



EUROPEAN CENTRAL BANK

EUROSYSTEM

EUROPEAN COMMISSION'S PUBLIC CONSULTATION ON THE TECHNICAL DETAILS OF A POSSIBLE EU FRAMEWORK FOR BANK RECOVERY AND RESOLUTION – ESCB CONTRIBUTION

On 6 January 2011, the European Commission released for public consultation the working document “*Technical details of a possible EU framework for bank recovery and resolution*”, with the a view to developing a formal legislative proposal by Summer 2011.¹ The consultation follows the Commission’s communications on “*An EU Framework for Crisis Management in the Financial Sector*” of 20 October 2010 and on “*Bank Resolution Funds*” of 26 May 2010.

The ESCB welcomes the opportunity to contribute to the definition of the technical details of a possible EU framework for bank recovery and resolution. Full support to the objective of developing an EU resolution framework and addressing obstacles to the effective management of crisis of EU cross-border financial institutions was already expressed in February 2010.² This contribution, nonetheless, should be considered without prejudice to the opinion that the ECB will adopt on the legislative proposals of the Commission once the ECB is formally consulted.

The reply focuses on those aspects that are considered of particular relevance from a central banking perspective. In particular, the contribution is structured as follows: the overall stance on the Commission’s proposals, is presented in Part 1 of the document; the input to a selected number of issues – organised following the structure of the Commission’s consultation document – is developed in Part 2. The list of the selected questions addressed in the contribution is provided in an appendix.

PART I – OVERALL STANCE

The ESCB supports the plans put forward by the Commission to develop a crisis management and resolution framework for EU financial institutions. The EU clearly needs better tools with well designed triggers to tackle problems in banks more effectively. National regimes should also be as harmonized as possible and arrangements for better coordination between Member States in crisis situations need to be found. In particular, the ESCB shares the view that the overriding policy objective of the new EU regime should be that all institutions can be allowed to fail in a way that safeguards the stability of the EU financial system as a whole and minimises public costs and economic disruption.

The ESCB considers that this challenging objective should be based on three pillars, namely: (i) an improved and harmonised set of preventative and resolution tools; (ii) clearly defined roles of authorities at the national level accompanied by balanced coordination mechanisms at EU level; and (iii) financing arrangements that limit reliance on public budgets to future crises. It is also important to recognise the international context within which the possible EU framework is being developed. The ESCB would like to emphasise the importance of co-ordination taking into

1 In its conclusions of 7 December 2010, the ECOFIN Council supported the Commission initiative with the approval of a set of orientations in the short-to-medium term.

2 Eurosystem’s reply to the public consultation on the Commission Communication on “An EU framework for cross-border crisis management in the banking sector” of 4 February 2010.

account the relevant initiatives of the Financial Stability Board (FSB) in order to promote the development of a globally consistent approach to bank recovery and resolution.

(i) An improved and harmonised set of preventative and resolution tools

The ESCB concurs with the Commission's approach which puts weight on prevention and preparation to be improved in a number of ways. Stress tests which national supervisors carry out annually should be considered as a key element of the enhanced preparedness of authorities. In order to ensure their credibility and consistency, supervisory stress tests would need to be conducted in full autonomy as well as independently of authorities that provide resources for bank recapitalisation.

A holistic group-level perspective is essential for recovery and resolution plans (RRPs) to be effective in the case of cross-border banks.

This should be achieved by giving group level authorities a strong mandate to coordinate the overall preparation of these plans regarding banking groups, without prejudice to the powers granted to the competent authorities responsible for supervision of subsidiaries of an EU parent credit institution or an EU parent financial holding company.³ The ESCB also believes that the microprudential viewpoint of the individual RRP should be complemented by a macroprudential perspective on the authorities' side, entailing a holistic analysis of the potential aggregate impacts on the financial system if, for instance, several plans are implemented simultaneously.

The ESCB considers that the proposal to base the intra group financial support arrangement on an ex ante agreement between the shareholders of the transferor is a step forward. It addresses the shareholder control issue, thus giving some protection to the board of directors of the transferor to approve such transfers. Nevertheless, the ESCB considers that the design of the "intra group financial support agreement" will be legally challenging. To be effective in a liquidity

crisis within the group, it would need to have a substantial level of specificity, anticipating the future situations of its application, which might prove difficult. The respective legal obligations would need to be defined precisely, including the trigger conditions. Such precise ex ante definition of the parameters of the intra-group asset transfer would be essential to allow the shareholders to make an informed and deliberate decision. It would also have to give the board of directors of the transferor sufficient protection against civil liability and potential criminal responsibility in cases whereby future board resolutions approving the transfer on the basis of the agreement might be challenged.

Furthermore, it is difficult to see how the intra group transfer can be based on the "common interest of the group" as this is not yet a well defined legal concept and thus cannot provide the parties to the transfer with a clear framework for their respective rights and obligations. Basing the intra group financial support arrangement on the economic interests of the 'group' risks blurring the fundamental concept of separate corporate legal personality, on the basis of which the expectations of financial market participants are formed when trading with their counterparties. Also, the ESCB would like to draw the Commission's attention to some unintended consequences that should be further explored. In particular, there is a risk that in certain situations the Commission's proposals on intra-group support may not address contagion risk and ultimately could even have a negative impact on the financial stability of the transferor and other involved countries. This is mainly due to the fact that the mechanism foreseen could turn the granting of intra group support into a semiautomatic procedure, leaving very limited opportunity to consider the impact of the transfer.

The ESCB favours the expansion of early intervention powers of supervisors as proposed by the Commission. The additional

³ For instance, the powers envisaged in paragraph 5 of Article 129 (3) of the Capital Requirements Directive.

powers should remain discretionary. In this context, the ESCB also deems that interference with third party rights should be as limited as possible at the early intervention stage.

The resolution toolbox proposed by the Commission appears to be sufficiently comprehensive but more elaboration is needed on the conditions that trigger resolution. They should be sufficiently clear so as to be predictable but also sufficiently broad to avoid a situation in which the resolution authority would want to act but could not legally do so. Furthermore, their assessment would require coordination in a cross-border context.

If the resolution authority is to have powers and tools to transfer all or certain of the assets and/or liabilities of the failing institution to another entity, it is important that this power – which significantly impacts on property rights – is supported by a legally robust set of safeguards for stakeholders. The ESCB supports the proposal to give the resolution authority the legal power to temporarily delay the exercise by any party of close out netting rights under a netting agreement with the failing institution in order to complete a transfer of certain financial markets contracts to another sound financial institution, a bridge bank or other public entity. Such temporary delay should be subject to a clear set of minimum safeguards for counterparties.

(ii) Clearly defined roles of national authorities accompanied by balanced coordination mechanisms on the EU level

At the domestic level, the ESCB suggests maintaining national discretion on the decision on which authorities should be responsible for resolution. Nonetheless, the national frameworks need to be designed in a way that minimises conflicts of interest and regulatory forbearance. Furthermore, for the sake of cross-border coordination, it is essential that a single point of contact is designated in each Member State.

Finding the proper role for central banks is highly important, taking into account their mandate to preserve financial stability in the EU. In this context, the ESCB sees a role for central banks in the systemic risk assessment in the resolution phase, and where appropriate, in the process of recovery and resolution planning.

At the cross-border level, the ESCB welcomes the intention to institutionalise cross-border stability groups (CBSGs) but also identifies some gaps and shortcomings in the Commission's plan. Both the mandate and the composition originally foreseen for CBSGs were broader than that of the planned resolution colleges. Furthermore, although it appears understandable that the so called group resolution scheme (which includes the measures that national authorities would take to jointly resolve the group) would be non-binding, the proposed regime should define the precise duties and responsibilities of those authorities that decide to act differently than previously agreed under the group resolution scheme.

(iii) Financing arrangements that limit exposure of public budgets to future crises

The ESCB considers that resolution funds would provide a useful means to support resolution based on clear, stringent and properly communicated conditions, but any form of bail-out of the previous shareholders should be excluded. The funds should be accumulated ex ante (via fees paid by the financial sector based on liabilities, net of equity and other insured sources of funding), and backed up with ex post arrangements. The implementation should fully take into account the impact of the new Basel III framework and have due regard to not jeopardising economic recovery.

(iv) Debt write-down (bail-in) tool

The ESCB shares the Commission's view that the practical outcome of the bail-in approach would be to restore the going concern to financial

health by providing a viable and economically efficient alternative to the liquidation of institutions when other resolution tools are judged not feasible, due to the overarching need to safeguard financial stability and market confidence.

The ESCB believes that it should be made clear that the tool could only be used for the future and follow the solution adopted in the context of the FSB. It is essential, however, that the write-down tool has a clearly (ex ante) defined legal framework, including transparent trigger conditions, in order to avoid legal uncertainty and market distortion. In this respect the bail in should not allow for discrimination among equally ranked creditors, in the sense of treating them differently without building this differentiation on objectively justified grounds, as this would conflict with the general principle of equal treatment and create legal uncertainty about the extent of creditor rights.

At present, the concrete ability of bail-in to achieve its stated purposes without unwarranted side-effects is hard to assess. **The ESCB emphasizes the need to conduct accurate and detailed case studies that would shed light into the practical implications of bail-in.** Realistic simulations are necessary to deliver a clear view on issues such as the feasibility of a rapid execution, the ability to respect the seniority waterfall in loss absorbency, the mechanics of conversion/write-down, etc.

