EU Bank Insolvency Law Harmonization: What Next?

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Abstract: After the COVID-19 crisis has subsided, the (further) harmonization of bank insolvency law will again be high on the agenda of EU regulators and policy makers. On the basis of an analysis of the status quo pain points, the paper advocates the extension of the BRRD resolution regime to all bank failures, regardless of their systemic relevance. This could be achieved by removing the public interest requirement as part of the resolution trigger. The ensuing consolidation would significantly reduce complexity and enhance the transparency and legitimacy of the EU crisis management framework.

Keywords: BRRD, SRM, bank insolvency, resolution, bail-in, deposit insurance

I. Introduction

Prior to the COVID-19 crisis, the (further) harmonization of insolvency laws pertaining to credit institutions was firmly in the crosshairs of EU regulators and policy makers.[1] The principal arguments were twofold: The complexities resulting from divergent national bank insolvency laws pose a challenge for the application and

[1] Elke König, *Why we need an EU liquidation regime for banks* Eurofi Article 5 September 2018 (available at https://srb.europa.eu/en/node/622); also Elke König, *Speech: Hearing at the ECON committee of the European Parliament - SRB Chair, Elke König* 2 July 2019 (available at https://srb.europa.eu/en/node/807); Fernando Restoy, *How to improve crisis management in the banking union: a European FDIC?* CIRSF Annual International Conference 2019, Lisbon, Portugal, 4 July 2019 at 5-8; Bundesministerium der Finanzen (BMF), non-paper: Positionspapier zum Zielbild der Bankenunion (November 2019), 3 (available at http://prod-upp-image-read.ft.com/d3117b58-ffbb-11e9-b7bc-f3fa4e77dd47); Ursula von der Leyen, A Union that strives for more: My agenda for Europe: Political Guidelines for the next European Commission 2019-2024, 9 (available at https://ec.europa.eu/commission/sites/beta-political/files/political-guidelines-next-commission_en.pdf); European Commission, Report from the Commission to the European Parliament and the Council on the application and review of Directive 2014/59/EU (Bank Recovery and Resolution Directive) and Regulation 806/2014 (Single Resolution Mechanism Regulation), COM(2019) 213 final, 9.

credibility of the BRRD[2]/SRM[3] resolution framework;[4] and inadequate national insolvency law regimes invite national bailouts through generous State aid outside the resolution regime.[5] In short, a harmonised bank insolvency law framework could mitigate 'the destruction of value, level the playing field for creditors, and reduce the risk of member states "gaming" the system'.[6] In the wake of the COVID-19 crisis, the Commission has temporarily relaxed the State Aid framework with a view to enabling Member States to adopt the necessary measures in support of their economies.[7] As a result huge amounts have been mobilised, and will put a strain on national budgets for years to come. As a consequence, effective and efficient national bank insolvency regimes will be even more relevant when the COVID-19 crisis subsides and economies return to, a perhaps new, normal.

On the basis of an analysis of the status quo pain points of the current crisis management framework in the banking sector, the paper advocates the extension of the BRRD resolution regime to all bank failures, by removing the public interest test as part of the resolution trigger. The ensuing consolidation would significantly reduce complexity and enhance the transparency and credibility of the resolution framework. The counterarguments, in form of possible fundamental rights infringements, liquidation as least cost option and lack of bail-inable debt at smaller institutions, remain unpersuasive. Section II critically analyses the conditions for resolution and

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[2] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms […], OJ L 173, 12.6.2014, 190; as amended by Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017, OJ L 169, 30.6.2017, 46; Directive (EU) 2017/2399 of the European Parliament and of the Council of 12 December 2017, OJ L 345, 27.12.2017, 96; Directive (EU) 2019/879 of the European Parliament and of the Council of 20 Mai 2019, OJ L 150, 7.6.2019, 296.
[3] Regulation (EU) 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010, OJ L 225, 30.7.2014, 1; as amended by Regulation (EU) 2019/877 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 806/2014 as regards the loss-absorbing and recapitalization capacity of credit institutions and investment firms, OJ L 150, 7.6.2019, 226.
[4] European Commission (n 1) 9.
[5] Agnès Bénasy-Quéré, et al, *Reconciling risk sharing with market discipline: A constructive approach to euro area reform,* Centre for Economic Policy Research Policy Insight No. 91 6 (January 2018); Fernando Restoy, *Bail-in in the new bank resolution framework: is there an issue with the middle class?* Speech at the IADI-ERC International Conference, Naples, Italy, 23 March 2018 at 6 (available at https://www.bis.org/speeches/sp180323.htm).
[6] International Monetary Fund, Euro Area Policies: Financial Sector Assessment Program Technical Note – Bank resolution and Crisis Management (IMF Country Report No 18/232, July 2018) para 28.
[7] Communication from the Commission: Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak C(2020) 1863 final.

possible opt-outs that allow policymakers to game the current multi-track system, it also discusses the complexities of the *status quo* and identifies the preferable high-level policy options for (further) harmonization. These may be implemented by extending the scope of the BRRD resolution framework to all bank failures, regardless of whether they meet the public interest test. The practicalities of, and objections to, this approach will be discussed in Section III. Section IV. concludes.

II. Status quo pain points and possible remedies

BRRD and SRM have established a harmonized and partly integrated framework for the resolution of potentially any financially distressed credit institution and certain investment firms[8] (hereafter: 'institutions' or 'financial institutions') as an alternative and exception to their treatment under domestic 'normal insolvency proceedings.'[9] Resolution applies where (i) the competent authority, after consulting the resolution authority,[10] determines that the institution is failing or likely to fail; provided (ii) there is no reasonable prospect that failure could be prevented through alternative, in particular, private sector measures; and (iii) resolution action is necessary in the public interest,[11] that is, it achieves, and is proportionate to, one or more of the resolution objectives, [12] and winding up of the institution pursuant to normal insolvency proceedings would not meet those objectives to the same extent. Thus, in the absence of systemic implications, 'normal insolvency proceedings' apply as the default option.[13] The BRRD/SRM resolution framework seeks to replicate the loss allocation principles of general insolvency law so as to curtail moral hazard and enhance market discipline; whilst at the same time providing a tailored administrative procedure with far-reaching powers to prevent the systemic implications of

[8] Art 1(1) of the BRRD delineates its subject matter and scope in line with the CRD IV Regime (Regulation (EU) No 575/2013 and Directive 2013/36/EU).
[9] As defined in BRRD, Art 2(1.)(47); BRRD, Art 32(1)(c) and (5), 32b; SRMR, Art 18(1)(c) and (5). '
[10] Or *vice versa*, if the Member State so provides and resolution authorities have access to the information necessary in order to make the determination of failure; BRRD, Art 32(2).
[11] BRRD, Art 32(1); SRMR, Art 18(1).
[12] These are: (i) to ensure the continuity of critical functions; (ii) to avoid significant adverse effects on financial stability, including by preventing contagion and maintaining market discipline; (iii) to protect public funds by minimizing reliance on extraordinary public financial support; (iv) to protect depositors as well as client funds and assets; in each case whilst minimizing the cost of resolution and avoiding the unnecessary destruction of value; BRRD, Art 31(2); SRMR, Art 14(2).
[13] BRRD, Art 32(5), 32b; SRMR, Art 18(5).

contagious knock-on effects.[14] When triggered, the BRRD/SRM resolution regime supersedes and displaces the applicable national bank insolvency law.[15] A semi-mandatory loss allocation cascade applies: Equity, capital instruments, subordinated debt and senior unsecured debt may be called upon to contribute to the absorption of losses, not, however, secured debt and covered deposits. The framework leaves considerable room for differential treatment of creditors of the same class and beneficial treatment on systemic risk grounds[16] of creditors and classes in deviation from the statutory order of priority under national insolvency law.[17] Investors are protected on the basis of the 'no-worse-off' principle.[18] However, before any losses can be passed on to the relevant resolution financing arrangement and eventually the national budget, shareholders and creditors must absorb a minimum amount of losses of 8% of total liabilities,[19] and fund aid is, in principle, limited to 5% of total liabilities.[20] Where resolution is financed through resolution funds and statutory deposit guarantee schemes, the relevant EU State aid rules apply concurrently with the BRRD/SRM framework. Outside of resolution, the State aid rules may override and modify the loss allocation schedule under national bank insolvency law and shield (some) investors from losses.

1) 'Designed for circumvention'[21]?

Any decision to let losses lie where they fall, or to impose losses on some but not on others, will inevitably hurt the constituencies that will be called upon to contribute to

[14] Christos Hadjiemmanuil, 'Bank Stakeholders' Mandatory Contribution to Resolution Financing: Principle and Ambiguities of Bail-In' in: ECB Legal Conference 2015: From Monetary Union to Banking Union, on the Way to Capital Markets Union, New Opportunities for European Integration (2015) 232-234; Christos Hadjiemmanuil, 'Limits on State-Funded Bailouts in the EU Bank Resolution Regime,' (2016.2) European Economy 91, 101; Jens-Hinrich Binder, 'Systemkrisenbewältigung durch Bankenabwicklung? Aktuelle Bemerkungen zu unrealistischen Erwartungen' (2017) Zeitschrift für Bankrecht und Bankwirtschaft 57, 60.
[15] BRRD, Art 86.
[16] BRRD, Art 48(5) with Art 44(2) and (3); Hadjiemmanuil (2015) (n 14) 237.
[17] Karl-Philipp Wojcik, 'Bail-In In The Banking Union' 53 (2016) C.M.L. Rev. 91, 130.
[18] Wojcik (n 17) 120-122; Emilios Avgouleas and Charles Goodhart 'Critical Reflections on Bank Bail-ins' 1 (2015) Journal of Financial Regulation 3, 18, pointing out the risk of litigation that the 'no-worse-off' principle is likely to generate.
[19] BRRD, Art 44(5), 101(2); SRMR, Arts 27(7), 76(3).
[20] Any additional fund aid or state aid beyond the 5% limit is subject to strict pre-conditions; BRRD, Art 44(7); SRMR, Art 27(9) and (10).
[21] Anna Gelpern and Nicolas Véron, 'An Effective Regime for Non-viable Banks: US Experience and Considerations for EU Reform' Study Requested by the ECON committee (2019), 53.

