EUROPEAN CENTRAL BANK
EUROSYSTEM

EN **ECB-PUBLIC**

OPINION OF THE EUROPEAN CENTRAL BANK

of 2 September 2015

on bank resolution

(CON/2015/31)

Introduction and legal basis

On 21 May 2015 the European Central Bank (ECB) received a request from the German Federal Ministry of Finance for an opinion on a draft law adapting the national banking resolution law to the Single Resolution Mechanism (SRM) and the Union provisions on the bank levy (hereinafter the 'draft law'). The draft law also delegates certain competences to the Federal Ministry of Finance related to the issuing of regulations in the areas of internal governance, risk management, outsourcing and recovery plans of credit institutions.

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union and the sixth indent of Article 2(1) of Council Decision 98/415/EC[1], as the draft law relates to rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. Purpose of the draft law

1.1 The principal purpose of the draft law is to align the German regime for the resolution of credit institutions with Directive 2014/59/EU of the European Parliament and of the Council[2] (hereinafter the 'BRRD') and to clarify the scope of application of the Law on recovery and resolution in light of Regulation (EU) No 806/2014 of the European Parliament and of the Council[3] (hereinafter the 'SRM Regulation'). The draft law amends several laws, in particular the Law on recovery and resolution, the Law on banking and the Law on a resolution fund, and provides for: (a) the adaptation of national provisions on recovery and resolution to the SRM Regulation; (b) the adaptation of the Law on a resolution fund to the BRRD and the SRM Regulation; (c) the use of bank contributions collected between 2011 and 2014; and (d) the clarification from the point of view

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1 Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions (OJ L 189, 3.7.1998, p. 42).

2 Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p. 190).

3 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 (OJ L 225, 30.7.2014, p. 1).

of German law of the interaction between the Law on recovery and resolution and the SRM Regulation, which is directly applicable, by incorporating certain practical measures, notably regarding the implementation by the national resolution authority of decisions of the Single Resolution Board (SRB).

1.2 The draft law delegates certain competences to the Federal Ministry of Finance to issue regulations relating to the internal governance, risk management, outsourcing and recovery plans of credit institutions[4]. Such regulations, where issued, would replace the existing administrative guidelines issued by the Federal Financial Supervisory Authority, notably the Minimum Requirements for Risk Management (MaRisk) and the Minimum Requirements for Designing Recovery Plans.

1.3 Moreover, the draft law provides for the statutory subordination in bank insolvency proceedings of certain senior unsecured debt instruments issued by credit institutions. In particular, such debt instruments would be subordinated under statute to interbank deposits, corporate deposits, money market instruments, certain claims under derivative transactions, and structured notes with derivative-linked features[5]. This subordination is intended to facilitate the application of the bail-in tool in the course of the resolution of a credit institution.

1.4 The draft law also sets out how national contributions are to be transferred to the Single Resolution Fund (SRF) and provides that contributions to the German resolution fund collected between 2011 and 2014 may be used during the build-up of the SRF for financing the resolution of national credit institutions. In addition, the mechanisms for the financing of the national resolution authority are specified.

2. Scope of the opinion

This opinion focuses on: (a) the potential impact on the ECB's responsibilities in the context of the Banking Union of the delegation of competence to the Federal Ministry of Finance to issue binding regulations; (b) the subordination of certain senior unsecured debt instruments issued by a credit institution to that institution's other senior debt in bank insolvency proceedings, in light of the proposals[6] of the Financial Stability Board (FSB) on total loss-absorbing capacity (TLAC) for global systemically important banks (G-SIBs) and of the Eurosystem's collateral eligibility requirements; and (c) the transfer of the contributions from the German resolution fund to the SRF including the use of the contributions accumulated by means of the bank levy between 2011 and 2014.

3. Specific observations

3.1 Competences of the Federal Ministry of Finance to issue regulations

3.1.1 The ECB understands that by means of the abovementioned delegation of competences to the Federal Ministry of Finance the German legislator transposes certain provisions of Directive

4 Sections 25a and 25b of the Law on banking and Section 21a of the Law on recovery and resolution, as amended by the draft law.

5 Section 46f(5) of the Law on banking, as amended by the draft law.

6 Available on the FSB's website: http://www.financialstabilityboard.org/wp-content/uploads/TLAC-Condoc-6-Nov-2014-FINAL.pdf

2013/36/EU of the European Parliament and of the Council[7] (hereinafter 'CRD IV'), particularly relating to risk management and governance of credit institutions, and the BRRD, including provisions relating to the incorporation of several guidelines of the European Banking Authority (EBA). These provisions are currently implemented by means of administrative guidelines and take effect through the individual supervisory decisions of the national competent authority (NCA).

3.1.2 Indeed, CRD IV provides Member States with the scope to accommodate in their legislation national specificities of the banking sector, legal requirements and supervisory practices. Pursuant to Article 4(3) of Council Regulation (EU) No 1024/2013[8] (hereinafter the 'SSM Regulation'), the ECB shall apply all relevant Union law and, where such Union law is composed of Directives, the national legislation transposing those Directives.