From a central banking perspective, further analysis is warranted for the financial stability implications raised by a large scale introduction of this approach. This instrument could prove crucial, within the risk management and resolution toolkit, in successfully avoiding externalities and spill-over effects linked to the liquidation option under distressed market conditions. As such, it could contribute to the safeguard of financial stability. However, the innovative character of bail-inable debt raises potential significant risks, including concerns that its design and triggers

may have destabilising effects on the financial sector (e.g. risks of higher market segmentation, debt fire-sales, and contagion effects). The FSB-sponsored work on the bail-in related issues is fully supported by the ESCB.

(v) Derogations from shareholder rights under the EU company law directives

The ESCB considers that a number of EU company law related directives, particularly the 2nd Company law, Takeover bids and Shareholder rights directives contain certain shareholder rights provisions which are obstructive to efficient bank restructuring. The EU framework on bank recovery and resolution should include a set of derogations from these shareholder rights for credit institutions, which are undergoing restructuring.

PART II – REPLIES TO A SELECTED LIST OF QUESTIONS

I GENERAL OBSERVATIONS

Policy objectives

1. The ESCB supports the Commission's plan to set out a comprehensive EU framework for troubled and failing financial institutions. The existing differences among national crisis management and resolution tools, and other institutional and legal constraints, hinder the ability of national authorities to engage in a more effective and cooperative approach in addressing a financial crisis affecting EU cross-border financial institutions.
2. The ESCB shares the view that the overriding policy objective of the new EU crisis management and resolution framework is that all insolvent financial institutions can in effect fail, in a way that would not impair the stability of the EU financial system as a whole, minimising public costs and ensuring continuity of essential financial services avoiding economic disruption. From this

perspective, the design of a credible EU resolution framework especially for large and cross-border financial institutions is essential.

3. To be credible, the framework should be designed in a manner that each of its elements clearly reflects the authorities' firm intention to decisively intervene in a sufficiently early phase, at the same time avoiding regulatory forbearance and bail-outs. In this context, we welcome the outlined order of priority in the consultation document, according to which failing banks should in principle be liquidated under ordinary proceedings, when deemed necessary wound down using resolution tools, and only as a last resort restructured as a going concern.
4. The dilemma whether to allow the continued existence of non-viable banks as a going concern is a key policy question for the sake of credibility. The ESCB notes that recent reforms in some non-EU jurisdictions ambitiously preclude such outcomes in order to limit moral hazard.⁴ However, the complexity of letting large cross-border institutions fail needs to be acknowledged. Against this backdrop, the ESCB considers the Commission's proposal as realistic, but at the same time stresses the importance, that the framework requires going concern restructuring to be always accompanied by measures reducing moral hazard (e.g. shareholders and unsecured creditors assuming losses and the management being replaced), in order to achieve consistency with the main policy objective.

Scope – [Questions 1a, b, c, and 2a, b]

5. The ESCB supports the Commission's view that the scope of the new EU crisis management and resolution framework should be as broad as possible. Based on the recent experience witnessed in the financial crisis, this would make easier the group resolution and allow the competent authorities to tackle each crisis. Therefore,

the proposal to apply the new framework to all credit institutions – as defined in Article 4 (1) of the Directive 2006/48/EC⁵ – is fully shared and should also be extended to all investment firms, and not to “some” of them, as proposed by the Commission.

6. In addition, the possibility to apply, as a first step, the new framework to an “appropriate class” of investment firms⁶ - also reinforced by the Ecofin Council Conclusions of December 2010⁷ – raises a number of further considerations:

First, the criteria proposed by the Commission to identify the investment firms on the basis of their activities and size do not seem to adequately reflect the complexity of assessing the systemic nature of financial firms. Such an assessment should be based both on quantitative and qualitative criteria, and it should also allow for flexibility so as to reflect country specific financial sector and financial market structures.

Second, given the dynamic nature of financial markets, there would be a need to define a time period for a regular re-assessment of the firms which would fall under the framework in order to address changing conditions. However, even such regular assessments could not ensure that the category of covered firms would be up to date in crisis situations. Furthermore, the more frequent the assessments are, the

4 For instance in the US, the Dodd Frank Wall Street Reform and Consumer Protection Act of July 2010 (DFA).

5 Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast), OJ L 177, p. 1 30.6.2006; also known as Capital Requirements Directive (CRD).

6 More precisely the application of the preparatory and preventative measures – included in Part 2 of the document under consultation – and the resolution tools, powers and connected provisions – included in Part 4 of the same document.

7 Ecofin Council Conclusions of December 2010: “priority should be given to covering as a first step all credit institutions and investment firms with potential systemic ramifications, irrespective of whether they operate cross-border or domestically, with a view to covering, as far as necessary all financial institutions at a later stage”.

higher the need for resources would be for supervisory authorities.

7. The ESCB agrees with the view of the Commission to extend the scope of application to bank holding companies, as credit institutions are often part of large financial groups. The regime should be extended to a bank holding company even if it does not meet itself the conditions for resolution when the application of the resolution tools is necessary for the resolution of one or more of the subsidiaries, or for the group as whole. However, given the need to further assess the provisions which would be appropriate for the financial holding companies, as defined in Article 4 par. 19 of Directive 2006/48/EC in banking groups, the extension of the scope to these companies could be considered, along with other categories of institutions, by the end of 2011 as well.

Authorities – [Questions 3a and 3c]

8. The ESCB is of the view that the decision about which authorities are responsible for supervision and resolution should be left to national discretion. In case that there are already reliable structures in place at the national level, there is no reason for changes. It is thus more important to put emphasis on clearly defined and harmonised procedures at European level for dealing with failing institutions.
9. Nonetheless, the important role of the central banks in crisis management and resolution should be acknowledged, not only because of their role as lenders of last resort, but also due to their macro-prudential and financial stability responsibilities as well as their expertise on financial markets. To this extent, central banks may play an important role in the assessment of recovery and resolution plans (see also Part 2 on recovery and resolution plans). Similarly, central banks should be involved in the assessment of the conditions triggering the use of

the resolution powers as these conditions do integrate public interest concerns (e.g. financial stability, continuity of financial services etc.). Finally, the central banks should also be associated to the assessment of the potential action of the resolution authority given that one of the main objectives of a resolution process is to avoid systemic disruptions.

10. We share the Commission's view that there should be adequate coordination between the authorities responsible for resolution, and that a single authority should be designated as a lead point of contact in case several authorities have responsibilities in this field. The single point of contact is crucial for the cross-border coordination of actions of different authorities.
11. At the EU level, we agree with the European Commission on the need to enhance role of the EBA in coordination. To the extent that the Commission decides to include investment firms in the scope of the new framework, the role of the ESMA should be further elaborated, while in the case of a financial group comprised of both credit institutions and investment firms, the possibility of involving the Joint Committee of the European Supervisory Authorities could be examined.
12. However, there are some concerns with regard to a possible intermediation role of the EBA on disagreements between resolution authorities. In particular, when Member States have designated as resolution authorities either central banks or ministries of finance, the adoption of a binding decision by the EBA might not be appropriate, especially in the case that due to the resolution measures to be adopted there are severe fiscal burdens for the relevant member states. Additionally, if investment firms are subject to the resolution framework, then the EBA might also not be the appropriate authority for intervening in case of a dispute.

13. The ESCB considers that the option of creating an additional sub-committee of resolution authorities, including central banks, might be more appropriate as it would consist not only of supervisors but also of other administrative authorities designated as resolution authorities. Nonetheless, the resolution authority of the home jurisdiction may need to have the power to take decisions, as appropriate.

2 SUPERVISION, PREPARATION AND PREVENTION

Stress test – [Questions 4a, 4b and 4c]

1. The ESCB considers that stress testing can be a useful tool for evaluating the resilience of credit institutions to high impact shocks, providing relevant information to management, supervisors and even market participants.
2. Stress tests carried out internally by banks are required in the context of internal risk and capital management. In contrast, stress tests conducted by supervisors target the resilience of the whole sector. Moreover, supervisory stress tests can be constructed to address specific assets or risks across all banks. Supervisory stress tests have proved to be crucial during the crisis in several jurisdictions, given the need of an independent, consistent and comparable risk assessment of credit institutions in a banking system. Therefore, internal bank stress tests as well as supervisory stress tests are needed.
3. Under normal market conditions stress test is a tool for ongoing supervision, thus the results should not be made public.⁸ However, in situations of market uncertainty, stress tests results could be made public, provided that adequate backstop is granted, with the view to restoring market confidence. The communication strategy should be carefully

designed, to clarify that stress tests are only one of the many supervisory tools to assess the resilience of a financial institution.

4. A common methodology is desirable, although it might not fully capture some national idiosyncrasies of local banking sectors. For instance, a common methodology might unintentionally “favour” or “discriminate against” any particular banking system due to its specific characteristics. Overall, the EU legislation should not be too prescriptive as to the way *national* stress tests are carried out. It could be required that the supervisor sets out itself the basic assumptions underlying the stress tests, but not the task allocation between supervisor and institutions in conducting the stress tests.
5. Nonetheless, the ESCB considers that supervisory stress tests conducted at the *EU level*, as it is the case for the ongoing exercise carried out under the coordination of the EBA in cooperation with the ESRB, the ECB and the Commission, should be based on a common methodology agreed at the EU level and should be submitted to a rigorous peer review process in order to ensure consistency and comparability of the results.

Recovery and resolution plans – [Questions 6, 7a, and 21a, b]

6. Avoiding situations where there is no choice other than between accepting the collapse of a banking group or rescuing it in its entirety is the basic aim of the recovery and resolution plans (RRPs). As such, the
- 8 In normal times, banks should be robust enough to be able to pass the test, and supervisors able to instruct weak banks to strengthen their balance sheet well ahead of the publication of annual stress tests, so that the provision of backstops would not be needed. On the other hand, if in normal times a weak bank cannot manage to strengthen its conditions so that it can pass the test, it should become the subject of normal supervisory procedures to restructure, and no backstops would be needed in this case either.