loss absorption, invite public scrutiny and criticism, and is likely to generate lengthy litigation.[22] Therefore, resolution authorities and competent authorities have strong incentives to avoid politically inconvenient decisions where possible. The conditions for resolution leave ample room for opting out of the BRRD's minimum loss contribution requirement. Whether the BRRD/SRM resolution framework will be triggered in any given case is largely a discretionary judgment on the part of the competent authority and the resolution authority.[23]

An institution will be deemed to be failing or likely to fail in case of a breach of capital requirements, illiquidity or insolvency[24], or if it requires extraordinary public financial support.[25] Given that according to Haldane, the reported capital ratios are 'as much an article of faith as fact, as much art as science,'[26] the determination of a breach of the regulatory threshold is largely a matter of discretion. Illiquidity and insolvency are similarly fluid concepts: financial assets are notoriously volatile and, depending on market movements, may quickly turn into financial liabilities, and *vice versa*.[27] 'Extraordinary public financial support' is defined as State aid under Art 107(1) TFEU (and similar public financial support at supra-national level).[28] According to the Commission's Banking Communication of 2013,[29] a public intervention does not constitute State aid if it takes the form of central bank emergency liquidity assistance (ELA) granted to temporarily illiquid but solvent institutions in exceptional circumstances. Liquidity assistance on this basis is subject to neither the BRRD/SRM nor the State aid framework. Thus, the eventually resolved Spanish banking group Banco Popular could be propped up for two days with

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[22] See the list of pending cases concerning the resolution of Banco Popular on the website of the European Banking Institute: https://ebi-europa.eu/publications/eu-cases-or-jurisprudence/; see further Rosa Maria Lastra, Costanza A Russo and Marco Bodellini, 'Stock take of the SRB's activities over the past years: What to improve and focus on?' Study Requested by the ECON committee, 13-15 (2019) Appendix.
[23] Jens-Hinrich Binder et al, 'The choice between judicial and administrative sanctioned procedures to manage liquidation of banks: A transatlantic perspective,' (September 2018) 8 (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3244334) at 12.
[24] BRRD, Art 32(4) (a) – (c); SRMR, Art 18(4)(a) – (c).
[25] BRRD, Art 32(4)(d); SRMR, Art 18(4)(d).
[26] A Haldane, 'Capital Discipline', Speech given at the American Economic Association, Denver, 9 January 2011, 3, available at www.bis.org/review/r110325a.pdf.
[27] S Schelo, Bank Recovery and Resolution (Alphen aan den Rijn: Kluwer Law International, 2015) 24.
[28] BRRD, 2(1)(28); SRMR, Art 3(1)(29.).
[29] Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication'), OJ EU 30.7.2013 C216/1.

EUR3.6bn of ELA from the Bank of Spain; only postponing the inevitable but allowing sophisticated creditors to exit without sustaining any losses. Moreover, an investment attributable to a Member State may not amount to State aid if made under the same conditions that a private owner would have accepted, in the sense that any risks assumed by the State and its emanations will be compensated at market rates. Consequently, when the regional government as shareholder funded the recapitalization of the German lender NordLB it did not amount to failure triggering resolution.[30] Further, a measure may exceptionally be subject only to the State aid regime, completely outside of the BRRD/SRM resolution framework. This will be the case where extraordinary public financial support takes the form of a so-called 'precautionary recapitalization' or constitutes a state guarantee of newly issued liabilities.'[31] With Commission approval, the Italian government recapitalized Banca Monte dei Paschi di Siena (MPS) on the basis of the former;[32] whereas Banca Carige was rescued by relying on the latter.[33] Both banks had been struggling for years with ever-increasing capital shortfalls, raising serious doubts as to their long-term viability.[34]

Advances from national industry financed resolution funds and deposit guarantee schemes may amount to State aid in accordance with general State aid doctrine.[35]

[30] European Commission – Press release, 'State aid: Commission concludes that recapitalization of German NordLB is market conform' (5 December 2019), available at https://ec.europa.eu/commission/presscorner/detail/en/IP_19_6684.

[31] This is subject to the following conditions: (i) support is being granted in order to remedy a serious disturbance in the economy of a Member State and to preserve financial stability; (ii) the beneficiary is solvent; (iii) the measure is of a precautionary and temporary nature and proportionate for remedying the consequences of a serious disturbance; (iv) it is not used to offset losses that the institution has incurred or is likely to incur in the near future; and for a precautionary recapitalization also (v) the injection of own funds or purchase of capital instruments is made at prices and on terms that do not confer an advantage upon the institution, that is, it is made at market prices and not as overpayment; (vi) the institution is not failing on other grounds; and (vii) a precautionary recapitalization is limited to injections necessary to address a capital shortfall established through a stress-test or similar exercise conducted by the ECB, EBA or national authorities. See further Hadjiemmanuil (2016) (n 14) 109; Christos V. Gortsos, 'A poisonous (?) mix: Bail-out of credit institutions combined with bail-in of their liabilities under the BRRD – The use of 'government financial stabilisation tools (GFSTs),' 16 (Oct. 12, 2016); https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2876508.

[32] Banca D'Italia, *The 'precautionary recapitalization' of Banca Monte dei Paschi di Siena* (Dec. 29, 2016); https://www.bancaditalia.it/media/approfondimenti/2016/ricapitalizzazione-mps/precautionary-recapitalization-MPS.pdf?language_id=1.

[33] European Parliament Briefing, Recent Measures for Banca Carige from a BRRD and State Aid perspective (February 2019), available at https://www.europarl.europa.eu/RegData/etudes/BRIE/2019/624413/IPOL_BRI(2019)624413_EN.pdf.

[34] Binder (2017) (n 14) 70-71; Ignazio Angeloni, 'EU's banking misfortunes share a common thread' Financial Times, September 12, 2019.

[35] Case 290/83 *Commission v France* ECLI:EU:C:1985:37 para 15.

However, in Joined Cases T-98/16, T-196/16 and T-198/16 *Italian Republic et al v European Commission* the General Court held that financial support granted by the privately organized and funded Italian *FITD* to the ailing Banca Tercas did not amount to State aid because the level of involvement and input of the Bank of Italy as competent authority in the restructuring measures was insufficient to render the Fund's intervention attributable to the State. [36] Thus, where the resources of the privately organized fund are exclusively obtained from the financial services sector on a voluntary basis,[37] the involvement of public authorities in any rescue measures is minimal and the available amount is sufficiently large so that the national budget is unlikely to be needed as a backstop, EU State aid would have no role to play,[38] the institution would not be failing and a rescue with deposit guarantee fund assistance may constitute a suitable private sector alternative.[39]

Resolution will be in the public interest if it achieves, and is proportionate to, one or more of the resolution objectives, and winding up of the institution pursuant to normal insolvency proceedings would not meet those objectives to the same extent. The SRB has attempted to clarify its approach to 'Public Interest Assessment.'[40] Although this provides some procedural clarity, the substantive elements remain vague and unspecific.[41] For example, the presence in the market of institutions with a business model that is similar to that of the failing institution may support the assumption of an enhanced risk of contagion justifying resolution;[42] or may suggest easy substitutability of the functions provided by the institution so that corporate

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[36] In Joined Cases T-98/16, T-196/16 and T-198/16 *Italian Republic et al v European Commission* ECLI:EU:T:2019:167. An appeal is currently pending before the Court of Justice.

[37] e.g. Statut des Einlagensicherungsfonds (December 2018), §2a; Satzung Bundesverband deutscher Banken (November 2018), §6. This will be different where the statutory DGS is utilized for restructuring purposes in accordance with DGSD, Art 11(3). The necessary involvement of resolution authority and competent authority are likely to trigger the applicability of the State aid framework; C Brescia Morra, 'The New European Union Framework for Banking Crisis Management: Rules *versus* Discretion' (2019) ECFR 349, 364-365.

[38] Gelpern and Véron (n 21) 42.

[39] BRRD, Art 32(1)(b); SRMR, Art 18(1)(b).

[40] Single Resolution Board, Public Interest Assessment: SRB Approach (July 2019), https://srb.europa.eu/sites/srbsite/files/2019-06-28_draft_pia_paper_v12.pdf.

[41] see further Lastra et al (n 22) 13-15.