3.1.3 While the ECB fully acknowledges the scope granted by CRD IV (and also the BRRD) to Member States to make such accommodation in their legislation, this needs to be in line with the objectives of the Banking Union. It has to take into account its potential impact on the effectiveness of the Single Supervisory Mechanism (SSM) and on the ECB's mandate to carry out prudential supervision with full regard for the unity and integrity of the internal market with a view to preventing regulatory arbitrage, as stipulated in Article 1 of the SSM Regulation. In accordance with these objectives, and pursuant to Article 6(1) of the SSM Regulation, the ECB is responsible for the effective and consistent functioning of the SSM, which shall ensure that the Union's policy relating to the prudential supervision of credit institutions is implemented in a coherent and effective way and that the single rulebook for financial services is applied in the same manner to credit institutions in all Member States concerned[9].

3.1.4 Binding national prudential legislation that leads to fragmentation of the prudential rules applicable to credit institutions within the Banking Union has an impact on the ECB's exercise of its responsibilities within the SSM, with respect to both direct supervision and the SSM's effectiveness and consistency. Member States should acknowledge that the advent of the SSM means that the ECB's new responsibilities have to be adequately considered in the context of the adoption of any future banking or prudential legislation with a view to facilitating the harmonisation of supervisory practices in the Banking Union. Indeed, fragmentation would result in a considerable additional burden not only on the SSM, which would have to consider and enforce at worst 19 different prudential regimes for credit institutions, but also on bank groups themselves, which would have to implement such different regimes for each group entity in other Member States participating in the Banking Union.

3.1.5 In addition, national mandatory diverging provisions will have an impact on the level playing field for credit institutions that the ECB seeks to ensure across the Banking Union. The establishment of uniform conditions of competition could be hampered significantly.

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7 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential regulation of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

8 Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

9 Recital (12) of the SSM Regulation.

3.1.6 In addition to the above considerations, the ECB notes the following. The BRRD and CRD IV require the EBA, in certain areas, to issue guidelines in order to establish consistent, efficient and effective supervisory practices within the European System of Financial Supervision, and to ensure the common, uniform and consistent application of Union law[10]. Competent authorities are subject to a 'comply or explain' procedure in relation to these guidelines, pursuant to Article 16(3) of Regulation (EU) No 1093/2010 of the European Parliament and of the Council[11] (hereinafter the 'EBA Regulation'). In this regard, it should be noted that the ECB is the competent authority as regards matters relating to the tasks conferred on it by the SSM Regulation. Therefore, regulations issued by the Federal Ministry of Finance under the competences delegated under the draft law may conflict with the ECB's discretion under the EBA Regulation to incorporate the guidelines into its supervisory practices: the regulations, which would qualify as national legislation transposing directives, could vitiate the measure of discretion available to the ECB under the 'comply or explain' procedure.

3.1.7 At the same time, the regulations would bind the NCA concerned and the ECB would be deprived, on the matters subject to the regulations, of the capacity to establish a consistent, harmonised and effective approach across the SSM to the supervision of credit institutions subject to the SSM. The alleged benefit resulting from converting non-binding guidelines into binding legal acts – namely, that infringements can be sanctioned directly[12] – should therefore be balanced against the objectives of the Banking Union and the abovementioned capacity of the ECB. An administrative guideline that contains provisions on governance and risk management and incorporates EBA guidelines, such as the MaRisk in its current form, already allows the NCA concerned to issue supervisory decisions enforcing the objectives of the guideline in individual cases, without unduly limiting the ECB in the performance of its tasks or depriving it of its capacity to establish consistency across the SSM.

3.1.8 To summarise, banking legislation adopted by the Member States after the establishment of the SSM should facilitate the exercise by the ECB of its responsibilities within the SSM including its capacity to enhance the consistency of the supervision of credit institutions across the SSM. Member States should refrain from setting obstacles both to uniform supervisory practice and to the exercise of supervisory discretion by the ECB within the SSM. In view of the principle of supremacy of Union law and the ECB's status as an independent institution, the ECB will not be bound by any governmental regulations or similar measures which may affect its independence or the smooth functioning of the SSM, for which the ECB is responsible.

3.2 Statutory subordination: effects on bail-in and TLAC eligibility

3.2.1 The ECB notes that the proposed statutory subordination of certain senior unsecured debt instruments of credit institutions to other senior debt of those institutions is expected to facilitate resolution action and the implementation of the FSB's forthcoming TLAC proposals.

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10 Article 16(1) of the EBA Regulation.

11 Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

12 As set out in the explanatory memorandum to the draft law.

3.2.2 Changing the statutory creditor hierarchy in bank insolvency proceedings is expected to enhance the implementation of the bail-in tool in resolution. By means of the subordination, which can be achieved statutorily, contractually or structurally, the resolution authority may apply the bail-in tool to liabilities under unsecured bank debt instruments prior to operational liabilities such as corporate deposits and derivatives while minimising the risk of compensation claims under the 'no creditor worse off' principle. The bail-in of such unsecured bank debt instruments is perceived to carry a lower contagion risk than that of operational liabilities.

