but that the measures are not made conditional on the central bank being informed.

9. It is noted that the proposal will only relate to those credit institutions the head office of which is outside the Community where, according to Article 1(2) of the draft, such an entity has branches in at least two Member States of the Community. The reasoning behind such a limitation is clear. However, it is noted that there are a number of very large non-EU banking groups which have a significant presence in the Community and which conduct their business in the Community through a mixture of branches and subsidiaries, conceivably having only one branch but

a number of subsidiaries. In view of this fact, the EMI encourages further proposals for Directives touching on reorganisation and winding up to take into account the impact of reorganisation or winding up of a branch of one undertaking on other entities within the same corporate group.

10. Article 23(1) of the proposal refers to a number of situations where the effects of the reorganisation or winding up are to be modified in some way. The EMI understands that the intention of this provision is to ensure the enforcement of the rules applicable to the relevant arrangement under the specific system of law mentioned in Article 23(1) and that, for these purposes, the provisions of the home Member State reorganisation or winding-up procedure are overridden. The EMI welcomes this approach, particularly in relation to those of the arrangements specified which have an immediate potential impact on financial institutions and markets (e.g. contractual netting, rights in securities and payment-system arrangements) and which will therefore have particular impact in relation to the EMI's field of competence. Similarly, the EMI understands that the intent of Article 23(2) is to ensure that statutory set-off is enforceable in accordance with the law of the Member State applicable to the failed credit institution's claim notwithstanding the reorganisation measure or winding-up procedure. This intent is also supported by the EMI. However, the importance of the legal issues dealt with in Article 23 calls for great care in the drafting with a view to ensuring that the full intended effect is given to these welcome objectives.

For the sake of clarity, the EMI also suggests the replacement of the word 'creditors' by the word 'counterparts' in Article 23(1), third indent. It is acknowledged that the existence of a contractual netting arrangement between parties implies that any party to such an arrangement will be the creditor in relation to one or more contracts which, in the absence of the netting agreement, would require the other party to settle obligations on a gross basis. However, it is the nature of most netting contracts that either party may be the net creditor or the net debtor and this position may change over time. By using the word creditor in this context there is a danger that this provision will be construed as only applying when the credit institution is the net debtor in respect of a contractual netting arrangement, where, on the commencement of reorganisation or

winding-up measures the credit institution is the net creditor in respect of a contractual netting arrangement the implication may arise that this provision does not apply.

11. Article 26 aims to exclude the application of the zero-hour rule and retroactivity provisions in so far as they may impact on the validity of transactions effected through payment system and interbank netting systems. This provision aims to add further certainty in relation to finality within payment systems, thereby having potential benefits for the stability of financial institutions and financial markets and, as a result, having the potential to reduce systematic risks. Therefore, the EMI welcomes this provision. However, to be effective, it is vital that the point in time at which arrangements or payments benefit from the provision, is clearly determinable from the drafting. Therefore, the Directive might induce rules governing national payment and settlement systems to make clear at what point in the processing arrangements the protections provided by the provision come into effect, this might for example be the moment when, under the rules of the relevant system and/or under the relevant law, the payment becomes irrevocable or final.
12. The EMI notes that Article 30 as drafted in document SN 4582/96 of the proposal sets a latest date by which Member States are to bring into force the laws, regulations and administrative provisions to comply with the Directive. The EMI understands that this provision has been changed in a subsequent draft of the proposal so that the Directive will be implemented three years after publication of the text in the *Official Journal of the European Communities* and will only apply to reorganisation measures or winding-up procedures which are opened or commenced after this date. The EMI welcomes this and any other moves to coordinate further the date of implementation of this proposal. The proposal will potentially have the effect of clarifying and altering the result of certain questions of private international law, particularly by virtue of Article 23. If these provisions were to come into effect at different times

in different Member States, however, uncertainty and confusion will arise during the transitional period. To avoid this to the extent possible, therefore, the EMI welcomes the amended provisions in Article 30 and any other moves to coordinate further the dates of implementation of this proposal.

13. One national central bank has requested that the following comment should also be made, in relation to Article 29 of the draft:

‘Article 29 provides that the Member States shall inform the Commission of any amendments to the legislative provisions listed in Annexes I and II and that the necessary amendments to those Annexes shall be adopted in accordance with the procedure laid down in Article 22 of the Second Banking Coordination Directive (89/646/EEC) (comitology).

Moreover, measures taken pursuant to the referred amendments shall not be the subject of mutual recognition until the amendments have been adopted by the aforementioned procedure.

These provisions could raise a rather peculiar situation if a given Member State adopts new legislation, revoking simultaneously the previous regulations, and decides to implement a reorganisation measure or open up a winding-up procedure concerning a credit institution with branches in other EU countries, before the latter host Member States recognise, under the terms of the Directive, the new legislation.

In these circumstances, even though the Directive does not attempt to apply harmonisation to reorganisation and winding-up procedures, the Member States will not be in a position to apply their laws effectively before a Community act is adopted.’

14. The EMI agrees that this opinion may be made public by the consulting authority.