ESCB fully supports the development of this preparatory tool as a necessary element of the framework.

7. However, the kind of ex-ante actions to be undertaken under the RRPs could differ considerably depending on the institutional environment. Actions that facilitate de-risking or strengthen resilience to stressed funding conditions (recovery plans) or increase preparedness for an orderly wind-down (resolution plans) may – in extreme circumstances – include changes in corporate structure (such as the separation of certain business operations) and changes in the business model. In this regard, an appropriate balance between the effective resolution of credit institutions and groups and the proper functioning of the Single Market should be stricken. Furthermore, the implementation of such measures would need to be clearly defined and harmonised at the international level, as such reorganisation powers in going concern situation would give to supervisors completely new powers and responsibilities to interfere with an institution's strategy and the way it runs its business.⁹
8. Moreover, both institutions' preparation and authorities' evaluation of the plans are likely to be very challenging and may pose serious operational burdens. Therefore, the introduction of RRPs as a binding legal tool for all banks requires careful considerations, in particular to avoid unnecessary administrative burdens for smaller institutions.¹⁰ The FSB-sponsored work on RRPs for individual banking groups could help to clarify the identification of the core components of the groups. This exercise could lead to giving more concrete content to this instrument also within the EU crisis management framework, ensuring that there is a sufficient diversity of options in the plans, since not every theoretic option will be available in real circumstances. Nevertheless, it needs to borne in mind that even the most

comprehensive RRPs will not be able to cover all the potential scenarios.

9. The Commission rightly emphasises that the focus of RRPs can be institution or group specific, entailing a full microprudential viewpoint. Nonetheless, the ESCB considers that this should not preclude authorities to also apply a holistic, macroprudential view, and assess whether the individual RRPs of several institutions could be simultaneously implemented in systemic situations and how the individual solutions would affect the financial system as a whole. In this respect, central banks may be best placed to carry out this assessment. However, the ESCB also deems that confidentiality issues with respect to individual institutions should be taken into account. Also it should be avoided to blur responsibilities, which are clearly assigned to resolution or supervisory authorities.
 10. The ESCB also recognises some other elements in resolution plans for which the involvement of central banks may be considered necessary or useful, regardless whether they are supervisory or resolution authorities. For instance, according to the Commission's proposal, a "resolution plan could set out options for applying the resolution tools to credit institutions in a range of conceivable scenarios, including circumstances of systemic instability". In this context, one might envisage, for example, the use of the results of stress-testing conducted by central banks.
- 9 Striking a correct balance between the efficiency and diversification benefits of more integrated banking groups and the greater speed and flexibility of a resolution in stand-alone subsidiaries model clearly depends on a number of "environmental" factors, such as the kind of support that individual entities in a group would provide to each other in the event of a crisis, the legal feasibility of asset transfers across borders, and the compatibility among resolution and winding-down procedures in different countries.
- 10 The principle of proportionality in case of resolution plans could be applied.

Intra-group financial support – [Questions 9, 10, 13a, and 14]

11. The ESCB notes that the Commission's proposal foresees the inclusion of a preliminary shareholders' agreement on intra group financial support in the recovery plan of the transferor institution. It also foresees that on the basis of such agreement the parent institution and its subsidiaries could apply to the consolidating supervisor of the group for approval of the transfer of assets from the transferor to another group entity. On the supervisory level, the proposal envisages the use of procedures under Article 129 of the Capital Requirements Directive 2006/48 to bring the arrangements into effect.
12. The ESCB considers the proposal to base the intra group financial support arrangement on an ex ante agreement between the shareholders of the transferor a step forward. It addresses the shareholder control issue, thus giving some protection to the board of directors of the transferor to approve such transfers.
13. Nevertheless, the ESCB considers that the legal obstacles described in its response to the Commission's public consultation of October 2010 regarding asset transfers as a means of intra group financial support may not be convincingly overcome by such agreements.
14. Also, the ESCB would like to draw the Commission's attention to the risk of unintended consequences that the framework proposed could have on financial stability. In particular, there is a risk that in certain situations the Commission's proposals on intra-group support may not contain contagion risk and ultimately could even have a negative impact on the financial stability of the transferor and other involved countries. This is mainly due to the fact that the mechanism foreseen could turn

the granting of intra-group support into a semiautomatic procedure, leaving very limited opportunity to consider the impact of the transfer.

3 EARLY INTERVENTION

Early intervention powers – [Question 24a]

1. The ESCB favours the proposed expansion of early intervention powers of supervisors under Article 136(1) CRD as proposed by the Commission. The additional powers should remain discretionary. As explained above, we remain sceptical about intra-group financial support being made a supervisory requirement based on a voluntary agreement. The company law and regulatory aspects of such financial support agreements need to be further assessed.
2. Second, interference with third party rights should be as limited as possible at the early intervention stage. If powers such as appointment of a special administrator or special manager are used – which potentially could interfere with shareholder rights – the limits to the exercise of the power should be legally precise. The opportunity should be taken in the interest of legal certainty to clarify where necessary in domestic company laws the rights and obligations of the shareholders, and of the board of directors in case of special administration over a failing credit institution. In particular, it should be clearly specified what are the remaining rights and obligations of shareholders and of the board of directors, if any, in a bank where a special administrator has been appointed and where he is stated to replace the board, or where his appointment is stated to suspend the functioning of the internal organs of the bank.
3. In principle, the EU regime should contain derogations from shareholder rights protected under the EU company law

directives only at the resolution stage. At that stage there is a sufficiently serious public interest such as financial stability and/or depositor protection to justify such interference. By definition these grounds should not exist at the early intervention or preventative stages of a bank crisis with no imminent danger of failing and when there is still time for the supervisory authority to take other, less intrusive measures.

4. However, if the credit institution is failing or in imminent danger of failing to meet its capital requirements and or other financial conditions of authorisation, and the shareholders have failed to increase capital upon request, in an emergency the banking supervisor may exceptionally be authorised to make the capital increase itself using public funds. For this purpose the shareholders' right under Article 25 of the 2nd company law directive¹¹ to convene a general meeting should exceptionally be derogated. In that case however the shareholders' fundamental rights must be respected, including the guarantee of due process and fair compensation.

Special management – [Questions 25a-c]

5. The ESCB supports the proposal that supervisors could be given the power to appoint a special manager for a limited period to take over the management when it is considered that the management of the bank is not willing or not able to take the measures required to address breaches that give rise to a substantial risk that the institution will fail (as specified in option 2). Such possibility should be however limited in time and subject to specific conditions such as (i) a clear mandate to the special manager to restore the soundness of the credit institution; (ii) the shareholders' approval for the special managers actions when it is required by statute or laws.

4 RESOLUTION TOOLS, POWERS, MECHANISMS AND ANCILLARY PROVISIONS

Conditions for resolution (FI) – [Question 28]

1. Three – partially overlapping – options for possible trigger conditions for resolution are considered by the Commission, for a single or combined adoption. The first one focuses on insolvency or likely insolvency, the second one is based on supervisory assessment of likely compliance with the financial conditions for authorisation and the third one is a quantitative trigger based on capital.
2. In general, the ESCB deems that the conditions for resolutions should be sufficiently clear so as to be predictable but also sufficiently broad to avoid a situation in which the resolution authority would like to act but could not legally do so.
3. Each of the three options seems to leave sufficient discretion to the authority to act as they require a qualitative assessment capturing the likelihood to fail to meet a given criterion (e.g. regarding the determination of the moment when a credit institution is “likely to be unable to pay its obligations/to incur losses that will deplete its equity”). They all three allow to act before actual balance sheet insolvency. However this discretion implies a lower predictability. Hence this assessment alone cannot trigger authorities' intervention. Indeed, two additional criteria mentioned in the working document under consultation – namely it should be a last resort option and

¹¹ Second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent, OJ L 026, p. 1, 31.01.1977.

with a clear public interest – are as important/mandatory as the trigger conditions.

4. Several members of the ESCB expressed support for option 2 in the communication, which is built on the principle that the condition for resolution is met when a credit institution is failing or likely to fail to meet the financial threshold conditions for being a sound and vital bank. The preference, nonetheless, was expressed by some ESCB members for a combination of option 2 with option 1 (reference to losses that will deplete equity or to assets less than obligations or impossibility to pay obligations) and a minority with option 3. The possibility of a combination of all the three options was also mentioned and has therefore to be further explored.
5. The Commission's document is not specific as to which authority should be in charge of these different assessments. The trigger condition could be assessed by the supervisory or resolution authority. The assessment of the public interest – based on financial stability, continuity of essential services, protection of public funds and protection of depositors – is an area where central banks, due to their expertise, can provide a relevant input.
6. The co-ordination of these assessments in a cross-border context needs to be carefully considered.

Transfer powers: ancillary provisions – [Question 36]

7. To ensure that where business has been transferred to another entity through the use of a resolution tool, the transfer is effective and the business can be carried on by the recipient, it should be considered to clarify in the Reorganisation and winding up of credit institutions directive 2001/24/EC¹² that such resolution measures are also 'reorganisation measures'. It should be

seriously considered to clarify also that the other resolution tools are 'reorganisation measures' under this directive.