3.2.3 The ECB also notes that, due to the statutory subordination, the bail-in of unsecured bank debt instruments is likely to be more effective and credible to market participants. It will allow losses in resolution to be allocated to holders of such instruments, who would be bailed-in ahead of other senior unsecured creditors, thus fostering effective resolution action and reducing the need to have recourse to the resolution fund, which is expected to promote adequate pricing of risk on the side of investors. Such statutory subordination is therefore expected to improve the resolvability of credit institutions under the Union resolution regime and enhance market discipline.

3.2.4 In addition, the statutory subordination may facilitate the implementation of the FSB's forthcoming proposals for G-SIBs which will, in particular, require TLAC-eligible debt instruments to be contractually, statutorily or structurally subordinated to operational liabilities[13]. Under the draft law, German banks will be able to use some of their already-issued debt instruments to meet the TLAC requirements as the statutory subordination applies to existing senior unsecured bank debt instruments. This will assist in reducing the possible disadvantages faced by German credit institutions with an operating parent company model, in comparison with credit institutions that have issued TLAC-eligible debt instruments via their holding company, which is a common model in some third countries. Moreover, statutory subordination avoids the need to issue a larger volume of contractually subordinated debt, which may be difficult to achieve in a short timeframe. In summary, the legislator introduces a legal feature (statutory subordination) to make existing debt instruments TLAC-eligible, without the need for any action by the issuer.

3.2.5 The ECB notes that the introduction of such statutory subordination will not be without an impact in particular on: (a) pricing and capital requirements for holding senior unsecured bank bonds; (b) investment mandates; and (c) the ratings and therefore refinancing costs of the German credit institutions, which should be ascertained. It is assumed that this is also clear to the legislator. Nonetheless, the ECB welcomes the effective removal of the implicit 'State guarantee'[14] by the draft law and acknowledges that these impacts result in principle from the efforts to facilitate resolution in accordance with the BRRD and SRM.

3.2.6 With regard to senior unsecured debt instruments issued under the law of a non-European Economic Area (EEA) country, credit institutions should in future, in accordance with Article 55 of the BRRD, and as stipulated in Section 55 of the Law on recovery and resolution, contractually

13 It should be noted that the TLAC proposals are still under discussion, notably in light of the ongoing impact assessment.

14 In this context, the implicit state guarantee refers to the fact that, in the absence of a credible resolution option which ensures the allocation of losses to creditors, the market will assume that losses will be borne by taxpayers and will therefore not adequately reflect the insolvency risk relating to the investment.

ensure that recognition of the bail-in tool is included in the contractual terms and conditions of these instruments. There is, however, significant uncertainty as to the treatment of existing debt instruments issued under the laws of third countries in the event that there is no contractual provision acknowledging the bail-in mechanism and/or the statutory subordination. The cross-border implications of the bail-in tool are a matter of substantial legal complexity, with discussions currently underway in international fora, including the FSB.

3.3 *Statutory subordination: effects on eligibility of debt instruments as collateral for Eurosystem credit operations.*

Guideline (EU) 2015/510 of the European Central Bank (ECB/2014/60)[15] sets out a single framework that applies in the Eurosystem for assets that can be submitted as eligible collateral for the purpose of participating in Eurosystem monetary operations. In order to be eligible as collateral for such operations, marketable assets must be debt instruments fulfilling the eligibility criteria laid down in Guideline (EU) 2015/510 (ECB/2014/60). In accordance with Article 64 of Guideline (EU) 2015/510 (ECB/2014/60), eligible debt instruments shall not give rise to rights to the principal and/or the interest that are subordinated to the rights of holders of other debt instruments of the same issuer. Therefore, bank debt instruments subject to a statutory subordination of the kind proposed in the draft law would currently no longer be eligible as collateral for Eurosystem credit operations. Furthermore, Article 141 of Guideline (EU) 2015/510 (ECB/2014/60) already sets a limit for the use of unsecured debt instruments issued by a credit institution or by any other entity with which the credit institution has close links.

3.4 *Fragmentation*

A common framework at Union level on the degree of subordination of senior unsecured bank debt instruments to other senior unsecured bank liabilities in bank resolution and/or insolvency proceedings may help to avoid fragmentation of the market within the Union market for these instruments and to avoid complicating the tasks of the ECB both with regard to monetary policy and to supervision within the SSM.

4. Use of the contributions to the German resolution fund between 2011 and 2014

The ECB welcomes the German legislator's intention to provide for the use of contributions to the German resolution fund collected between 2011 and 2014 as an alternative funding measure pursuant to Article 73(1) of the SRM Regulation, albeit only for the German compartment. The ECB welcomes the fact that the draft law does not make use of the possibility, provided for in Article 70(5) of the SRM Regulation, to compensate institutions for their ex ante contributions by using contributions from the existing German resolution fund collected prior to the entry into force of the BRRD, which helps to

15 Guideline (EU) 2015/510 of the European Central Bank of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (ECB/2014/60) (OJ L 91, 2.4.2015, p. 3).

reinforce the SRF, even if limited to the German compartment.

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 2 September 2015.

[signed]

The President of the ECB

Mario DRAGHI