

EBI – European Banking Institute

5th EBI YRG Virtual Workshop Session

Title

*Exploring governance issues between the SRB
and the ESM in the use of the Common
Backstop*

Speaker

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1. Introduction

- Field: resolution of credit institutions in the euro area
 - Complex procedure requiring timely and well-structured decision making:
 - Bodies
 - Processes
- Research problem: governance issues → decision-making process (Common Backstop)
 - Need to ensure smooth provision of funding during resolution
- Covid-19 Pandemic shifted interest:
 - ESM Treaty Reform → ESM Pandemic Crisis Support
 - ESM Role as safety net for sovereigns consolidated (what about BU banks?)
- Despite interventions post financial crisis, Covid-19 pandemic → severe/unpredictable events
- Authorities involved: SRB and ESM
 - Core point of the study: Common backstop ESM → SRF

1. Introduction

- Structure of the paper:
 - Background, establishment, scope of action, governance
 - ESM-SRB/SRF
 - Needs of the SRF on the base of State Aid 2007-2014
 - Decision-making processes and related shortfalls
 - Solutions:
 - Possible changes to current framework
 - Arrangements to simplify/shorten procedures

2. The European Stability Mechanism

- Intergovernmental Organisation under International Public Law
 - IMF as example for structure, methods of intervention, financing (i.e. Greece 2010)
- Treaty Establishing the ESM in February 2012 (sovereign debt crisis)
 - Financial assistance under strict conditions
 - Conditionality political issue – divisions between MS
 - From ESM Treaty reform to ESM Pandemic Crisis Support
- ESM Members: 19 euro area Member States
- ESM Resources:
 - Initial capital stock €700 billion (each share of €100 000 nominal value) + Article 3 ESM Treaty
 - Bigger quota, more power (governance issue – i.e. DE, FR, IT)

2. The European Stability Mechanism

- ESM Lending toolkit
 - Precautionary financial assistance:
 - Precautionary conditioned credit line (PCCL)
 - Enhanced conditions credit line (ECCL)
 - Financial assistance for the recapitalisation of financial institutions of an ESM Member:
 - Loans for indirect bank recapitalisation (Spain)
 - Direct Recapitalisation Instrument (DRI) – never used
 - Loans (macroeconomic adjustment programme)
 - Support facility in the form of purchases in:
 - Primary markets
 - Secondary markets

2. The European Stability Mechanism

- Governance:
 - Board of Governors (BoG)
 - Representative of ESM MS – finance minister
 - Main ESM decision-making body
 - Chair: President of the Eurogroup
 - Board of Directors (BoD)
 - Former senior officials of ESM MS
 - Chair: Managing Director (also CEO of EFSF) – assisted by Management Board
 - Ensures ESM managed according to ESM Treaty
 - Decision-making body on delegation from BoG
 - Independent Board of Auditors

3. The Single Resolution Fund

- Established with the Single Resolution Mechanism Regulation (SRMR) – Article 67
- Managed by the Single Resolution Board (SRB)
- Associated with BU's highest objectives:
 - stop of the vicious circle banks-sovereigns;
 - equal bailout prospects for BU banks
 - use of Fund (+ Backstop) when private funds are unavailable/insufficient
- Composed of:
 - national compartments to be gradually mutualised
 - *ex-ante* contributions collected at national level
 - under the rules of the Intergovernmental Agreement (IGA) – political concerns


3. The Single Resolution Fund

- Target level:
 - 1% of BU covered deposits
 - To be reached by 31/12/2023 (period 2016-2023)
 - Dynamic target
- SRB's governance:
 - Plenary Session
 - Executive Session (restricted or extended)
 - 1 Chair
 - 4 full-time board members (1 vice chair with no voting rights)
- SFR insufficient acknowledged in Recital 102 SRMR and Recital 10 IGA


3. The Single Resolution Fund

- Fund can intervene:
 - extend short-term funding to
 - failed bank
 - bridge entity
 - provide guarantees to potential purchasers of a failed bank
 - inject capital in a bridge entity
- Fund cannot provide:
 - loss absorption
 - recapitalisation
 - exception (min 8% bail-in and max 5% SRF contribution)


4. The Common Backstop

- Sort of “rescue” support to the SRF when depleted
- No alternative funding solutions
 - “Last resort” principle
- Size depending of SRF level for:
 - transitional period (until 2023)
 - steady state (from 1/1/2024)  or before depending on reduction of risk factors (i.e. NPLs)

4. The Common Backstop

- 2 Types of credit lines:
 - Revolving
 - Parallel (i.e. Croatia, Bulgaria)
- Decision-making similar to State Aid  EC approval
 - De Groen and Gros background (period 2007-2014) example as justification for Backstop
 - Comparison with possible effects of pandemic
 - Data: (EC DG COMP)
 - 72 banks – 45% BU total assets - €313 billion in losses – out of 72 complete data for 62 banks
 - Out of 62 – 31 banks outside scope (17 enough capital – 14 minimum capital reached with bail-in)
 - Remaining 31 banks (6% BU assets) – 72 billion SRF intervention:
 - 13 banks need €32 billion, after bail-in need €10 billion
 - 18 banks need €182 billion, after bail-in + own funds need 149 billion – fund to provide max €62 billion (what about €87 billion?)

4.1 Decision-making process

- Conditions:
 - depletion SRF
 - unavailability/failure to raise funds from alternative sources as:
 - Temporary transfer of no mutualised funds
 - Borrowing from third parties
 - Sale of shares
 - DRI  Backstop (Article 19 ESM Treaty)
 - Forward looking approach – “just in case”
 - Disseminate security – reputation
 - Funding from alternative sources still not sufficient

4.1.1 SRB

- Financing arrangements to be included in resolution plans
- Decision-making process for the use of the SRF:
 - if strict conditions of Article 76 SRMR
 - if approved by EC (State Aid rules)
 - Council can intervene if
 - public interest
 - material modifications by EC
- Executive session to decide
- Any Plenary Member can intervene if
 - €5 billion from the Fund per single resolution action
 - Above €5 billion in a period of 12 months
- SRB makes request to ESM

4.2.1 ESM

- SRB request to ESM BoG accompanied by proposal of ESM Managing Director
 - Source of delay – Solution inspired by FOLTF declaration (Article 18 SRMR)
 - Mandatory consultation (i.e. SRB for ECB), which form?
 - ESM-SRB MoU on working arrangements
 - Specific provision in the revised ESM Treaty
- Decision made by BoG on unanimity – or delegation to BoD (under discussion)
- BoD takes decision about disbursement
- Decision to be taken within 12hrs, Managing Director can delay up to 24hrs

Conclusion

- Objective: timely and effective decision-making process
- Solutions:
 - Improvement of SRB request procedure
 - Shortening of ESM internal decision-making process:
 - Possibility to delegate the entire process to BoD (Article 4(4) ESM Treaty)
 - Issue of conclusions by ECB and EC, further delays
 - SRB instead of ECB-EC? Possible political issues, accountability?
 - Possibility to delegate for a limited period to the Managing Director (ESM Terms of Reference)
 - Excluding possibility of delays by the Managing Director
 - MoU ESM-SRB on working arrangements about Common Backstop (EC-ESM example)
 - Good impact of SRB arrangements
 - Existing MoU SRB-EC does not improve use of the Fund

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