Protection of stakeholders: compensation – and valuation [Question 41]

8. The right to compensation for a deprivation of property is a fundamental right enshrined in both the Charter of Fundamental Rights of the European Union and the European Convention for the Protection of Human Rights and Fundamental Freedoms. Furthermore, the level of compensation must be subject to an independent valuation method provided for by law. The authorities should however be able to assess whether in the concrete case compensation should be payable at all to the stakeholders of the affected institution. We note that there is case law of the European Court of Human Rights which gives considerable leeway to the authorities when acting in the public interest to exercise judgement on the level of compensation payable, if any.¹³

Limited suspension of certain obligations – [Question 42]

9. The ESCB supports the proposal to give the resolution authority the legal power of imposing a temporary suspension of payment or delivery obligations pursuant to any contract to which a credit institution under resolution is a party, in order to take the decisions needed to preserve the financial stability.

12 Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions, OJ L 125, p.15, 5.5.2001.

13 See ECHR Jahn-case (30.5.2005) ECHR: rec. 94: "the taking of property without payment of an amount reasonably related to its value will normally constitute a disproportionate interference and a total lack of compensation can be considered justifiable under Article 1 of Protocol No. 1 only in exceptional circumstances"; rec. 95: "the interference in question satisfied the condition of lawfulness and was not arbitrary, the lack of compensation does not of itself make the State's taking of the applicants' property unlawful".



10. However, the transfer orders of an institution under resolution that have been entered prior to the imposition of a temporary suspension into a system designated under the Settlement Finality Directive 98/26/EC¹⁴ (SFD) as well as the netting of such transfer orders should be protected from such a suspension. These transfer orders and their netting should benefit from the same protection as the one provided for the SFD for transfer orders entered into designated settlement and payment systems before the moment of opening of insolvency proceedings.¹⁵ Not to apply these protections even temporarily may create significant systemic risk whose effects it would be difficult to predict.
11. Central banks should also be protected from the temporary suspension of payment or delivery obligations due by their counterparties under resolution, taken due account of their core tasks in the monetary policy of the Union, the financial stability and the operation of systems. Further consideration will also need to be given to the implications of this stay for CCPs' operations.
- Temporary suspension of close out netting rights – [Question 43]**
12. The ESCB recognises the need to temporarily protect resolution measures from the exercise of close out netting arrangements, which may put at risk the transferability of the credit institution's business once it is under resolution.
13. The ESCB supports the proposal to give the resolution authority the legal power to temporarily delay the exercise by any party of close out netting rights under a netting agreement with the failing institution in order to complete a transfer of certain financial markets contracts to another sound financial institution, a bridge bank or other public entity.
14. This would give the authorities time in which to decide what to do with those financial contracts and whether to transfer them or not and if so to which entity. It would also help to manage the risk to the stability of the financial system that would arise if the counterparties were to deem the resolution decision – particularly if it was declared following court proceedings – as an event of default and forthwith exercised their termination rights.
15. We note that this is also the view of the Basel Committee on Bank Supervision's Cross Border Bank Resolution Group (CBRG) which in its March 2010 final Report¹⁶ made a similar recommendation.¹⁷ In line with the CBRG, we consider such a power is necessary subject to a clear legal framework in the interests of financial stability and security of market counterparties. Thus the temporary delay should be permitted provided that:
- (i) it should only be available in case of a resolution measure taking the form of transfer of contracts to a sound financial institution, such as a bridge bank or other public entity or another credit worthy credit institution or private party purchaser, whereby the contracts would need to be transferred as a whole in order to avoid 'cherry picking';
 - (ii) the early termination rights are preserved in relation to any subsequent

14 Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems, OJ L 166, p. 45, 11.6.1998.

15 Article 2(j) defines insolvency proceedings widely to include any collective measure provided for in the law of a Member States either to wind up the participant or re-organise it, where such measure involves the suspending of, or imposing of limitations or transfer or payments.

16 Report and recommendations of the Cross-border Bank Resolution Group, March 2010, <http://www.bis.org/publ/bcb169.pdf>, hereinafter CBRG Report.

17 See CBRG Report recommendation no. 9.

(i.e. post transfer) default by the transferee;

- (iii) where a transfer of the contract is not available, e.g. it remains with the institution which contracted it, the resolution authorities should ensure that contractual rights to terminate, net, and apply pledged collateral are preserved.

The fact that the Commission proposal broadly mirrors those recommendations is helpful for the coordination of such measures at international and EU levels and is therefore welcome. The ESCB would like to emphasise the importance of an international approach and solution regarding the temporary suspension of close out netting and early termination rights.

- 16. Thus, following the expiry of the temporary delay the EU regime should safeguard the close out netting and early termination rights of the counterparty and ensure that it can exercise those contractual rights against the relevant post transfer entity, i.e. either the institution, where the contract has been transferred, or against the residual entity if the contract remains with it - as the case may be depending on the terms of the specific transfer order. The taking of the resolution measure per se should not be treated as an event of default.
- 17. The only legally secure way to prevent the temporary stay for the purpose of the transfer being treated as an event of default in financial contracts would be by an amendment of the Financial Collateral Arrangements Directive 2002/47/EC.¹⁸ The amendment should take the form of a 'carve out' of transfer orders involving a temporary stay on rights to close out netting from Article 7(1)(a) of the Directive, which currently provides that notwithstanding the commencement or continuation of winding up proceedings or reorganisation measures in respect of the collateral provider and/or the collateral taker, Member States shall

ensure that a close out netting provision shall take effect in accordance with its terms.

The temporary stay would also need to be integrated into the current work of the Commission services on the elaboration of a proposal on an EU Netting Directive.

- 18. Careful considerations will have to be given to the effects of a temporary stay on close-out netting and termination rights on the operation of a Payment System, CCP or SSS. Further consideration will also need to be given to the implications of this stay for Central Bank operations.

Scope of rights – [Question 44]

- 19. We consider it would be difficult to limit the scope of third party rights entirely as suggested. Whilst it may be possible to limit the right to a review of the legality of the resolution measure, it should not be possible to limit the affected person's remedy to compensation alone and to deny the affected person's right to apply to the court to render the administrative decision void or ineffective. This remedy is protected under administrative and constitutional law of many Member States and by Article 47 of the Charter of Fundamental Rights of the European Union (EU Charter), which guarantees the right to an effective remedy and to a fair trial before a tribunal. Moreover, in principle, we consider the scope of remedies available against a measure, which is held by the court to be illegal, should not depend on the type of measure being attacked.
- 20. The ESCB agrees that it is necessary once the credit institution is in resolution to prohibit the filing of an insolvency application by that institution or in respect of that institution by any creditor. The supervisory authority for

¹⁸ Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements, OJ L 168, p. 43, 27.6.2002.

the credit institution should however retain the discretionary power to file for winding up of the institution under resolution if the conditions for doing so are in its reasonable estimation met. There should be clear rules in the EU regime as to the extent of the supervisory authority's power to wind up any institution under resolution particularly in the case of a residual entity which is in orderly wind down. It should be clarified if, where the resolution authority is not also the banking supervisor, to what extent if at all the banking supervisor may exercise the right to file for the winding up of the residual entity, even if the resolution authority has approved its orderly wind down over time.

Safeguards in respect of transfers

21. The ESCB agrees that third parties, such as creditors and market counterparties should be protected by a minimum set of safeguards that must be respected upon any transfer (or part transfer) of property, assets, rights or liabilities of the affected credit institution to another financially sound entity. The minimum rights should include that

- the potential scope of the transfer should cover all forms of property, assets, liabilities, rights, claims etc.;
- the third parties should retain the same rights against the transferee as they had against the transferor;
- it should not be possible to transfer only some but not all rights in any securities or other financial instruments;
- there should be appropriate protection for security, set off and netting arrangements;
- there should be no transfer of the underlying obligation unless the security

interest is also transferred (and vice versa);

- the creditors 'left behind' in the residual entity should receive compensation on the basis of an independent valuation, if they can show they are worse off than if the credit institution had been put into insolvency.

These safeguards are required to prevent 'cherry picking' of rights and interests by the resolution authority and to ensure that the transfers do not unnecessarily disturb the transferor's contractual relations with its creditors and market counterparties.

22. Further considerations would need to be given whether a resolution measure, for instance a transfer of assets and/or liabilities order, should affect ESCB central banks as regards their rights to collateral security provided to them. Currently the collateral securities of the national central banks of the EU Member States and the ECB are not affected by any reorganisation measure or winding up order against any of their counterparties (viz. Article 9 of the Settlement Finality Directive).

23. The ESCB agrees with the introduction of the "no worse off principle", but considers that it may be difficult to apply. At the point of resolution there is unlikely to be any longer a reliable market price for the shares and the affected institution may be, in some cases, supported with state aid. For this reason, the resolution authority should be allowed to rely on its reasonable judgement as regards the level of compensation to stakeholders, if any, based only on an independent expert valuation. The resolution authority, if necessary assisted by the banking supervisor, should however be able to prescribe the valuation method which the independent expert is to use.

5 GROUP RESOLUTION – [Questions 53a and 54]

1. The Commission is proposing the setting-up of resolution colleges to enhance cross-border cooperation in preparing and managing a crisis. While the ESCB agrees that cross-border cooperation should be improved, we do not see any real added value for resolution colleges next to the already existing Crisis Management Groups (CMGs, initiated by the Financial Stability Board) and Cross-border Stability Groups (CBSGs, initiated by the Ecofin Council).
2. Moreover, while the Commission highlights the need to preserve an international level playing field, we believe that the proposals made in the communication are not consistent with this key principle. We find that the proposed composition and competences of resolution colleges differ from what has been agreed for at the FSB level for Crisis Management Groups. We would therefore recommend the Commission to:
 - (i) ‘institutionalise’ the EU Cross-border stability groups CBSGs – defined by the 2008 MoU¹⁹ and reinforced by the Ecofin Council of May 2010²⁰ – as resolution colleges. This would not only facilitate crisis management and resolution, but also enhance preparedness in normal times and provide for a broader composition, involving also central banks without direct resolution functions;
 - (ii) closely align the features of the CBSGs with those of the FSB CMGs at the international level, avoiding the need for authorities to set-up a separate CBSG for the EU banks that already have a CMG.
3. The ESCB agrees with the Commission that there is an urgent need to promote cross-border cooperation during emergency situations, and to prevent fragmented

national responses. CMGs and CBSGs should serve a useful forum to facilitate group wide solutions in case of cross-border crises. Overall, the ESCB is of the view that an appropriate balance between the correct functioning of the single market and the effective resolvability of credit institutions and groups should be found in order to avoid losing the benefits of integrated groups which have been, either through branches or subsidiaries, a key driver of financial market integration, especially in retail markets.