[42] Decision of the Single Resolution Board in its Executive Session of 7 June 2017 concerning the adoption of a resolution scheme in respect of Banco Popular Español, S.A, (the "Institution") with a Legal Entity Identifier: 80H66LPTVDLM0P28XF25, Addressed to FROB (SRB/EES/2017/08) para 4.4.2.

insolvency would be sufficient.[43] With this flexible public interest test, smaller institutions may be resolved through national bank insolvency law, supported by generous State aid packages granted by the home Member State. Generally, under national bank insolvency law any losses sustained by an institution are to be fully absorbed by equity and debt investors in accordance with a (largely) mandatory order of priority. Only covered depositors will never be asked to contribute to loss absorption, although the deposit guarantee scheme subrogated to the claims of covered depositors may. However, this baseline loss sharing arrangement may be superseded by the EU State aid regime. Pursuant to the Banking Communication, the State aid regime requires a contribution to loss absorption of equity, capital instruments and subordinated debt only; senior unsecured debt and any higher-ranking debt will in principle remain untouched.[44] The Commission has wide discretion for differential treatment of creditors within the same class and across classes, subject only to the 'no-worse-off' principle.[45] There is no minimum amount of loss contribution by investors and no fixed cap on the amount of public money that may be advanced.[46] Although conceptually this route seems to be reserved for smaller non-systemic institutions, there is nothing that would prevent a 'national champion' from being rescued in this way: the government of a Member States may strike a deal with the Commission on the granting of State aid, and then argue that resolution under BRRD/SRM would not meet the resolution objectives to the same extent as (part) liquidation under national insolvency law combined with generous

[43] Decision of the Single Resolution Board in its Executive Session of 23 June 2017 concerning the assessment of the conditions for resolution in respect of Veneto Banca S.p.A. (the "Institution") with a Legal Entity Identifier 549300W9STRUCJ2DLU64, addressed to Banca d'Italia in its capacity as National Resolution Authority (SRB/EES/2017/11) para 4.2.1.1; Decision of the Single Resolution Board in its Executive Session of 23 June 2017 concerning the assessment of the conditions for resolution in respect of Banca Popolare di Vicenza S.p.A. (the "Institution") with a Legal Entity Identifier V3AFM0G2D3A6E0QWDG59, addressed to Banca d'Italia in its capacity as National Resolution Authority (SRB/EES/2017/12) para 4.2.1.1. See further Single Resolution Board, Notice summarising the decision taken in respect of ABLV Bank, AS (Feb. 2018); https://srb.europa.eu/en/content/ablv; Single Resolution Board, Notice summerising the decision taken in respect of ABLV Bank Luxembourg S.A. (Feb. 2018); https://srb.europa.eu/en/content/ablv; and Single Resolution Board, Notice summarizing the decision taken in respect of AS PNB Banka (August 2019), https://srb.europa.eu/sites/srbsite/files/20190815_summary_of_non-resolution_decision_pnb_banka.pdf.
[44] Banking Communication, para 41-46.
[45] Gortsos (n 31) 18.
[46] Although aid should be limited to the minimum necessary, Banking Communication, para 15.

State aid would.[47] The Bank of Italy has already argued along these lines.[48] Although at the resolution planning stage the public interest assessment should disregard any extraordinary public financial support,[49] at the resolution trigger stage this prerequisite does not apply, and in any case the prospect of state aid may *de facto* influence the SRB's decision.[50] That this is not just a theoretical concern shows the loss of credibility resulting from the Deutsche Bank bail-out speculations[51] shortly after the new framework had become operational.[52]

The ability to circumvent the resolution framework introduces flexibility into the system, and arguably allows resolution authorities to deal with individual cases in the most appropriate way. However, as it stands, the BRRD/SRM regime is likely to be relevant for only a small number of 'easy cases' where the application of resolution tools and powers is straightforward, the potential spillover effects limited and/or the political implications minimal.[53] 'Hard cases' are likely to be treated to generous public funding and State aid measures. Of the available escape routes, central bank liquidity can be freely created without directly affecting national budgets;[54] precautionary recapitalizations and state guarantees of newly issued debt are (at least on paper) subject to strict preconditions; and industry funded rescue measures do not directly expose taxpayers to losses.

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[47] The new BRRD, Art 32b does not make a difference; see III 4. below.

[48] Where the SRB has decided to launch the BRRD/SRM procedure, the entire value of the equity and the junior bonds of an institution may be lost, and senior bonds and unprotected deposits may be subject to bail-in. This may generate higher costs for all the parties involved: the State, banking customers and the rest of the banking system, contrary to the goal of minimizing the costs of resolution and avoiding the destruction of value; https://www.bancaditalia.it/media/fact/2017/0712-venete-anticipo/index.html.

[49] BRRD, Art 15(1); SRMR, Art 8(6); SRB, Public Interest Assessment, 12.

[50] Gelpern and Véron, (n 21) 45.

[51] When Deutsche Bank faced the prospect of a $14bn fine in the United States, the German newspaper *Die Zeit* reported that officials in Berlin, Frankfurt and Brussels were secretly preparing a rescue package.; M Schieritz and A Storn, 'Was wäre, wenn …' Die Zeit Online (13 October 2016) (http://www.zeit.de/2016/41/deutsche-bank-aktie-krise-rettungsplaene). The German government flatly denied the report. However, speculation in the financial press continued for several weeks.

[52] Lea Steinbruecke, *Are European banks still too-big-to-fail? The impact of government interventions and regulatory reform on bailout expectations in the EU*, 3-4 (Dec. 31 2017); https://ssrn.com/abstract=3098296. The study demonstrates that paying higher prices for large European bank stocks is rational for investors because of the implicit state guarantee, as demonstrated by the loss in portfolio value immediately following the Lehman bankruptcy which signalled that even a large bank may fail. Portfolio losses were soon reversed when it became clear that no large European bank would be allowed to fail.

[53] Binder (2017) (n 14) 68; Hadjiemmanuil (2015) (n 14) 247.

[54] Josh Ryan-Collins, Tony Greenham, Richard Werner & Andrew Jackson, Where Does Money Come From? (New Economics Foundation, 2012), 67, 79-80, 103.

It is therefore the public interest test that constitutes the Achilles heel of the BRRD/SRM resolution framework. Relying on State aid to bailout institutions that have been referred to treatment under national bank insolvency procedures may significantly add to the unsustainable strain already put on (some) national budgets as a result of the COVID-19 measures. Overall, this is likely to jeopardize the credibility of the crisis management framework as a whole. The Banking Union was designed with a view to breaking the negative feedback loop between the banking sector and sovereign debt.[55] The current set-up seeks to address this vicious cycle at two levels: First, by pooling certain supervisory powers at the ECB,[56] national competent authorities are prevented from engaging in regulatory forbearance with a view to putting their national champions at a competitive advantage. Secondly, the installation of an integrated resolution framework seeks to enhance the credibility of the notion that national budgets will in future be less exposed to the costs of bank bailouts.[57] However, national budgets remain exposed and the negative feedback loop intact where an institution's (part) liquidation under national insolvency law is funded by State aid (and also as long as national budgets backstop national deposit guarantee schemes).[58] This may not matter much for smaller banks. However, the availability of this escape route for larger and even the largest and most complex institutions blows a massive hole into the EU crisis management framework.

2) Internal complexity

Within the EU crisis management framework, national bank insolvency law is relevant as either a standalone default option where resolution tools and powers are unavailable, or as a supporting regime that complements the resolution framework.

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[55] European Commission, Communication from the Commission to the European Parliament and the Council: A roadmap towards a banking union, COM(2012) 510 final; also European Commission, Communication to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions on completing the Banking Union, COM(2017) 592 final 3.
[56] Art 1 of Regulation (EU) No 1024/2013. Any supervisory tasks that have not been conferred remain with the national competent authorities.
[57] Nicolas Véron, Europe's Radical Banking Union (Bruegel Essay and Lecture Series, 2015) 20-23.
[58] S Buckingham et al, Study on the differences between bank insolvency laws and on their potential harmonization, Final report (Brussels, November 2019) 61, available at https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/191106-study-bank-insolvency_en.pdf.

Harmonization with a focus on the supporting role may (pragmatically) seek to address only certain issues. A focus on bank insolvency law as a standalone default option requires a (more) comprehensive approach.

The BRRD/SRM resolution framework remains incomplete and is supplemented by the applicable national insolvency law, resulting in complexity within the resolution regime itself. Two issues are particularly pertinent: the liquidation of the residual entity under 'normal insolvency proceedings' where the viable parts of an institution have been transferred to a private sector purchaser or a bridge institution;[59] and the liquidation analysis on the basis of the ranking of different classes of creditors under national insolvency law mandated by the 'no-creditor-worse-off' principle.[60]

The sale of business tool, the bridge bank tool and the asset separation tool entail a transfer of an institution's shares, assets, rights, and/or liabilities to a separate legal entity. The residual entity must be wound up under 'normal' insolvency proceedings.[61] In this context, a lengthy and inadequate bank insolvency procedure may prevent the resolution authority from applying the transfer tools at all.[62] The enactment of bank specific insolvency law was deemed to be necessary by some Member States to ensure that the residual entity can provide to the recipient entity the services and facilities necessary to ensure an uninterrupted continuation of critical functions. The prime example is the bank administration procedure under English law.[63] Short of comprehensively harmonizing the liquidation of the residual entity, at least the grounds for opening bank insolvency proceedings should be harmonized so as to bring them in alignment with the resolution trigger. This is relevant also where national bank-insolvency law applies as a standalone process. When Latvian ABLV Bank A.S. and its Luxembourg subsidiary (ABLV Bank Luxembourg S.A.) had to be closed in the wake of allegations of money laundering, sanctions violations and bribery, the SRB's decision that resolution was not in the public interest[64] was

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[59] BRRD, Art 37(6).
[60] BRRD, Arts 34(1)(g), 73–75; SRMR, Arts 15(1)(g), 29.
[61] BRRD, Art. 37(6).
[62] Jens-Hinrich Binder et al, 'The choice between judicial and administrative sanctioned procedures to manage liquidation of banks: A transatlantic perspective,' (September 2018) 19 (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3244334).
[63] Banking Act 2009, sec.136(2); 137(1)(a); 138.
[64] Single Resolution Board (ABLV Bank, AS) (n 43); Single Resolution Board (ABLV Bank Luxembourg S.A.) (n 43).

addressed to the national resolution authorities of Latvia and Luxembourg, respectively, with a view to its implementation in accordance with national law. As a result, the Latvian parent entity was liquidated under Latvian law. However, upon request by the Luxembourg resolution authority, the Tribunal de Commerce de Luxembourg decided that the evidence provided was insufficient to justify the opening of liquidation proceedings, dismissing the resolution authority's request.[65] Thus, aligning the grounds for opening bank insolvency proceedings with the criteria for failure would ensure the ready availability of procedures for dealing with the residual entity following the application of transfer tools, and may prevent further financial loss through a smooth transition to national bank insolvency procedures where resolution is not in the public interest.

