

6. Resolution: lessons learned

The framework needs improvements

The handling of the recent cases shows that, despite having common legal (BRRD) and institutional (Banking Union) frameworks at EU level, bank failures are still not treated in a homogeneous way across Europe. Furthermore, the resolution framework requires improvements as its practical implementation has given rise to new challenges.

Now that we have seen how the new regime works in practice (last June Banco Popular was resolved, two Veneto banks were liquidated, and Monte dei Paschi was subjected to a preventive recapitalisation), it is time to draw some conclusions. Legal loopholes and practical implementation challenges show that there is a need to amend the framework to make it more credible and guarantee the new post-crisis paradigm whereby private shareholders and debt holders must absorb losses first without taxpayers' money being committed. In fact, there are several opportunities to do just that: i) following the mandate of article 129 of the BRRD, when the Commission carries out its first revision of implementation of the BRRD at the end of 2018, and ii) in the course of current negotiations of the banking reform package ("CRDV"). So what can be done to improve it?

1. Minimise the loopholes in current legislation

It is crucial to stress the fundamental importance of ensuring that the resolution framework is applied uniformly across the EU so that all bank shareholders, creditors and depositors are guaranteed equal treatment under resolution. One way to ensure this is by restricting the use of preventive recapitalisations once the resolution framework is complete (i.e. once banks have their MREL buffers fully built-up, provided that the problem of retail investors holding "bailinable" liabilities other than common stock is solved in a standard way). Moreover, the 2013 Commission's State Aid Communication should now be aligned with the BRRD (which was approved at a later stage) in terms of burden-sharing.

2. Harmonise bank liquidation regimes in the EU

This is necessary, not only to avoid better treatment in liquidation than in resolution, but also to ensure compliance with the fundamental principle of "no creditor worse off than in liquidation" (NCWO) that is enshrined in the BRRD. Accordingly, it is necessary to achieve a minimum of harmonisation among national insolvency laws and at the same time align them to the EU resolution framework.

3. Clarify the provision of liquidity

The latest ECB policy on Emergency Liquidity Assistance¹ seems to cover the case of an entity in resolution needing liquidity. However, more clarity is needed to include the cases where a bank is past the point of non viability but before

¹: <https://www.ecb.europa.eu/mopo/ela/html/index.en.html>

the application of resolution/liquidation. That is, allowing the lender of last resort to provide sufficient liquidity while plans to create a bridge bank, recapitalise the entity or liquidate it are put into effect. Furthermore, the EU should adopt the FSB's principles on funding in resolution which should be further clarified². Finally, a public backstop should be created to reinforce the credibility of the Single Resolution Fund.

4. Adopt a common approach to retail investors holding “bailinable” liabilities

Authorities at EU level should come up with a common solution to this problem to guarantee a level playing field at European level, by either prohibiting or seriously limiting the sale of bailinable (other than common stock) instruments to retail investors.

5. Improve the recovery phase

The recent resolution cases highlight the shortcomings of the recovery phase which must be revised and, if needed, authorities should have more instruments at their disposal (or the ability to use the existing ones without any interferences). But, the proposed pre-resolution moratorium tools are not a solution: their effect would be counterproductive as they would exacerbate bank runs at an even earlier stage than the PONV³. Their mere existence might deter investors and depositors and force a run at the first sign of deterioration. Furthermore, if the provision of liquidity is clarified as suggested in point 3, then these moratorium tools would not be needed.

2: <http://www.fsb.org/2016/08/guiding-principles-on-the-temporary-funding-needed-to-support-the-orderly-resolution-of-a-global-systemically-important-bank-g-sib/>

3: The Point of non viability (PONV) is already a vague concept, and authorities have ample discretion to activate it.

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