4. However, it has to be acknowledged, that in the absence of group level deposit guarantee or insolvency regimes, implementation of group level resolution comes with a number of challenges. Against this backdrop, the *de facto* “comply or explain” mechanism in the decision on group resolution proposed by the Commission appears to be a realistic direction, but there are important limitations to this approach. In particular, it is doubtful whether this cooperation framework will adequately foster cross-border resolution in practice, as individual national resolution authorities maintain the power not to comply with the resolution scheme for reasons of national financial stability. The framework should therefore define the precise duties and responsibilities of those authorities that decide to act in contrast to the group resolution scheme.²¹

19 Memorandum of understanding on cooperation between the financial supervisory authorities, central banks and finance ministries of the European union on cross-border financial stability of June 2008.

20 In fact, the ECOFIN in its Conclusions of 18.5.2010 has decided to establish the so-called cross border stability groups by mid-2011 for all big cross border financial institutions. [Comment by Germany].

21 As long as there is no European solution to burden sharing, Member States will act within their respective national mandates and responsibilities in the next crisis; for the latter, the development of operational criteria and principles for ex post burden sharing based on concrete experience where possible would be an important step forward. The ECOFIN Council in its conclusions of 10 May 2010 provided important indications in this respect: “to this end, the CBSGs should organise crisis management simulation exercises – including burden sharing discussions – aimed at enhancing the preparedness of the Member States for tackling a financial crisis”.

5. In practice, the balance between coordination of national measures that is necessary to deal with a failing group and the need for authorities to act quickly and decisively when needed, will depend on how the group resolution concept is effectively implemented by the different resolution authorities. The framework proposed by the European Commission states that *failing a decision within [e.g. 1 calendar day], the other relevant resolution authorities may take their own decisions*. This approach not only entails the aforementioned limitations, but also introduces a coherent approach to crisis management/resolution, where the trigger event is well-identified, the crisis well delimited, and problems easily addressed. However, a crisis situation may be much more dynamic and complex, with trial and errors. For instance, authorities which start to apply resolution powers at the group level may, after a while, consider that it is no longer efficient and decide to solve problems at the local level, where they reasonably consider that these measures are necessary for reasons of national stability. Alternatively, the incapacity to initially solve problems at the local level may convince authorities to act together at the group level.
6. Finally, as for the purpose of effective resolution of global groups, the ESCB agrees with the Commission on the need to strive for an internationally coordinated approach by implementing multilateral arrangements with third countries. This is not only valid for group resolution but also, more generally, for all features of the proposed framework. To this end, the ongoing work in relevant international fora should be taken into account.²²

6 FINANCING ARRANGEMENTS

Requirements for each Member State to establish a bank resolution fund – [Question 57]

1. The ESCB holds the view that in the new framework, resolution funds should provide financing to mitigate the impact of the distress of an institution (i.e. in a context of a resolution). In order to reduce the risk of moral hazard, the use of resolution funds should exclude any form of bail-out of the previous shareholders and be based on clear, stringent and properly communicated conditions.²³
2. The purpose of resolution funds should therefore be to mitigate the effects of a failure to different stakeholders by trying to maximise the value of remaining assets and facilitate, if possible, a quick return to their productive use. In this context, resolution funds could be used: (i) to facilitate the transfer of certain assets or liabilities to a bridge bank; or (ii) to a private sector purchaser; (iii) to partially transfer assets to a ‘bad bank’ or ‘good bank’; and (iv) to cover administrative costs, legal and advisory fees.
3. The ESCB broadly shares the Commission’s view that the option of resolution funds established at national level is more realistic

²² 2010 Report and Recommendations of the Cross border Bank Resolution Group (BIS) as well as work under way by the FSB subgroup of the Steering Committee on Resolution regarding Cross-border cooperation arrangements.

²³ Such as the lack of an automatic correspondence between the pay-in (contributions) and the pay-out (financial support for resolution). Other conditions should include, inter alia, the imposition of losses on equity and bond holders and the removal of the management.

in practical terms at the current juncture. Nonetheless, this may raise issues of coordination in a crisis, as is the case in the context of burden sharing with respect to public funds. Moreover, from a competition perspective, diverging national approaches may raise serious concerns as regards the maintenance of a cross-country level playing field. A cross-country harmonisation of application criteria would be indispensable to minimise potential market distortions.

4. The setting up of resolution funds at national level is therefore supported. However, the establishment of a network of national funds should not exclude the possibility of establishing, at a later stage, an European fund-of-funds to address the issues which may arise in respect of cross-border banks. Depending on developments in the financial conditions of the EU banking sector, it should also not be excluded to move the establishment of a European bank resolution fund up in the agenda. Nonetheless, the ESCB acknowledges that, in some Member States, other issues may pose additional challenges to move for such more integrated arrangements.
5. Resolution funds should be available for resolution of all banks irrespective of their size and interconnectedness. Requiring all banks to contribute in a graduated manner would help to preserve a level playing field between EU banks while it is also important for reasons of financial stability.²⁴ The design of resolution funds should also take into account: (i) branches of third country banks active in the EU (both for reasons of financial stability and to avoid competitive distortion) and (ii) EU banks active in third countries via branches.

Financing of the Fund – [Question 58]

6. Considering the financing of resolution funds itself, the ESCB supports ex ante financing arrangements, which have the advantage of being cyclically neutral in principle,

avoiding survivor bias as all institutions are required to pay in, and inspiring confidence in orderly resolution. Properly designed fees may further help to internalise externalities as regards systemic risk and lead to banks taking steps to reduce their contribution to systemic risk.

7. In order to determine the target size of resolution funds, a thorough assessment should be conducted considering the range of its functions and the size of financial institutions covered. When assessing the target size it should be kept in mind that the resolution funds in the EU Member states would only have to finance wind-down and transfer costs, but not provide guarantees or recapitalisation funding. Irrespective of the eventual size, the timeline according to which the resolution funds will be built up to their optimal size would need to be carefully determined so as not to jeopardise near-term recovery and the banks' role in the provision of credit and thus promoting growth of the economy. Lastly, it is important that resolution funds also have the ability to draw on ex post funding and even, as a last resort, have alternative funding arrangements in place.²⁵

Calculation of contributions to the Fund – [Questions 59 a-b]

8. The ESCB supports the adoption of a harmonised approach, taking into account the systemic importance and the size of possible resolution costs of the covered institution.

²⁴ The inclusion of all banks would reflect the experience of the current crisis, when a number of domestic banks, some of which were small or medium-sized, needed to be bailed-out. The inclusion of domestic banks is also consistent with the significant damage that some of them would inflict on banks in other Member States should they be unwound in a disorderly manner.

²⁵ These must however comply with the monetary financing prohibition, and in particular with the prohibition of national central banks providing overdraft facilities or any other type of credit facility within the meaning of Article 123 of the Treaty on the Functioning of the European Union, as further defined through the secondary Union legislation and established ECB guidance.

9. Overall, the choice of liabilities, net of equity and other insured sources of funding appears a sensible way forward. While in principle it could be desirable to specifically target a levy on the most volatile liabilities as well as to measures of maturity mismatch (hence accounting to some extent for the assets' profile), a pragmatic approach seems to be focusing on a broad liability definition. This would also have the advantage of requiring a lower rate than a narrower base.²⁶ The introduction of financing arrangements on the basis of liabilities should fully take into account the impact of the ongoing regulatory overhaul, in particular the new Basel framework and the DGS reform, which is already expected to have significant effects on the composition of both assets and liabilities of banks. The ESCB considers that allowing Member States to decide on the basis for the calculation of contributions could give rise to level playing field issues, which concern was underpinned by the report approved by the Ecofin Council.²⁷

Synergies between resolution funds and deposit guarantee schemes – [Question 60]

10. In principle, different possibilities regarding the organisation of DGS and Resolution Funds can be found in the EU Member States and no prescriptive provisions should limit these possibilities once the objectives of the respective schemes are fully respected. Nonetheless, for those countries whose DGS already perform resolution functions, the ESCB considers that the objectives of DGSs should be combined with the objectives of the resolution funds and that this simplification will benefit the whole system.

11. Financial resources available for pay-out should be ring-fenced within the balance of the fund and used to cover the part of the resolution cost that indirectly ensures the depositors' protection. If funds are segregated, this implies that contributions to funds cannot compensate each other and that, ideally, two contributions should be

paid, one for each side of the fund. However, a mechanism could be foreseen to limit the total contribution due by a bank so as to take account of its contribution capacity.²⁸

7 DEBT WRITE DOWN AS AN ADDITIONAL RESOLUTION TOOL (ANNEX I TO THE COMMISSION CONSULTATION) – [Questions 62a-b, d, 63a-b, 64a-b, 65, and 67]

Main rationale

1. The ESCB believes there is a sound economic rationale for developing a debt write-down tool (bail-in) within the context of bank resolution. Its main purpose should be to efficiently enforce burden sharing within the private sector and avoid taxpayer support. It is essential, however, that the introduction of this tool should follow closely the solution adopted in the context of the FSB.
2. The practical outcome of the bail-in approach would be restoring the going concern by providing a viable and economically efficient alternative to the liquidation of institutions when other resolution tools²⁹ are judged not feasible, due to the overarching need to safeguard financial stability and market confidence. Especially in the context of market-wide crises, the ESCB is of the view that bail-in could represent a superior tool to other

²⁶ In the light of the experience during the crisis, off-balance sheet exposures should also be included in the base of the levy, at least insofar as they present systemic implications (for instance, implicit support to ABCP conduits, SIVs, etc.).