The BRRD has harmonized the national orders of priority to a limited extent: eligible deposits[66] of natural persons and micro, small and medium-sized enterprises (NP/SME eligible deposits) take priority over claims of ordinary, unsecured creditors. To the extent that eligible deposits are covered by deposit insurance, they have an even higher ranking than non-covered NP/SME eligible deposits.[67] Art 108(1) BRRD does not require general depositor preference, however. Accordingly, general depositor preference (in tiered form) has been adopted by some Member States, notably Italy and Slovenia, whereas others adhere to the tiered preference of covered and NP/SME eligible deposits only, with Germany, Luxembourg and Ireland following this latter approach.[68] The former benefits large corporate depositors at the expense of other senior unsecured debt who, under the latter approach, will share *pari passu* with corporate depositors. The new Art 108(2) has introduced the asset class of non-preferred senior debt, ranking below ordinary unsecured claims and above capital instruments. This new asset class aims to facilitate the meeting of the subordination requirement as a prerequisite for TLAC/MREL eligibility with a view to enhancing the effectiveness of the bail-in tool. Moreover, the newly introduced BRRD, Art

[65] The alternative request to put the institution under the protection of the suspension-of-payments regime was successful and two external administrators appointed. Eventually, the institution agreed to the commencement of the judicial liquidation process.
[66] BRRD, Art 2(1) No 95; Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes OJ L173, 12.6.2014,149 (DGSD), Arts 2(1) No 4, 5.
[67] BRRD, Art 108(1). A deposit guarantee scheme subrogating to the rights of covered depositors has the same (higher) ranking as covered depositors.
[68] Patrizia Baudino et al, 'How to manage failures of non-systemic banks? A review of country practices' FSI Insights on policy implementation No 10 (2018) 12-15; Buckingham et al (n 58) 35.

48(7) ensures that own funds items (Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments) have a lower priority in national insolvency law than any other claim that does not qualify as an own funds item.[69]

Legal systems show great diversity when it comes to creditor hierarchies and differences may have significant (re-)distributive effects. For example, a high ranking of employee wage claims benefits labor at the expense of other investors; carve-outs from a security interest for the benefit of unsecured creditors may work to the advantage of customers and suppliers at the expense of secured creditors; the statutory subordination of shareholder loans, imposed under German,[70] Spanish and Austrian law, but not in the Netherlands or England[71] benefits outside lenders at the cost of intra-group debt. In this respect, a certain order of priority may reflect the fundamental value judgements inherent in an insolvency law regime. On the other hand, the assigning of preferential status to a certain class of creditors may indicate nothing more than the lobbying power of a social group at a particular moment in time. In any case, different orders of priority under national bank insolvency law may have a direct impact on the costs of resolution and on the exposure of the respective resolution fund. Moreover, on the basis of BRRD, Art 109, the exposure of the relevant (statutory) deposit guarantee scheme also depends on the applicable order of priority. Consider otherwise identical credit institutions licensed in France and Germany, respectively,[72] with assets of 1000 that are funded as shown in Table 1:[73]

[69] Introduced by Directive (EU) 2019/879, the provision has to be implemented by 28 December 2020. On the issues potentially arising under the old law see Buckingham et al (n 58) 33-34.

[70] For Germany: InsO, §39(1) No.5, (4) and (5): shareholder loans but also debt securities held by a shareholder have a ranking subordinate to general unsecured creditors, except where the shareholder-creditor holds less than 10% of the share capital and is not involved in the management. There is further the so-called 'rescue privilege' exempting shareholders who acquired their shares in the course of a rescue attempt.

[71] Martin Gelter and Jürg Roth, 'Subordination of Shareholder Loans From a Legal and Economic Perspective' (2007) Harvard John M Olin Fellow's Discussion Paper No. 13, available at http://ssrn.com/abstract=998457; Rolef de Weijs, 'Harmonization of European Insolvency Law: Preventing Insolvency Law from Turning against Creditors by Upholding the Debt-Equity Divide' (2018) ECFR 403, 418-420.

[72] Under the 'home Member State' principle, where an institution has obtained authorization determines the applicable resolution and insolvency law; Directive 2001/24/EC, Arts 9 and 10.

[73] On bank funding structures in the Eurozone see ECB, 'Recent developments in the composition and cost of bank funding in the euro area' (2016) ECB Economic Bulletin 26, 34.

	France[74]		Germany[75]	
Assets 1000	Employee wage claims	70		
	New money privilege	150		
	Covered deposits	500	Covered deposits	500
	NP/SME Eligible Deposits	100	NP/SME Eligible Deposits	100
	Senior unsecured debt Bail-inable	50	Senior unsecured debt Bail-inable	50
	Non-bail-inable (other deposits)	30	Non-bail-inable (other deposits of 30, employee wage claims of 70)	100
		80		150
	Subordinated bonds (MREL[76])	50	Subordinated bonds (MREL)	50
			Shareholder loans	150
	Capital	50	Capital	50

Assume that asset values have to be written down to 700.[77] Consider the institution licensed in France. In liquidation, the losses would be fully absorbed by capital,

[74] Diego Valiante, Harmonising Insolvency Laws in the Euro Area: Rationale, stocktaking and challenges, CEPS Special Report No. 153 / December 2016, 18.

[75] Stephan Kolmann, 'Bail-in und Verlustabsorption – Ein Überblick' in Andreas Igle, Marcel Krüger, Christian Stepanek and Sven Warnecke (eds) Bankenabwicklung und MREL (Frankfurt School Verlag, 2018) 169, 176-182.

[76] To be more precise, the amount depicted in this and the following tables as 'MREL' is actually 'MREL – capital,' with MREL being the sum of the loss absorption amount (basically equal to minimum capital requirements) and the recapitalization amount; BRRD, Art 45c(2).

[77] For losses sustained in recent bank failures see Stefan Best and Oliver Read, 'Bankenabwicklungsrichtlinie – Theorie und Praxis der europäischen Bankenabwicklung' in Andreas

subordinated bonds, senior unsecured debt and NP/SME deposits. The deposit guarantee fund would pay off covered depositors and take their place within the creditor hierarchy. After paying the employee wage claims and new money creditors in full, the remaining 480 of the (net) proceeds would go to the deposit guarantee fund, receiving 96 cents for every Euro and sustaining a 4% loss. If resolution was in the public interest, for example in order to prevent depositor runs at other institutions, the sale of business tool could be utilized to transfer the deposit portfolio to a private sector purchaser and liquidate the residual entity. When applying any of the transfer tools the resolution authority is constrained by the general resolution principles, notably that creditors bear losses in accordance with the order of priority under national insolvency law and that creditors of the same class are treated equitably, unless provided otherwise in the BRRD.[78] The normative force of these 'principles' is not entirely clear. Although the wording seems rather strict and prescriptive, their designation as 'principles' (rather than rules) suggests that they do not have to be applied in an 'all-or-nothing' fashion, but merely have to be taken into account without dictating a particular outcome; in other words, principles have a dimension of weight or importance depending on the circumstances, and can be overcome where conflicting principles are attributed a higher weight in a given case.[79] This reading would grant resolution authorities a significant margin of discretion, supported also by the resolution framework's underlying rationale: ensuring the continuation of systematically important arrangements by selecting them for transfer and leaving behind non-critical arrangements for liquidation.[80] If this reading is correct,[81] the resolution could unfold as follows: The deposits of 630 and an equivalent amount of assets could be transferred to a private sector purchaser for the nominal amount of 1 Euro. The employee wage claims would remain with the residual entity and receive full payment in liquidation out of the proceeds of the remaining assets. The 'new

Igle, Marcel Krüger, Christian Stepanek and Sven Warnecke (eds) Bankenabwicklung und MREL (Frankfurt School Verlag, 2018) 341, 347-348.

[78] BRRD, Art 34(1)(b) and (f); SRMR, Art 15(1)(b) and (f).

[79] Ronald Dworkin, Taking Rights Seriously (Bloomsbury, 1977) 39-44.

[80] Jens-Hinrich Binder, 'The Position of Creditors Under the BRRD' in: *Commemorative Volume in memory of Professor Dr. Leonidas Georgakopoulos*, Bank of Greece's Center for Culture, Research and Documentation, 2016, 37, 49 (available at SSRN: https://ssrn.com/abstract=2698086).

[81] A strict interpretation as rules would not change the exposures of resolution and deposit guarantee funds. All deposits (630) as well as employee wage claims and new money claims could be transferred together with assets of 700, leaving a shortfall of 150 for which the resolution fund would compensate the purchaser. The deposit guarantee scheme would have saved 20, for which it has to reimburse the resolution fund.

money' creditors would have to be compensated to the tune of 150 pursuant to the no-creditor-worse-off principle.[82] Left behind capital, junior debt and senior unsecured debt other than deposits would receive nothing. In this resolution, depositor access to their funds has been ensured without a payout from the deposit guarantee fund. Pursuant to Art 109 BRRD, the deposit guarantee fund has to contribute to the resolution an amount equal to the loss the covered depositors - rather: the deposit guarantee fund – would have sustained in liquidation which is here 20.[83]

Now consider the credit institution licensed in Germany: In a hypothetical liquidation, of the (net) assets of 700, 500 would have gone to the deposit guarantee scheme subrogated for the covered depositors, and 100 to NP/SME eligible depositors. The remaining 100 would be shared by all senior unsecured creditors on a *pro rata* basis, receiving 67 cents in the EUR and sustaining losses of 33%.[84] In resolution, the deposits of 630 and an equivalent amount of assets could be transferred to a private sector purchaser for a nominal purchase price of 1 EUR. In the liquidation of the residual entity, the remaining 70 would be shared pro rata among senior unsecured debt (other than deposits), receiving 58 cents in the EUR and sustaining losses of 42%. Capital, shareholder loans and subordinated bonds would receive nothing. Under the 'no-creditor-worse-off' principle, senior unsecured debt (other than deposits) will have to be compensated out of the resolution fund to the tune of overall 10.8.[85] No contribution would be required from the deposit guarantee fund.

