

The function of the single resolution mechanism (SRM) as central institution for bank resolution in the EU

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Abstract

The paper aims to provide the comprehensive analyze on how the single resolution mechanism works and its role in the process of the European Banking Sector integration. It is evident that since 2008 the European Commission carried a number of initiatives to safe the financial sector from crises occurred on some parts of the banking sector. On that base, after the establishment of Single supervising Mechanism, the EU Member States also agreed to have so called resolution mechanism for all its financial actors to preserve financial stability. The purpose was to take measures such as: setting rules for managing failing banks and improve protection of depositors.

The paper will analyze the impact of the Single Resolution Mechanism of the European Banking Union (EBU) on the unifying national bank resolution and Single Resolution fund to be able to recapitalize banks directly when it fails.

Keywords: SRM, SRB, single resolution fund, banking union.

Introduction

In 2014 the EU reached a political agreement creating the so called Single Resolution Mechanism (SRM) and Single Resolution Fund (SRF) in order to preserve financial stability and to minimize direction of bail out from public finds and protect the deposits.

The SRM was adopted on the basis of TFEU (Article 114) regulation containing uniform rules and procedure for resolution of credit institutions in the Member States which have entered into a close cooperation with European Central Banks. The credit institutions include financial institutions, investment firms as well as parent institutions. Until then for resolving failing banks the financial contribution was coming only from EU Member States instead of banks itself.

Under the Single Resolution Mechanism, centralized decision-making power in respect of resolution has been entrusted to the Single Resolution Board, which derives its powers from both the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR). If a bank fails despite stronger supervision, the SRM allows bank resolution to be managed effectively through a single resolution fund that is financed by the banking sector. The SRM within Eurozone supplements common supervision and ensures resolution through any bank crisis. Countries that will join Single Supervision Mechanism automatically

will be part of the SRM as well.

After many discussions and opinions it is evident that SRM is step by step process holding mutual risks or risk sharing between the entities in bail out planning. Other than that not each bank has right to join the SRB. First it must be sure their balance sheets and asset quality before joining banking union. The countries shall not fear of any loss of national sovereignty because EBU provides greater security and greater market access.

Single resolution board

The single resolution board is established by the SRM regulation and is fully independent EU agency acting as the central resolution authority within the European Banking Union. Together with the national resolution authorities of participating countries, it creates the SRM. The mission of the SRB is to ensure the orderly resolution of failing banks with minimum impact on the real economy and the public finances of banking union countries and to manage the single resolution fund. As of 2 March 2017, 21 European states have ratified the intergovernmental agreement (IGA) allowing the Single Resolution Board (SRB) to take over full responsibility for bank resolution.

The ECB through SRB as the resolution authority for banks decided to exercise directly all of the relevant supervisory powers; and other cross-border groups, where both the parent and at least one subsidiary bank are established in two different participating Member States of the Banking Union. Among others SRB it is also responsible for drawing up the resolution plans and taking decisions relating to the entities group in participating Member States and other cross-border groups (entities in more than one participating Member States).

The SRB makes an assessment whether a bank is likely to fail. The ECB shall provide all relevant information about a bank to the SRB to assess the process. The SRB remains ultimately responsible to determine whether a resolution action is necessary in the public interest.

The SRB places the bank under resolution if a bank meets the conditions. This means the adoption of a resolution scheme, which determines what resolution tools are to be applied to the bank and whether the Single Resolution Fund is to be used to support the resolution action. But, the SRF has limited means. As of 30 June 2017, the SRB had collected € 6.6 billion from 3,512 institutions in annual contributions to the Single Resolution Fund. In total, the SRF now holds an amount of €17.4 billion.

The main tasks of the SRB include:

- Prepare, assess and approve resolution plans for entities and groups, the assessment of bank's resolvability, setting minimum requirement for own fund and eligible liabilities;
- Preparatory work undertaken prior resolution, when ECB or national competent authorities act to prevent a possible failure;
- Cooperation and coordination with national resolution authorities both within the EU and with third countries.
- Adoption of resolution schemes, decision whether conditions for resolution are met.