²⁷ "Financial levies – short term issues" approved by the December 2010 Ecofin Council.

²⁸ One possibility would be to implement a system based on a ceiling. For instance, in such a system, the contribution to the DGS would be due in any circumstances. The contribution to the resolution fund, on the other hand, would depend on indicators of the contributing capacity of the bank. The contribution would only be due if the sum of the two contributions does not exceed a given predetermined ceiling. Such a financing mechanism should, however, not be conditional on the existence of a combined fund, but could be also applied if two separate funds co-exist.

²⁹ Such as bridge bank, asset sales, etc.

alternative options, given the challenges linked to placing several banks in liquidation/resolution at the same time (as it would be the case in a systemic crisis). In order to limit moral hazard, it is important to stress and properly communicate that going concern restructuring via bail-in is to be used as a last resort option in resolution.

3. The ESCB finds that both debt-equity swap mechanism and write-down raise a number of issues, which deserve further analysis. On the one hand, conversion into equity seems to have the advantage of (i) restoring the equity base once the claims of the incumbent shareholders (and other types of subordinated debt-holders) have been wiped out (ii) providing prospective investors with some upside risk once they have participated to the rescue of the financial institution.³⁰ On the other hand, if conversion is required by regulations, some non-joint stock company credit institutions could face legal obstacles due to company law impediments, as they cannot use the debt-equity swap mechanism.
4. In spite of its sound economic rationale bail-in entails significant risks, including concerns that its design and triggers may have destabilising effects on the financial sector.
5. At present, the ability of bail-in to achieve its stated purposes without unwarranted side-effects is hard to assess. The ESCB emphasizes the need to conduct accurate and detailed case studies that would shed light into the practical implications of bail-in. Realistic simulations are necessary to deliver a clear view on issues such as the amount of required liquidity needs, the feasibility of a rapid execution, the ability to respect the seniority waterfall in loss absorbency, the mechanics of conversion/write-down, etc.

Scope of the framework

6. To maintain the going concern under difficult market conditions, bail-in should

be designed in order to maximise the likelihood of the financial institution to rapidly return to solvency and regain market confidence, as well as to minimise disorderly market behaviour both before and after the implementation of bail-in.

7. To this purpose, several classes of debt, beyond deposits, should be exempted from sharing losses under the framework: short-term debt, swap and repo counterparties, secured long-term funding (covered bonds).³¹ The main rationale behind these exemptions regards the need to prevent both pre-emptive and ex-post runs from creditors, clients and counterparties which would clearly play havoc with the main objective of the regime and severely impact the ability of the financial institution to continuously perform vital business functions.

Design of a possible EU bail-in regime

8. The ESCB is of the view that, in most foreseeable instances, a bail-in will need to be implemented alongside broader resolution measures (such as removal of problem assets, replacement of management) in order to ensure the viability of the financial institution after the restructuring, limit moral hazard and enforce market discipline. Legal provisions for the overall resolution architecture need to be established anyway, which provides support to a statutory approach to bail-in over a purely contractual one.³²

³⁰ Equity upside could be seen as an automatic compensation for creditors.

³¹ Other classes of exposures, although not necessarily classified as debt contracts, should also be exempted, such as securities lending, exposures to market infrastructures, payment systems and clearing houses, custody money and, in general money related to clients' business.

³² Since a bail-in mechanism would most likely not be activated on a voluntary basis, a well-defined legal framework governing the powers and the modus operandi of the public authorities seems necessary. Nonetheless, for all those bonds that are considered by the authorities as bail-inable, it remains necessary to include terms and conditions that clearly specify that they are subject to conversion into equity or haircut once the relevant trigger is activated.

9. As regards more specific features of the bail-in framework, a prudent stance is generally supported, based on a detailed impact assessment and in-depth consultations with the financial sector. This background work should be instrumental in determining which approach (e.g. comprehensive vs. targeted) should be favoured.
10. The ESCB deems, therefore, it is premature to express a conclusive preference between a comprehensive and targeted approach. On the one hand, it seems that some key risks in terms of market distortions and erosion of the investors' base may be more easily curbed within "targeted approach" than with a "comprehensive approach", especially considering that bail-in is a new and untested tool.
11. A risk related to regulatory arbitrage and debt restructuring regards the potential shift towards liabilities that would fall outside the scope of bail-in, notably short-term debt and secured funding. Likewise, adequate investors' demand and reduced market segmentation could be ensured by the creation of a specific – but limited – class of bail-inable debt. A sensible solution to these problems would probably be to mandate a minimum level of bail-inable debt to be continuously held³³ as a share of Risk Weighted Assets.
12. Generally it would be a legally clearer solution to legislate for a new class of issued debt which would include special write down terms for that new debt class rather than by superimposing legislation on debt write downs onto all existing debt issues. In the latter case this may cause greater legal uncertainty as some unsecured creditor rights might be more negatively affected by the prescribed write down than others.
13. On the other hand, a fixed requirement for bail-inable debt is not devoid of challenges. For instance, restructuring authorities might face reputational issues whether the amount of bail-inable debt applied to a specific institution would prove insufficient to achieve its purposes.³⁴
- The trigger*
14. It is challenging to envisage feasible alternatives to a trigger linked to a discretionary supervisory determination of a firm reaching resolution stage.³⁵ Ratio-based triggers and market-based triggers are less suitable as they can be subject to accounting manipulation (ratio-based triggers) or market manipulation (market-based triggers).
15. Nonetheless, it is very important to reduce the uncertainty surrounding the activation of the triggers in order to avoid negative impacts on market behaviour, fire-sales by debt-holders and arbitrage opportunities. To this end, transparency will be crucial. Greater clarification and convergence on how the national supervisory authorities may assess the viability of credit institutions should be promoted. Likewise, an appropriate communication strategy, possibly based on guidelines and realistic examples, should seek to improve rating agencies and investors' ability to forecast the probability of conversion.
16. A possible shadow area would arise in those cases where early losses have not yet triggered the gone concern state but the supervisor anticipates further losses that would precipitate insolvency (for instance as a result of timely stress tests). Such cases would call for an early activation of bail-in, provided that the capital that would occur as a result of the conversion/write down at the
- 33 Of course, waivers to the rule should be contemplated for the post-bail-in stage, when the financial institution is restoring its long-term viability.
- 34 However, given appropriately designed regulatory minima, such cases would probably be conducive to resolution rather than bail-in, and thus should foresee the imposition of losses on several classes of unsecured creditors (irrespective of whether the relevant debt is bail-inable or not).
- 35 Possibly in analogy to the Basel Committee proposal on point of non viability capital.

point of non-viability – as proposed by the Basel Committee – would not be sufficient. In general, more clarity about borderline cases would also be needed to provide certainty to market participants and limit the risk of litigation.

17. Furthermore, the ESCB suggests that the availability of a last resort tool does not diminish the need for more preventative tools able to enforce an early intervention/prompt corrective action at the materialization of distress in the going concern state. The framework should not preclude the usage of debt with contractual conversion mechanisms with relatively high triggers (contingent capital) as additional going concern buffers. Among other things, such instruments would be key in avoiding individual banks' distress to spiral into a systemic crisis.

Marketability – pricing difficulties

18. The feasibility of consistent and economically convenient pricing and the availability of external ratings are key issues regarding the viability of bail-inable debt as a regulatory tool. Some relevant considerations are provided below.

19. Supervisors already at present have some discretion of when to close a financial institution. Therefore, provided bail-in would take place once a bank is in (the vicinity) of insolvency, the *probability of default* would be little changed.³⁶ On the other hand, *the loss given default* for bondholders would be surely higher than in a bail-out scenario but also lower than that under liquidation (provided the 'no creditor worse off than in liquidation' clause applies³⁷). The difference between these two outcomes is approximately the value of the implicit government support that needs to be abolished. As a result, bail-inable debt would be more expensive than current debt but also cheaper than equity (due to both the low ex-ante probability of conversion and

the higher capital buffers and additional regulation envisaged under Basel III).

20. Therefore, the problem requiring assessment is whether the increased expected loss can be easily priced in by the market and which categories of investors will be attracted to a riskier class of debt. Although clearly challenging, it seems that an uncertain government support is similarly difficult to forecast and price. More importantly, a comprehensive resolution regime would also allow imposing losses on junior and senior debt holders in liquidation, even in the absence of the bail-in option.
21. Following this reasoning, it could be argued that it is equally challenging to project the loss given default (and therefore calculate the risk premium and the price) of debt without bail-in, once a credible resolution regime is in place. It is not bail-in itself but rather the intention to avoid tax-payers' support that modifies the expected loss of debt instruments.

Marketability – the question of investor base

22. From a central bank perspective, the complexity of predicting future behaviour of market participants, be they investors or rating agencies, in the context of a regime with still many open questions should be highlighted. That said, market participants' appetite for such instruments will clearly depend on the risk/reward profile they offer. A transparent process to ensure authorities' compliance with the "no [creditor] worse off [than in liquidation]" principle is key to ensure legal certainty and improve the attractiveness of bail-inable bonds. Market demand will likely be higher under an

³⁶ Arguably very close to that embedded in the pricing of subordinated debt or current hybrids.