This simple numerical example shows that, *ceteris paribus*, the difference in creditor ranking has a direct impact on the costs of resolution and the exposure of the resolution fund (150 v 10.8), even under the integrated resolution framework of the SRM. Also, this analysis is straightforward only because our scenarios are based on legal systems under which the treatment of various classes of creditors is reasonably clear. Where there is no clear determination by statute and conflicting case law muddies the waters,[86] application of the 'no-worse-off' principle may be very challenging and result in prolonged litigation. The example shows further that

[82] Full payment of 150 in liquidation; 0 in resolution.
[83] 4% loss of 500 in covered deposits.
[84] 100/150.
[85] 67%*(50+70) – 58%(50+70) = 10.8.
[86] de Weijs (n 71) 419.

different orders of priority under national bank insolvency law can have a direct impact on the exposure of national deposit guarantee funds (20 v 0), and thus indirectly, through the inevitable government back stop, on national budgets.

As the third pillar of the Banking Union, the Commission has proposed a European Deposit Insurance Scheme (EDIS)[87] that envisages a European Deposit Insurance Fund administered by the Single Resolution Board. Deposit Insurance would be progressively mutualized,[88] eventually resulting in full insurance at Banking Union level. The scheme remains politically controversial.[89] Divergent national insolvency laws may result in varying degrees of loss exposure of the European Deposit Insurance Fund depending on a failing institution's home jurisdiction. In addition to differences in creditor hierarchies, divergent outcomes may be caused by lengthy and inefficient insolvency regimes, potentially reducing recovery rates for the Fund in liquidations.[90] This in turn may be reflected in the risk-based premiums levied on banks to fund EDIS, contrary to the idea of a level playing field. Further harmonization of bank insolvency law is therefore essential before EDIS or a similar regime for the Eurozone can be launched.[91]

General (tiered) depositor preference, as repeatedly advocated by the ECB,[92] would make it less likely that compensation will be payable to senior unsecured creditors under the 'no-worse-off' principle. It could be introduced by amending BRRD, Art 108(1) accordingly. Although this would go a long way, creating a true level playing field would require more comprehensive harmonization. General depositor preference would have to be combined with a rule that grants all deposits (in tiered form) priority

[87] Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 806/2014 in order to establish a European Deposit Insurance Scheme, COM(2015) 568 final.
[88] In its 2017 Communication, the European Commission (n 116) 10-13 suggested a more gradual introduction of EDIS.
[89] The German Bundesministerium der Finanzen seems to have relaxed its previously stiff opposition somewhat; BMF (n 1) 6-7.
[90] Binder et al (n 62) 19.
[91] Maria J. Nieto, 'Bank Resolution and Mutualization in the Euro Area' 2016.2 European Economy 131, 151-152.
[92] ECB, Opinion of the European Central Bank of 3 May 2016 on the resolution and winding up of banks (CON/2016/28) para. 3.1.7.; ECB, Opinion of the European Central Bank of 8 March 2017 on a proposal for a directive of the European Parliament and of the Council on amending Directive 2014/59/EU as regards the ranking of unsecured debt instruments in insolvency hierarchy (CON/2017/6) para 1.2. – 1.4.; ECB, Opinion of the European Central Bank of 16 October 2015 on recovery and resolution of credit institutions and investment firms (CON/2015/35) para 3.7.3.

over all other unsecured claims. This would require tackling contentious redistributive issues, such as employee wage claims, new money privileges, and shareholder loans. It has been pointed out that in respect of creditor hierarchies a significant level of harmonisation has already been achieved.[93] Given the strong national preferences for certain orders of priority it could be argued that tackling the remaining discrepancies may not be worth the political effort,[94] in particular where the overall amount of creditor classes that receive preferential or subordinated treatment in any given jurisdiction is likely to be small. However, whereas this latter consideration may be relevant for items like employee wage claims, the effect of new money privileges or shareholder loan subordinations may potentially be quite substantial.

3) External complexity

National bank insolvency regimes differ in terms of the role and responsibilities of courts and regulatory authorities, the powers of office holders, the degree of creditor involvement, and the triggers for opening proceedings, as well as a myriad of substantive law issues, including the scope of a moratorium, set-off, transactions in the vicinity of insolvency, executory contracts and pending litigation.[95] The institutional design alternatives range from court-centered judicial proceedings at one end of the spectrum to purely administrative procedures with regulators in the driving seat at the other, and various hybrid systems in between.[96] The availability of multiple procedures across and within Member States, combined with the division of responsibilities between Union and national levels, both institutionally (SRB/Commission *versus* national resolution authorities) and substantively (SRM *versus* BRRD implementing national legislation), renders the crisis management framework very complex and opaque.

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[93] Buckingham et al (n 58) 44.
[94] ibid 58.
[95] Baudino et al (n 68); Binder et al (n 62); Buckingham et al (n 58); Eva Hüpkes, 'Insolvency—Why a Special Regime for Banks?', in IMF, Current Developments in Monetary and Financial Law Volume 3 (Washington DC 2003); International Monetary Fund and World Bank, An Overview of the Legal, Institutional, and Regulatory Framework for Bank Insolvency (April 2009).
[96] Binder et al (n 62); Baudino et al (n 68); Buckingham et al (n 58) 13-15; IMF and World Bank (n 95).

Consider a credit institution that has obtained its banking license in Germany, and will be within the scope of application of the SRM.[97] If the institution is under direct ECB supervision, that is, if it is deemed to be significant in accordance with the relevant criteria[98] or the ECB assumes direct supervision,[99] its resolution will be within the remit of the SRB as resolution authority.[100] Otherwise, the German resolution authority[101] will be responsible.[102] If the institution is failing and the SRB as resolution authority makes the determination that resolution is in the public interest,[103] the SRB will adopt a resolution scheme on the basis of the directly applicable SRM Regulation[104] that places the institution under resolution, determines the application of resolution tools and powers and the use of the Single Resolution Fund.[105] In order to implement the resolution scheme, the SRB ensures that the national resolution authority takes the necessary action pursuant to the German law implementing the BRRD (which is the SAG[106]).[107] If resolution is within the remit of the national resolution authority, the BaFin may determine that resolution is in the public interest in which case the institution will be subject to resolution under the SAG.[108]

Where the relevant resolution authority (SRB or BaFin) determines that resolution is not in the public interest, German corporate insolvency law will apply as the default option. For institutions and their investors, anticipation as to whether the resolution

[97] SRMR, Art 2(a).
[98] Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, OJ EU 29.10.2013 L287/63 (SSMR); Art 6(4); Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation) OJ EU 14.5.2014 L141/1.
[99] SSMR; Art 6(5).
[100] SRMR, Art 7(2)(a).
[101] That is the Federal Agency for Financial Supervision (BaFin), SAG, §3(1).
[102] SRMR, Art 7(3)(e).
[103] SRMR, Art 18(1)(c) and (5).
[104] The resolution scheme will enter into force only if within 24 hours of its transmission by the SRB to the Commission neither Commission nor Council object; SRMR, Art 18(7)-(9).
[105] SRMR, Art 18(6). This is subject to a prior decision by the Commission confirming that the use of the Fund is compatible with the Treaty provisions on State aid; SRMR, Art 19(1) and (3).
[106] *Gesetz zur Sanierung und Abwicklung von Instituten und Finanzgruppen (Sanierungs- und Abwicklungsgesetz – SAG)*, of 10 December 2014 (BGBl. I S. 2091), last amended by Article 8(10) of the Law of 8 July 2019 (BGBl. I S. 1002).
[107] SRMR, Art 18(9), 29.
[108] SAG, §62(1) No. 2. However, where a resolution action requires the use of the Single Resolution Fund, the SRB would again be mandated to adopt a resolution scheme; SRMR, Art 7(3) sentence 2.

framework (supranational or domestic) or national bank insolvency law will come into play is not an easy endeavor. Designation of an institution as significant for SSM purposes does not necessarily mean that resolution will be in the public interest.[109] Similarly, an institution that has not been designated as significant may be brought within the remit of the SRB by either the ECB assuming direct supervision[110] or the SRB taking direct responsibility.[111] Again, neither of these decisions would preclude a determination that resolution is not in the public interest. And neither can an institution within the responsibility of BaFin be certain that resolution will not be deemed to be in the public interest, or that the SRB will not assume direct responsibility. Resolution planning may provide some relief in this respect. However, resolution plans are not binding; although the envisaged resolution strategy will be the starting point at the 'failing or likely to fail' stage, the resolution authority may deviate from the plan where this appears to be appropriate in the light of the circumstances at the relevant time.[112]

Within the realm of bank insolvency law our institution would be confronted with a range of different procedures: 'pre-insolvency' procedures specifically for credit institutions in form of the restoration procedure and the reorganization procedure [113] or liquidation through the general insolvency procedure in modified form.[114] However, both resolution and (pre-)insolvency may be avoided through Germany's complex web of deposit guarantee and institutional protection systems. For example, the *Einlagensicherungsfonds des Bundesverbandes deutscher Banken eV*, provides additional protection[115] to the depositors of private law credit institutions. The fund's responsibilities go beyond a mere 'paybox' function: 'In the interest of depositors', the fund is tasked with 'providing assistance to banks that are currently in, or in the

[109] As seen in the cases of Banca Popolare di Vicenza and Veneto Banca; Decision of the Single Resolution Board (Veneto Banca) (n 42); Decision of the Single Resolution Board (Banca Popolare di Vicenza) (n 42).
[110] SSMR, Art 6(5).
[111] SRMR, Art 7(4)(b).
[112] SRMR, Art 7(3) sentence 3.
[113] The restoration procedure is available to any failing German credit institutions; KredReorgG, §§1(1), 2(1). The reorganization procedure is only available for credit institutions whose continuation is under threat, resulting in a threat to the stability of the financial system as a whole; KredReorgG, §§1(1) sentence 2, 7(2).
[114] Only BaFin as the competent authority can petition the court for the opening of insolvency proceedings; KWG, §46b.
[115] In addition to the protection mandated by the DGSD and implemented through statutory compensation schemes.

near future likely to face, financial difficulties.' It may take any suitable measure, including the payment of creditors, the furnishing of guarantees and the assumption of other obligations.[116] When Düsseldorfer Hypothekenbank suffered significant portfolio losses and a fatal margin call, the fund initially guaranteed the bank's loss exposure and subsequently took it over through a wholly owned investment company, to eventually sell it back to the market.[117] Provided the intervention does not amount to State aid, the deposit guarantee fund option has emerged as the preferred alternative.[118] However, the ready availability of such funds may increase moral hazard with detrimental effects on market discipline.[119] Moreover, institutions in Member States where such funds are available may obtain a comparative funding advantage, contrary to the notion of an EU level playing field.