The resolution tools which will be applied after the Board adopts a resolution scheme are:

- The sale of business tool (parts or all of bank is sold)
- Parts or all of a bank is transferred to a transitory entity controlled by the SRB
- Some assets, rights or liabilities are transferred
- The bail-in tool (equity and debt must be written down or converted before any use of the SRF)

Single Resolution Fund

The SRF is based on the agreement which applies to the Contracting Parties whose institutions are subject to the SSM and SRM. The fund will be used to bail out a bank in the event of a collapse, to cover the cost of a potential bail out. First, the parties must transfer the contribution raised at national level to the SRF during a transitional period of eight years reaching a target level of at least 1% of the amount of all credit institutions in all participating Member States. However, first the losses should be afforded by shareholders and then by creditors through "bail-in", but in any case shall not lead to a situation in which a creditor is worse than under normal insolvency proceedings. In the case of those contributions being insufficient, the resolution may draw on additional re-sources provided by the Single Bank Resolution Fund ("SRF"). The contributions are calculated at the level of the individual bank. There is a particular treatment for small credit institutions which only contribute with a lump-sum payment in proportion to their size. All bank contributions are pooled at Union level in accordance with an intergovernmental agreement on the transfer of those contributions.

In any case, the pre-conditions for the use of the SRF are that losses totaling not less than 8 % of total liabilities (including own funds) have already been absorbed by shareholders and creditors. Moreover, the additional funding that can be provided by the SRF is limited to a maximum of 5% of the bank's total liabilities.

National Resolution Authorities (NRAs)

The NRAs are the resolution authorities of the participating Member States of the Banking Union, which must be a public administrative authority or an authority entrusted with public administrative powers such as national central bank, a competent ministry or authority entrusted with public administrative powers.

National Resolution Authorities is the main points of contact for credit institutions and investment firms in their jurisdiction. When necessary the SRB can decide, or an NRA can request the SRB to exercise directly all its powers. However, the NRA should ensure that any decision intended to adopt should comply with the SRB.

The question is how these institutions and processes will work with countries outside the European Union. In defining the resolution plans for cross-border banks, the location of the bail-in funds will be a key point of contention. Indeed the Bank Recovery and Resolution Directive offer limited options for access to resolution by third countries. In any case, non-EU countries that want to participate in resolution will have to provide a resolution fund in order to become credible participants.

SRM and resolution authorities of non-participating Member States and third countries

The European Resolution Colleges has direct responsibility for non-participating

Member States. The Resolution Colleges is composed from: the resolution authorities of non-participating Member States; the competent ministries; the authorities responsible for the Deposit Guarantee Schemes (DGSs) of relevant Member States; and the EBA, as non-voting member.

The resolution authorities of third countries (i.e. countries outside of the EU) where a credit institution or an investment firm established in the EU has a significant subsidiary or branch, can at their request be invited to participate in the Resolution College as observers, provided that they are subject to equivalent confidentiality requirements. Furthermore, European Resolution Colleges (ERCs) must be set up where two or more subsidiaries or significant branches are located in the EU of a parent undertaking, credit institution or investment firm that is headquartered in a third country. The Board, the ECB and the resolution competent authorities of the non-participating Members States must conclude MoU's containing general terms of their cooperation.

Conclusions

The function of the SRM in its current position appears well suited to handle resolution cases that can be carried out in a pretty predictable way over an extended period. The SRM reduces costs when the bank is failing or likely to fail, expecting to help avoid problems such as reorganize or liquidate the bank before balance-sheet insolvency occurs.

The crisis has shown the importance of having framework in place for resolving failing banks. Thus acting timely will avoid problems in one banks and affecting other banks. Through bailouts the SRM will ensure that those who gain are also those that will cover the losses. Indeed, in order for SRM to be effective a comprehensive power and tools are required.

The single resolution mechanism as specialized body for the regime of bank failures shall minimize the resort of bail out through public funds and at the same time shall protect the depositors thus preserving the financial stability.

The Single Resolution Mechanism is expected to strengthen confidence in the banking sector, prevent bank runs and saving internal market for financial services.

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