³⁷ The point seems to be true more generally, given the role of bail-in as a last resort tool, namely to avoid major negative consequences stemming from outright resolution (including market-wide disruptions that would trigger a large decline in the liquidation value of residual assets).

equity conversion option when compared to a pure debt write-down mechanism.³⁸

23. In practice, it can be expected that the market would adjust progressively to financial and regulatory innovation. Once a class of bail-inable debt is introduced, it is likely that initially sophisticated and more risk-tolerant investors will buy the bonds. Provided further experience is gained and standardisation and liquidity improve (for instance whereby the creation of specific market indices), more conservative investors may gradually follow, as the instruments receive market acceptance.³⁹ It is thus important that first implementations of the procedure end up successfully thus entrenching market trust.

24. As said, a practical option would be to mandate the issuance of a specific (but limited) asset class of bail-inable debt, whose terms and conditions clearly specify the possible outcome of bail-in (whose activation would anyway rely on the authorities' statutory powers). Creating a limited class of unsecured senior debt instruments would provide more clarity about which investors can be adversely affected and would not impact the behaviour of the (extant) market base for unsecured senior debt which remains not bail-inable.⁴⁰

25. Nonetheless, it remains important to study the interplay between bail-inable debt and other forms of convertible debt contemplated by the current regulatory agenda, such as low trigger contingent convertibles and point of non viability capital. A fair and consistent treatment of the post-conversion claims of these different investor classes seems necessary to attract sufficient market interest. In particular, the relationship between point of non-viability capital and bail-inable debt seems delicate, as both classes of fixed income investors could be transformed in 'forced shareholders'.

26. It is plausible to assume that both classes of investors could be called to contribute to the rescue of a distressed bank at the same time. Indeed, bail-in should logically follow the conversion of point of non-viability capital. Yet, the triggers for both types of instruments appear quite similar from an economic perspective and on the basis of available definitions of non-viability and resolution stage. Therefore, clarity should be provided about the relative treatment of the equity claims stemming from the conversion of point of non-viability capital and bail-inable debt.

Potential unintended consequences

27. The mere fact that a non viable bank is restructured and maintained as a going concern could give rise to *moral hazard*, at least in the creditors who are not bail-inable. This should be mitigated by clarity about the activation of bail-in under only extreme circumstances (as a last resort tool) and by the use of accompanying restructuring measures.

³⁸ Write-up features could also be foreseen.

³⁹ However, from an investors' perspective, it should be considered that, given the embedded equity option, banks and insurance companies would be required higher regulatory capital to hold bail-inable bonds, potentially resulting in lower demand and higher expected returns for this type of debt. Currently, many banks hold senior unsecured bank debt in their liquidity portfolio, but especially in light of the new liquidity framework, it is doubtful whether bail-inable unsecured bonds could be held in liquidity portfolios any more. The issuance prospects of banks with different financial strength should also be distinctly examined. Although strong market players will most likely always find funding for many kinds of instruments, it is a different question whether many of the second tier big, medium and small sized banks can have effective access to this funding. The risks of market fragmentation and discrimination should be considered more than just theoretical.

⁴⁰ In principle, institutions could be permitted to insert a write down term in any debt instrument they deem appropriate to meet the fixed requirement for bail in debt. However, regulators would still need to strike a balance between market flexibility, needed to ensure the emergence of a robust investors' base, and fragmentation. It seems important to promote standardisation and homogeneity rather than leaving room for unconstrained complexity and heterogeneity, also from a level playing field perspective.

28. Another possible drawback of the regime is that investors might require an additional degree of loss absorbing buffers (common equity and contingent capital instruments) in order to accept the extra risk. Such an outcome would be de facto equivalent to mandate a higher degree of going concern loss absorbency and would tend to *increase banks' cost of capital*. If authorities have a preference for bail-inable debt also on the basis that – as a resolution/going concern loss absorbing tool – it allows banks to access a lower cost funding option, this objective would be largely missed. In general, it remains useful to evaluate the possible trade-offs between different loss-absorbing tools, be they going or gone concern.
29. The ESCB considers that potential contagion channels, disturbances in the supply of funding, including liquidity problems both prior and post bail-in should be carefully analysed. One concern is that, as the likelihood of a debt write-down increases, fire sales of debt investors and the closure of refinancing possibilities could ensue, leading to liquidity risk for the financial institution and contagion effects. To mitigate this risk, again, the transparency of the regime is crucial.
30. The other concern is that immediately after the event of bail-in, a bank could experience difficulties in its access to funding sources, even when it is viable (given the negative signalling effects associated with a bail-in triggering). In this context, those jurisdictions which plan the creation of ex-ante funded resolution funds could employ (part of) those resources to provide liquidity assistance. It should also be left open the possibilities for ad-hoc private pools of capital to be established.
31. The Commission tentatively suggests that a further potential tool to mitigate this risk would be to give some creditors of a newly bailed-in institution a 'super senior' status. However, such an option needs careful evaluation, as correctly pointed out by the Commission. It seems difficult to single out which set of creditors need to be granted a super senior status, as well as justifying why and for how long. Such approach would likely raise fairness and financial stability issues, related to the disadvantageous treatment enjoyed by the creditors who bear the direct costs of the restructuring. Super senior creditors might also threaten to remove funding from the institution when they see the risk to lose their status which will keep a constant pressure on the authorities to maintain some kind of implicit support for the restructured institution.
32. Overall, it seems a more linear course of action to ensure that the outcome of a bail-in is to sharply improve a bank's capitalisation well beyond the prevailing market levels. This level should be determined so to be sufficient to stifle potential liquidity risks under most foreseeable instances.

Main legal concerns

33. It is a fundamental principle of insolvency law that unsecured creditors' claims rank generally *pari passu* and must be settled equally and in the same proportion.⁴¹ This should also be the guiding principle for bail-ins as a resolution measure of last resort. It would be legally problematic for the resolution authority to offer different write down terms on non objective grounds to different creditors within the same class or sub class of debt. If the terms offered to equally ranked creditors are not based on objective grounds this would constitute discriminatory treatment⁴² and would not be justified. Also, any bail-in which differentiates between equally ranked

41 There are exceptions to this fundamental principle in a few legal systems, such as priority of settlement for guaranteed depositors; this is a matter of public policy.

42 Discrimination may be defined as the different treatment of equal situations or the equal treatment of different situations; treatment of creditors claims which is not justified by objective differences among the situations can be described as discriminatory.

creditors in a discriminatory way cannot be judged to give proportionate weight to the creditors. This would render the bail in measure in breach of the principle of proportionality.⁴³

34. In the case of discriminatory treatment, there is a significant risk of a successful legal challenge by affected creditors on the grounds of infringement of their fundamental property rights.⁴⁴

35. Furthermore, administrative measures such as statutory bail-ins, which discriminate amongst creditors raise serious doubts with regard to the *no-worse-off* principle as it is not clear whether in such case the creditor would not be better off in a liquidation, reorganisation of debt or other normal insolvency proceeding. The severe consequences that bail in instruments have for creditors' property rights should be taken into account and it cannot be excluded that the bail-in is challenged on the grounds that the authorities could take measures, which are less restrictive of property rights.

36. There is also a serious risk that a bail-in which discriminates between equally ranked creditors may unnerve the market on which banks depend for funding. The *pari passu* principle is perceived by the market as an important element of fairness and security and should therefore be protected. The avoidance of any discrimination is of the utmost importance in order to ensure fair treatment of all parties concerned and to meet legitimate expectations concerning the strict respect of the proportionality and fair treatment principles.

37. It should be noted that the authorities are generally bound by the public law principles of equal treatment and proportionality. Both principles would be infringed by giving the resolution authority the statutory discretion to discriminate between equally ranked creditors within the same class of debt. If there should be objective reasons for

differentiating between creditors, any such differentiation should not be discriminatory. In such cases the bail-in measure could take effect and the authority would be free to act without needing to rely on any clause allowing for "discretionary power to discriminate".

38. Several techniques are possible to achieve the intended result of the write down. As regards the debt to equity swap, what is key is an objectively assessable and transparent trigger for deciding when the debt converts into a write down or equity. As explained above, by definition a write down is an interference with creditors' property rights.

39. As regards compensation rights, creditors would have the right to be compensated if in the case of the write-down mechanisms they could show that they are worse off than in the case of an orderly insolvency procedure. It would need to be carefully considered whether other rights to compensation might be required under applicable legal principles.

8 DEROGATIONS FROM SHAREHOLDER RIGHTS IN THE EU COMPANY LAW DIRECTIVES⁴⁵ (ANNEX 2 TO THE COMMISSION CONSULTATION) [Questions 69, 70]

1. The ESCB considers that a number of EU company law directives contain shareholder

⁴³ The need to respect this principle and not to discriminate between equally ranked creditors has been identified and respected by the German legislator during the recent introduction of the new German restructuring law, see Article 1, Gesetz zur Reorganisation von Kreditinstituten, Section 19 (3). It is also respected in the Minister of Finance's otherwise sweeping emergency resolution powers under the recent Irish (Credit institutions) Stabilisation Act 2010.

⁴⁴ Property rights are protected by Article 17 of the Charter of Fundamental Rights of the European Union and Article 1 of the 1st Protocol to the Convention for the Protection of Human Rights and Fundamental Freedoms.

⁴⁵ Please note that on 1 February 2011 the Chairman of the ESCB Legal Committee sent to DG Internal Market and Services the December 2010 Report and recommendations on amendments to the EU company law directives in respect of banks in emergency restructuring.

protections which are obstructive to efficient bank restructuring. The EU framework on bank recovery and resolution should therefore include a set of derogations from shareholder rights in the EU company law directives.