The various German bank insolvency law procedures remain predominantly court-based, although the arguments in favor of administrative bank insolvency regimes are well rehearsed: Standard insolvency law is unable to deal with the impact of failure on other institutions and on the financial system as a whole.[120] There are no adequate mechanisms for safeguarding financial stability concerns and for ensuring continued access to vital financial services notably deposits and lending.[121] A judicial process is too slow to effectively protect depositors and minimize the risk of runs at similar institutions.[122] Proponents of court-based solutions point to the 'rule of law virtues' as compared to an administrative process based on regulatory discretion. Both sides agree that banks in distress require special treatment. Disagreement mainly concerns the extent to which special treatment should deviate from standard insolvency

[116] Statut des Einlagensicherungsfonds (December 2018), §2.
[117] https://bankenverband.de/newsroom/presse-infos/verkauf-der-dusseldorfer-hypothekenbank/.
[118] A De Aldisio et al, 'Towards a framework for orderly liquidation of banks in the EU' (2019) 15 Notes on Financial Stability and Supervision 1.
[119] Gelpern and Véron (n 21) 44.
[120] Commission Staff Working Document: Impact Assessment accompanying the document Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms, COM(2012) 280 final, SWD(2012) 166 final (BRRD IA), 11; EU Commission, Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms, COM(2012) 280 final (BRRD Proposal), 5; FDIC, 'The Orderly Liquidation of Lehman Brothers Holding Inc. under the Dodd-Frank Act' (2011) 5 FDIC Quarterly 1, 5.
[121] BRRD IA, 11; BRRD Proposal, 5; FDIC (n 130) 1.
[122] FDIC (n 120) 7-9; M Čihák and E Nier, The Need for Special Resolution Regimes for Financial Institutions – The Case of the European Union, IMF Working Paper WP/09/200 (September 2009) 6-7; T Jackson, 'Chapter 11F: A Proposal for the Use of Bankruptcy to Resolve (Restructure, Sell, or Liquidate) Financial Institutions', in K Scott, G Schultz and J Taylor (eds.), Ending Government Bailouts As We Know Them (Stanford, CA: Hoover Press, 2009) 217, 218.

procedure.[123] For deposit taking institutions the swift and efficient transfer of deposits will usually entail a transfer of the liability side of the deposit agreement in disapplication of the general principle that only the asset side of a contractual arrangement may be assigned to a third party without the consent of the counterparty in debt under the contract.[124] Thus, even where the procedure is essentially court-based and structured in accordance with general insolvency law, the necessity for efficiently handling deposits inevitably introduces an 'administrative element.'[125] For deposit-taking institutions a purely court-based system therefore seems unsuitable; the special powers that are necessary to override the generally applicable law would render any framework at least hybrid, regardless of whether these powers are exercised by the court, the office holder, or an administrative authority. The lack of such comprehensive powers to transfer assets and liabilities in German court-based bank (pre-)insolvency law may explain its limited relevance in practice, which instead heavily relies on the intervention of deposit guarantee and institutional protection schemes.

The newly inserted BRRD, Art 32b provides that an institution the resolution of which is not in the public interest shall be wound down in accordance with national law.[126] Although it seems clear that the institution as a legal entity has to be liquidated, this does not preclude a reorganization of (parts of) its business on a going concern basis where this is possible under national insolvency law and would not adversely affect resolution objectives.[127] In practical terms there is no clear dividing line between liquidation and reorganization/corporate rescue anyway. Usually the viable parts of a firm will be preserved as a going concern and the non-viable assets

[123] ibid 449; D Skeel, 'Single Point of Entry and the Bankruptcy Alternative' (2014) University of Pennsylvania Faculty Scholarship Paper 949, 15-18.
[124] Jan Dalhuisen, Dalhuisen on Transnational Comparative, Commercial, Financial and Trade Law Volume 2: Contract and Moveable Property Law (Hart, 5th edn 2013) 393.
[125] For example, the UK Bank Insolvency procedure for deposit takers, as a modified version of the general compulsory winding up process, requires specific provisions for allowing the bank liquidator to arrange for the transfer of deposit accounts to another institution. Accordingly, such arrangement 'may disapply … any restriction arising by virtue of contract or legislation …;' including 'any restriction, inability or incapacity affecting what can and cannot be assigned or transferred …, and a requirement for consent.' Banking Act 2009, sec.124.
[126] Whereas the SRMR has always been clear that the institution is to be wound up under national insolvency law where the Council objects to a resolution scheme on public interest grounds (SRMR, Art 18(8)) this was less obvious where the resolution authority determined that the public interest requirement had not been met (BRRD, Art 32(5)).
[127] Decision of the Single Resolution Board (n 42) para 4.3: winding up as referring to applicable Spanish insolvency law in its entirety, presumably including the restructuring option.

disposed of on a piecemeal basis and liquidated. Where the entire business of the residual entity is no longer viable, liquidation will be the most cost effective and perhaps only option. However, there seems to be no good reason as to why in appropriate circumstances national bank insolvency law may not be utilized for preserving a failing institution or parts thereof, notably its depositor base, as a going concern. This can be achieved in two principal ways: First, the business remains with the institution and the latter's debt load is reduced, by writing down or rescheduling liabilities and/or converting debt to equity. Although in this case the legal entity will be preserved, non-viable parts of the business may still be liquidated, for example by divesting from non-profitable lines of business and disposing of impaired assets. In bank insolvency regimes the role of creditors will be much reduced,[128] and the transformation of their property rights effectuated through administrative powers in form of bail-in, write down and/or transfer tools. Alternatively, the business (assets and certain liabilities), or parts thereof, may be transferred (sold) to a new entity with a more sustainable capital structure, leaving some of the existing debt behind with an empty shell to be liquidated.[129] Although the initial legal entity, which is never worth preserving in its own right, will eventually come to an end, the viable parts of the business are rescued and preserved as a going concern under new ownership, possibly integrated into an existing firm. This requires extensive powers on the part of an office holder or public authority to dispose of the debtor's assets and liabilities without creditors' or shareholders' consent. In practice, both techniques may be combined.[130] As US experience shows, an effective sale of business tool or bridge bank tool makes (even more) sense and should be available for smaller, non-systemic institutions as well.[131]

III. The way forward: BRRD extension?

[128] Baudino et al (n 68) 20-22; Buckingham et al (n 58) 37.
[129] On the Italian bank specific Compulsory Administrative Liquidation procedure: Decision of the Single Resolution Board (Veneto Banca) (n 42) para 15; Decision of the Single Resolution Board (Banca Popolare di Vicenza) (n 42) para 15; further Buckingham et al (n 58) 38-40.
[130] For non-financials, see Kon Asimacopoulos & Justin Bickle (eds.), European Debt Restructuring Handbook: Leading Case Studies from the Post-Lehman Cycle (2013).
[131] BMF (n 1) 2; Buckingham et al (n 58) 59.

It is possible to reduce the complexity emanating from divergent national bank insolvency laws within the BRRD/SRM resolution framework by further harmonizing the most pertinent issues, notably creditor rankings and the initiation problem. However, given that the transfer tools rely on the availability of an effective and efficient procedure for dealing with the residual entity, even the harmonization of bank insolvency law with a focus on its supporting role within the resolution process seems to necessitate a more comprehensive approach. This is certainly true for the harmonization of bank insolvency law as the standalone default option. In this respect, a harmonized European bank insolvency law should not be limited to a liquidation tool but be able to accommodate restructuring and reorganization options in appropriate circumstances. An EU-level bank insolvency regime with broad administrative powers currently exists in form of the BRRD/SRM resolution framework for institutions that at the point of failure are deemed to be systemically important. Extending this regime to institutions of all shapes and sizes, by removing the public interest test as part of the resolution trigger, would prevent a further gaming of the system based on public interest considerations, enhance the credibility of the crisis management framework and protect national budgets, thereby reducing the bank-sovereign debt feedback loop.

This would mean that any institution regardless of its size and complexity would be subject to the resolution tools and powers provided for by the BRRD. Depending on a least cost assessment, the institution could be restructured by transferring the viable parts of its business to a private sector purchaser or bridge bank, possibly in combination with a bail-in, and liquidating the non-viable parts on the basis of the BRRD-implementing legislation; or the institution could be recapitalized through bail-in with financial support from resolution funds. In addition to the removal of the public interest test, a number of further amendments would be necessary to make this solution viable.

1) Geographical reach

Restraining the negative feedback loop between sovereign debt and the banking sector is particularly significant for the Eurozone. Consequently, some commentators envisage (further) harmonization only for the Banking Union.[132] Others, including the ECB[133] and the Chair of the SRB, Elke König, favor EU-wide rules.[134]

Early on the Commission emphasised that the 'creation of the banking union must not compromise the unity and integrity of the single market.' Accordingly, 'a move to the banking union without any risk of fragmenting the single market' was possible only because of the 'single rulebook' providing a common substantive foundation across the single market on which the banking union could be built.[135] This line of reasoning strongly supports bank insolvency law harmonization for the single market in its entirety. In respect of the administrative responsibilities of the SRB, the German Constitutional Court has argued that a Euro-zone only harmonisation measure could still reduce single market fragmentation.[136] However, this is less plausible for the substantive law on which the banking union is built. The applicable bank insolvency law directly or indirectly determines the content of a claim holder's property rights, the expected value of an investor's claim, and an institution's cost of capital. A Eurozone only harmonization measure has the propensity of perpetuating an un-level playing field within the single market: Eurozone institutions may attract funding on better terms than their counterparts from rest-EU Member States. Eurozone investors may shy away from investing in institutions outside the Eurozone's bank insolvency framework which they are familiar with and avoid incurring the search costs emanating from familiarising themselves with other regimes, thereby reducing financial integration within the single market.[137]

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[132] Bénasy-Quéré et al (n 5) 6; IMF (n 6) para 27, 28. The Commission's Study, albeit not entirely clear, seems to favour a similar approach; Buckingham et al (n 58) 56-64.
[133] ECB (2016) (n 92) para. 3.1.7.; ECB (2017) (n 92) para 1.2. – 1.4.; ECB (2015) (n 92) para 3.7.3.
[134] König (2018) (n 1), but see also König (2019) (n 1) advocating a more incremental approach; Restoy (n 5) 5-8.
[135] European Commission, Communication from the Commission to the European Parliament and the Council: A roadmap towards a banking union, COM(2012) 510 final 4 and 5.
[136] German Constitutional Court (BVerfG), Judgment of 30 July 2019, 2 BvR 1685/14 and 2 BvR 2631/14, para 251, 252.
[137] Of course, rest-EU Member States would have an incentive to either join the banking union or adjust their bank-insolvency laws accordingly, or perhaps provide an even better regulatory framework to create an advantage for their national champions. However, an uncoordinated catch up would further increase fragmentation. Also, search costs would remain, and where rest-EU Member States outcompete the Eurozone, adjustments to the harmonized regime could be made only through the slow and cumbersome ordinary legislative procedure.

Consequently, in accordance with the approach underpinning the banking union, the harmonization of bank insolvency law should be aimed at the single market in its entirety. Extending the BRRD to all failures regardless of their systemic impact by removing the public interest test would fill a major gap within the single rule book and prevent regulatory fragmentation between Eurozone and rest-EU.

2) Property rights implications

However, according to the Commission, because 'the possible tools may involve a significant interference with the fundamental rights of shareholders and creditors, the triggers for resolution must … ensure … that the intervention is in the public interest.'[138] Resolution therefore constitutes only an alternative to normal insolvency proceedings and provides a means for restructuring or winding down a bank the failure of which would create concerns as regards the general public interest.[139] This line of reasoning suggests that the BRRD/SRM resolution framework is compatible with fundamental rights only if the public interest test is included as part of the trigger for launching resolution proceedings, which therefore, can only ever be *ultima ratio*. This conclusion seems doubtful.

The fundamental right most likely to be implicated through the application of resolution tools and powers is the right to property, which can be found in the EU Charter on Fundamental Rights[140] and is guaranteed by the ECHR.[141] It consists of the general right to own, use and dispose of lawfully acquired possessions,[142] including shares in a company[143] and claims that are enforceable[144] or have come into existence under applicable law.[145] Any interference may be justified in the public interest and

[138] BRRD IA 39; BRRD Proposal para 4.4.7.
[139] BRRD Proposal 6.
[140] Charter of Fundamental Rights of the European Union (2010/ C 83/02) OJ EU 30.3.2010 C83/389 (CFR), Art 17.
[141] European Convention on the Protection of Human Rights and Fundamental Freedoms (ECHR), Article 1 of the Additional Protocol to the Convention.
[142] ECtHR, Case of *Soctransavto Holding v Ukraine* (Application no 48553/99, Judgment of 25 July 2002) para 90.
[143] ECtHR, Case of *Soctransavto Holding v Ukraine* (Application no 48553/99, Judgment of 25 July 2002) para 92.
[144] ECtHR, Case of *Stran Greek Refineries and Stratis Andreadis v Greece* (Application no 13427/87, Judgment of 09 December 1994) para 59.
[145] ECtHR, Case of *Pressos Compania Naviera SA v Belgium* (Application no 17849/91, Judgment of 20 November 1995) para 31.

subject to the principle of proportionality, which, in case of a deprivation of possessions, requires fair compensation.[146] The relevant provisions of the BRRD/SRM resolution framework as the legal basis for individual measures imposed by resolution authorities must meet the proportionality test in the abstract and independently of any concrete resolution action.[147]

Consider our earlier hypothetical.[148] Assume that the bail-inable senior unsecured debt holder has acquired its property rights at time T_0 when liquidation under national insolvency law was the only option. If the institution later (at T_2) sustains asset losses of 300 resulting in liquidation, senior unsecured debt would, under German law, receive a dividend of 67 cents in the Euro. Now assume that at T_1 a resolution regime was introduced as an *ultima ratio* alternative. If subsequently (shortly after T_2) resolution is triggered, the bail-inable senior unsecured debt would, *ceteris paribus*, receive only 58 cents in the Euro.[149] The legal provisions that authorize the resolution action constitute an interference with the bail-inable senior unsecured debt holders' property rights (established at T_0); initially in the form of a regulation of the use of property by law, which when exercised may amount to a (partial) deprivation. Protecting financial stability is generally considered a legitimate aim in the public interest.[150] Compensation for the bailed-in senior unsecured debt is provided for under the 'no-worse-off' principle.[151]

Now assume that the senior unsecured bail-inable debt was obtained at time $T_{1.5}$ when the resolution alternative had already been in place. The property rights of our debt holder are from their inception encumbered with the possibility of resolution action, including bail-in. Property rights only exist by virtue of the applicable law, and their content is determined solely by the legal provisions that shape and define them.[152]

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[146] EU Network of Independent Experts on Fundamental Rights, Commentary of the Charter of Fundamental Rights of the European Union (June 2006) 166.
[147] Wojcik (n 17) 120.
[148] Above Table 1.
[149] 100/300 = 0.33.
[150] ECtHR, Case of *Bugajny and others v Poland* (Application No 22531/05, Judgment 6 Nov 2007), para 63.
[151] BRRD, Arts 34(1) lit. g, 73, 75. Compensation does not have to be at full market value in all circumstances; ECtHR, Case of *The Holy Monasteries v Greece* (Application No. 13092.87 and 13984/88, Judgment of 9 December 1994) para 71.
[152] Maunz/Dürig, Grundgesetz-Kommentar, 87. EL März 2019, GG Art. 14 para 148.

However, the legal framework establishing property rights must be of a certain quality.[153] According to the ECtHR, the law must be 'formulated with sufficient precision to enable the individual … to regulate his conduct,'[154] 'to foresee to a degree that is reasonable in the circumstances, the consequences which a given action may entail.'[155] These requirements in the current context demand a sufficiently precise restriction on the exercise of the resolution authority's discretion: the application of resolution tools and powers cannot be arbitrary and at will, but must be subject to predefined and reasonably observable trigger conditions. Although vague and subject to the discretion of competent or resolution authorities, the 'failing or likely to fail' test is, at least theoretically, based on observable economic conditions. An additional level of discretion in form of the public interest test does not enhance accessibility and foreseeability; on the contrary, it significantly reduces predictability. Further, to appreciate the consequences of an investment decision, potential rights holders must be able to price the respective property rights reasonably accurately *ex ante*. Given that the special treatment of certain liabilities on a discretionary basis is inherent in the resolution process,[156] the adequate pricing of property rights would be very difficult without a specific baseline scenario. Under the 'no-worse-off' principle the likely loss given default will be at least not worse than the loss given default in a hypothetical liquidation. Thus, the cost of capital can be based on this 'worst-case scenario' as a benchmark.[157] The 'no-worse-off' principle is thus relevant, not so much as a compensation mechanism for deprivation, but as a device for ensuring compliance with the 'foreseeability' criterion.

Now assume that at T_1 resolution is not introduced as *ultima ratio*, but as a complete replacement without the public interest test. For the holders of bail-inable senior unsecured debt who obtained their property rights at $T_{1.5}$ the analysis would be the same as before: provided the resolution authority's discretion is adequately restricted and the property rights can be priced with reasonable precision *ex ante*, there would

[153] Advocate General Cruz Villalón, Opinion Case C-70/10 *Scarlet Extended v SABAM*, 14 April 2011, ECLI:EU:C:2011:255 para 94.
[154] ibid.
[155] ECtHR, Case of *Margareta and Roger Andersson v. Sweden* (Application No 12963/87, Judgment of 20 January 1992) para 75.
[156] Binder (n 80) 46-47.
[157] S. Gleeson, 'Legal Aspects of Bank Bail-Ins' *LSE Financial Markets Group Paper Series, Special Paper 205* (January 2012), 8-10.

be no interference with property rights. For holders of bail-inable debt obtained at T_0 there would be an interference with property rights. However, this regulation of the use of property (authorizing a partial deprivation) can be justified as serving a legitimate aim in the public interest. In *Olczak v Poland* the ECtHR has held that measures taken by the National Bank of Poland to protect the interest of a bank's customers who had entrusted their assets to the bank and to avoid the heavy financial losses that the bank's bankruptcy would have entailed are compatible with the notion of public interest.[158]

Consequently, extending the BRRD/SRM resolution regime by removing the public interest test would constitute an interference only with the property rights in existence at the time this transformation takes effect. Property rights that emerge thereafter would already be encumbered with the potential application of resolution tools and powers. For deposit taking institutions, the interference with pre-existing property rights could be justified. After all, according to the Commission, '[i]n the absence of bank specific resolution tools, the reorganization of banks under insolvency procedures would most likely be unsuccessful, as debtors would immediately withdraw funds from the banks.'[159] This makes it difficult to argue that resolution can only ever be the *ultima ratio* alternative: if the default option is likely to be unsuccessful – in other words, less effective for achieving the legitimate aim of protecting depositors – why retain it at all? This conclusion is confirmed by the fact that some Member States, notably Italy, [160] already operate purely administrative bank insolvency procedures very similar to the BRRD resolution regime. And even under standard insolvency/restructuring law for non-financials may dissenting creditors be 'expropriated' in a cross-class cramdown or simply by being outvoted within their class, provided that some form of best-interest-of-creditor test is satisfied.[161]

[158] ECtHR, Case of *Olczak v Poland* (Application no. 30417/96, Judgment of 7 November 2002) para 84; further CJEU Joined Cases C-8/15 P to C-10/15 P *Ledra Advertising* ECLI:EU:C:2016:701 para 74; GC Case T-680/13 *Dr K Chrysostomides & Co LLP v Council of the European Union* ECLI:EU:T:2018:486 paras 288-292, 317-323.