2. In particular, the 2nd Company law, Takeover bids and Shareholder rights directives could be usefully amended to exempt banks undergoing restructuring from certain shareholder rights, which delay or obstruct rapid restructuring or have the potential for doing so.
3. The Commission services should therefore give serious consideration to the possibility of:
 - exempting credit institutions, which are under resolution from the obligation to hold a general meeting to decide on an increase of capital under Article 25 of the 2nd Company law directive, as well as on a reduction in subscribed capital under Article 30 of the said directive;
 - removing shareholder pre-emption rights in share issues by credit institutions, which are under resolution for the duration of the resolution procedure. Accordingly, the pre-emption rights under Article 29 of the 2nd Company law directive could usefully be removed in the case of shareholders of such institutions;
 - exempting credit institutions, which are under resolution from the Takeover bids Directive *in toto*, or at least from the obligation to make a mandatory public offer under Article 5 thereof; and
 - exempting credit institutions which are under resolution from the obligation to give the minimum notice periods for general meetings under the Shareholder rights directive.

APPENDIX

LIST OF QUESTIONS CONSIDERED IN THE REPLY

Institutional Scope

- 1a. What category of investment firms (if any) should be subject to the preparatory and preventative measures tools and the resolution tools and power?
- 1b. Do you agree that the categories of investment firm described in Question Box 1 are appropriate? If not, how should the class of investment firm covered by the proposed recovery and resolution framework be defined?
- 1c. Are the resolution tools and powers developed for deposit-taking credit institutions appropriate for investment firms?
- 2a. Do you agree that bank holding companies (that are not themselves credit institutions or investment firms) should be within the scope of the resolution regime?
- 2b. Should resolution authorities be able to include bank holding companies in a resolution even if the holding company does not itself meet the conditions for resolution: i.e. is not failing or likely to fail (see conditions for resolution)?

Authorities

- 3a. Do you agree that the choice of the authority or authorities responsible for resolution in each Member State should be left to national discretion? Is this sufficient to ensure adequate coordination in case of cross border crisis?
- 3c. Is it desirable (for example, to increase the checks and balances in the system) to require that the various decisions and functions involved in resolution – the determination that the trigger conditions for resolution are met; decisions on what resolution tools should be applied; and the functional application of the resolution

tools and conduct of the resolution process – are allocated to separate authorities?

Supervision

- 4a. Should the stress tests be conducted by supervisors, or is it sufficient for institutions to carry out their own stress tests in accordance with assumptions and methodologies provided by or agreed with supervisors, provided that the results are validated by supervisors?
- 4b. The current crisis has shown that stress test disclosure is necessary to reassure markets and to bring to light potential problems before they become too large to be managed. It cannot, however, be excluded that in some circumstances disclosure without consideration of the possible impact in the market could do more harm than good. Do you agree that under exceptional circumstances the results of the stress tests should be made public only after appropriate safeguards have been agreed and introduced?
- 4c. Do you agree that in an integrated European market, stress testing should be conducted on the basis of a common methodology agreed at the EU level and subject to cross verification?

Recovery Planning

6. Are the required contents of preparatory recovery plans suggested in section B1 sufficient to ensure that credit institution undertake adequate planning for timely recovery in stressed situations? Should we include additional elements?
- 7a. Is it necessary to require both entity-specific and group preparatory recovery plans in the case of a banking group? How to best ensure the consistency of recovery plans within a group?

Intra-group Financial Support

9. Is a framework specifying the circumstances and conditions under which assets may be transferred between entities of the same group is desirable? Please give reasons for your view.
10. Section CI suggests that the support that might be provided under an agreement should be limited to loans, guarantees and the provision of collateral to a third party for the benefit of the group entity that receives the support. Do you agree that financial support should be restricted in this way, or should it allow a broader range of intra-group transactions?
- 13a. Should the agreement specify the consideration for the loans, provision of guarantees or assets, or simply set general principles as to how consideration should be determined for each specific transaction under the agreement (e.g. how the rate of interest should be set)?
14. Do you agree with the conditions for the provisions of intra-group financial support suggested in section C4?

Resolution Plans

- 21a. Should resolution plans be required for all credit institutions or only those that are systemically relevant?
- 21b. Would the requirements for resolution plans suggested above will adequately prepare resolution authorities to handle a crisis situation effectively? Are additional elements needed to ensure that resolution plans will provide adequate preparation for action by the resolution authorities in circumstances of both individual and wider systemic failure?

Early Intervention

- 24a. Is the revised trigger for supervisory intervention under Article 136(1) CRD (i.e. extended to include circumstances of likely breach) sufficiently flexible to allow supervisors to address a deteriorating situation promptly and effectively?
- 25a. Should supervisors be given the power to appoint a special manager as an early intervention measure?
- 25b. Should the conditions for the appointment of a special manager be linked to the specific recovery plan (Option 1 in section E2), or should supervisors have the power to appoint a special manager when there is a breach of the requirements of the CRD justifying intervention under Article 136, but the supervisors have grounds to believe that the current management would be unwilling or unable to take measures to redress the situation (Option 2 in section E2)?
- 25c. If the conditions for appointment of a special manager are based on Article 136, is an express proportionality restriction required to ensure that an appointment is only made in appropriate cases where justified by the nature of the breach?

Conditions for resolution

28. Which of the options proposed, either alone or in combination, is an appropriate trigger to allow authorities to apply resolution tools or exercise resolution powers? In particular, are they sufficiently transparent, and practicable for the authorities to apply? Would they allow intervention at the appropriate stage?

Transfer powers: ancillary provisions

36. The ancillary provisions set out in section G6 are intended to ensure that where business has been transferred to another entity through the use of a resolution tool, the transfer is effective and the business can be carried on by the recipient. Are the suggested provisions sufficient? Are any additional provisions necessary?

Protection of stakeholders: compensation and valuation

41. Are the principles suggested in section G11 sufficient to ensure that creditors receive appropriate compensation?

Limited suspension of certain obligations

42. Please give your views on the suggested temporary suspension of payment or delivery obligations? Is it appropriate to exclude eligible deposits? Should any other obligations be excluded?

Temporary suspension of close out netting rights

43. Please give your views on the temporary suspension of close out netting rights suggested in section G13, including the appropriate length of the suspension. Should any classes of counterparty be excluded from the scope of such a suspension: for example, Central Banks, CCPs, payment and securities settlement systems that fall within the scope of the Settlement Finality Directive?

Scope of rights

44. Do you agree that judicial review of resolution action should be limited to a review of the legality of the action, and that remedies should be limited to financial compensation, with no power for the court to reverse any action taken by resolution authorities?

Alternatively, should the court have the power to reverse a transfer of assets and liabilities in limited circumstances where unwinding of the transfer is practically feasible and would not cause systemic risk or undermine legitimate expectations?

Group Resolution

- 53a. Does the framework suggested in Part 5 strike an appropriate balance between the coordination of national measures that is necessary to deal effectively with a failing group, and the proven need for authorities to act quickly and decisively where the situation requires it?

54. Should it be a priority for the EU to strive for an internationally coordinated approach?

Financing Arrangements

57. Is it sufficient to make a general reference to the financing of resolution tools or is it necessary to be more explicit about what a fund can or cannot finance (e.g. recapitalisation, loss sharing, etc.)?

58. Should there be more explicit provision about the alternative funding arrangements, for example reference to specific types of arrangements such as debt issuance or guarantees?

- 59a. Should the basis for the calculation of contributions be fully harmonised or left to the discretion of Member States?

- 59b. Are eligible liabilities an appropriate basis for calculating contributions from individual institutions, or a more risk adjusted basis be preferable? The latter might take account of elements such as: a) the probability that the institution would enter into resolution, b) its eligible liabilities, c) its systemic importance for the markets in question, etc. However, would that add too much complexity?

60. Do you agree that when the DGS of a Member State is also able to finance resolution, this should be taken into account when calculating the contributions to the Fund? Are additional safeguards necessary to protect the interests of insured depositors?
65. Under what circumstances would additional compensation mechanisms be needed and what form might they take?

Annex I: Debt write-down

- 62a. What classes of debt (if any) would need to be excluded from a statutory power to write down senior debt?
- 62b. Is it desirable to undermine the principle that creditors of the same ranking should be treated similarly? Should a discretionary power allow authorities to discriminate within classes of debt?
- 62d. What measures would be appropriate to reduce debt restructuring and regulatory arbitrage? For example, would it be necessary to require a minimum amount of debt remains in scope at all times?

Annex II: Derogations to Company Law Directives

69. Are these provisions sufficient for the effective application of the resolution powers? Please specify the missing provisions, if any.
70. Do you agree on the need to create a mechanism for a rapid increase of capital? What would be the preferred option for the mechanism? Is there a need to specify that this mechanism can only be used close to the resolution triggers, i.e. not throughout the entire early intervention?
- 63a. What factors should authorities take into account when determining the correct amount of 'bail-in debt' that should be issued acknowledging the need to ensure that institutions are 'resolvable' while avoiding single market distortions?
- 63b. Would a market for large amounts of such debt exist at a cost which is lower than equity?
- 64a. Would the trigger be sufficiently clear and predictable (i.e. will instruments be rateable and will markets be able to price them) if linked to the failure of an institution?
- 64b. Are market participants likely to have an appetite for such instruments? Why or why not? If you consider that the pool of likely investors would be small, are there any adjustments which could be made to make such instruments more attractive without undermining the objectives of the tool?

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ISBN 978-92-899-0803-0 (online)