[159] BRRD IA, 11. Indeed, at least initially policy makers envisaged that the new resolution regime would apply to banks of all shapes and sizes; Buckingham et al (n 58) 52.

[160] On the Compulsory Administrative Liquidation procedure under Italian law: Decision of the Single Resolution Board (Veneto Banca) (n 42) para 8-18; Decision of the Single Resolution Board (Banca Popolare di Vicenza) (n 42) para 8-18; and further Buckingham et al (n 58) 13-15.

[161] Directive (EU) 2019/1023, Arts 10, 11; or for German law see InsO, §245. This seems compatible with the right to property: ECtHR, Case of *Bäck v Finland* (Application No 37598/97, Judgment of 20 July 2004).

Moreover, removing the public interest test would actually benefit investors. Pricing uncertainty would be reduced. Creditors would be faced with a more aligned system of creditor rights as the new baseline and could more easily price their investments accordingly.

3) Liquidation as least cost alternative

According to Binder, the BRRD resolution toolbox may be unsuitable as a 'catch all solution' for bank failures of all sizes and complexity because liquidation may yield more efficient outcomes than the application of resolution tools in cases where the risk of systemic contagion is small or nonexistent.[162]

Under the BRRD, resolution authorities already seem to have the powers necessary to effectively liquidate a failing institution. Notably, resolution authorities may take control of an institution so as to operate it with all the powers of the shareholders and the board of directors and to manage and dispose of its assets.[163] Further, the resolution authorities have the power to remove or replace senior management, and to transfer equity and debt securities as well as any other assets, rights, and liabilities without the need for approval of concerned parties that would normally apply.[164] The transfer of assets may take effect free from any encumbrances or third party rights. Moreover, securities may be delisted, and contracts may be modified or cancelled.[165] And further, the 'rights and powers conferred upon shareholders, other owners and the management body' that the resolution authority may exercise[166] also entails, depending on the applicable corporate law, the shareholders' right to liquidate their corporate entity at will, and the management's or office holder's responsibility to pay dividends to the creditors and shareholders out of the proceeds of liquidation.[167] On

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[162] Jens-Hinrich Binder, 'Proportionality at the resolution stage: Calibration of resolution measures and the public interest,' 18 (July 3, 2017); https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2990379.
[163] This control may be exercised directly, by the resolution authority itself, or indirectly, through a person or persons appointed by the resolution authority for that purpose; BRRD, Arts 63(1), 72; or even a 'special manager;' BRRD, Art 35.
[164] BRRD, Art 63(2).
[165] BRRD, Art 64(1).
[166] BRRD, Art 63(1) lit. (b); 72(1) lit. (a).
[167] C Gerner-Beuerle and M Schillig, Comparative Company Law (OUP 2019) 890-901.

that basis, it seems entirely feasible for the resolution authority under the BRRD resolution framework to seize a failing institution, operate it with a view to effectuating an orderly liquidation, sell its assets on a piecemeal basis, and distribute the proceeds in accordance with the order of priority applicable under national law.

It may be argued that these resolution powers are only available in the context of the application of one or more of the resolution tools – sale of business, bridge bank, asset management and bail-in – and not in isolation. BRRD, Art 63 (1) sentence 1 could be interpreted in this way ('powers necessary to apply the resolution tools'). Also, according to Recital (84), '[r]esolution authorities should have all the necessary legal powers that, in different combinations, may be exercised when applying the resolution tools.' However, this textual argument is not conclusive. Pursuant to Art 72 (1), the powers to take control of an institution and to dispose of its assets may be exercised 'in order to take a resolution action,' the latter being defined as the decision to place an institution under resolution combined with 'the application of a resolution tool, *or* the exercise of one or more resolution powers.'[168] This suggests that the availability of resolution powers is not limited to their application within the context of a particular resolution tool. This conclusion is also supported by a purposive interpretation. The objective of the BRRD/SRM resolution framework is to provide authorities with 'adequate resolution tools to handle situations involving both systemic crisis and the failure of individual institutions.'[169] Moreover, it was not deemed to be 'necessary to prescribe the exact means through which the resolution authorities should intervene in the failing institution.' Rather, resolution authorities should decide on the exercise of their powers according to the circumstances of each case.[170] If this reading is correct, the application of the BRRD liquidation powers currently requires the support of the applicable national law: for the order of priority of claims, and also for an effective claims procedure that the BRRD currently does not include. On both issues there is room for further harmonization.

Under the SRM, it is currently not possible for the SRB to devise a resolution scheme that would mandate the liquidation of the institution under resolution, without the

[168] BRRD, Art 2(1) (40), *my emphasis*.
[169] BRRD, Recital (6).
[170] BRRD, Recital (85).

application of at least one of the resolution tools. This is clear from the wording of SRMR, Arts 18(6) lit. (b) and 23.[171] This would leave room for a liquidation in combination with, say, the sale of business tool, similar to a purchase and assumption transaction, where parts of an institution are transferred to a private sector purchaser or purchasers and the rest is liquidated in accordance with the national legislation implementing the BRRD. If the public interest test would be removed, SRMR, Arts 18(6) lit. (b) and 23 could be amended so as to make clear that the resolution scheme shall determine the application of resolution tools *and/or powers*, which would then include the BRRD liquidation powers to be implemented by the national resolution authority on the basis of national transposing legislation.

A further issue would be to ensure that the resolution authority actually goes down the liquidation route where this is the most cost efficient alternative. It is possible to read a version of the 'least cost rule' into the BRRD/SRM resolution framework.[172] In pursuing the resolution objectives the resolution authority must aim to minimize the cost of resolution and avoid the unnecessary destruction of value.[173] Although of equal significance, resolution authorities are required to balance the resolution objectives as appropriate in each individual case, and, more importantly, to choose the tools and powers that best achieve the objectives that are relevant in the circumstances at hand.[174] For those institutions for which the risk of systemic contagion is negligible, the objectives of the protection of public funds combined with the minimization of the resolution costs would seem to strongly direct the resolution authority towards liquidation if this is the least costly strategy. In that sense, resolution authorities are not completely free to pick and choose between the different objectives. Given the limited experience thus far with the BRRD/SRM resolution framework it is probably too soon to introduce a firmer 'least cost test.' For now, resolution authorities could communicate and clarify their approach to the 'least cost test' and thereby self-restrict their discretion in this respect.[175]

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[171] '[S]hall determine the application of the resolution tools' sale of business, bridge institution, asset separation or bail-in; SRMR, Art 22(2). The German version of Art 18(6) lit. (b) seems to be even clearer: 'Durch das Abwicklungskonzept … wird bestimmt, … die Abwicklungsinstrumente …, anzuwenden.'

[172] See also DGSD, Art 11(3)(c), establishing the least cost principle in the context of a statutory DGS being utilized for alternative measures with a restructuring purpose; Brescia Morra (n 37) 363.

[173] BRRD, Art 31(2); SRMR, Art 14(2).

[174] BRRD, Art 31 (1) and (3); SRMR, Art 14(1) and (3).

[175] C-526/14 *Kotnik and others* ECLI:EU:C:2016:570 para 38-44.

3) Minimum loss absorption

Finally, it could be argued that the BRRD/SRM resolution framework is only suitable for institutions 'whose size and business models allow for a sufficiently large issuance of subordinated liabilities that could be bailed in … without undue risk of negative impacts;'[176] or in other words, smaller banks for which liquidation would be the preferred option may not have the capacity to issue sufficient MREL instruments so as to comply with the mandatory 8% loss contribution requirement without the risk of hurting retail investors and depositors.[177]

The setting of a minimum requirement of own funds and eligible liabilities (MREL) and the verification of whether institutions maintain the minimum aggregate amount is part of the resolution planning process.[178] Resolution authorities may determine the required minimum on a case-by-case basis depending on the risks associated with a specific institution and its resolvability.[179] Under the SRM, the SRB—after consulting the competent authorities, including the ECB—determines the minimum requirement for the institutions for which it is directly responsible ('significant' institutions and cross-border groups).[180] For other institutions, minimum requirements are to be determined by national resolution authorities in the course of the drafting of resolution plans.[181]

MREL seeks to ensure that an institution can absorb losses to an extent sufficient to restore compliance with minimum capital requirements.[182] The required minimum amount depends on the feasible resolution strategy and the need to ensure that the institution can be resolved through the application of resolution tools or through

[176] Restoy (n 5) 5.
[177] A Lehmann, 'Impediments to resolvability of Banks' In-Depth Analysis Requested by the ECON committee (December 2019), available at https://bruegel.org/wp-content/uploads/2019/12/IPOL_IDA2019634360_EN.pdf, 16.
[178] BRRD, Art 10(7)(o), 45e, 45f; SRMR, Art 12(4), 12a(1).
[179] BRRD, Art 45c(1); SRMR, Art 12(1) and (3).
[180] SRMR, Art 12(1). The determination is addressed to the national resolution authorities, which then implement the minimum requirements in accordance with their powers under national law and verify and ensure that institutions are in compliance with minimum requirements at all times; SRMR, Art 12(5).
[181] SRMR, Art 12(3).
[182] BRRD, Art 45(2)(a) and (b); SRMR, Art 12a(2)(a) and (b).

liquidation in a way that meets the resolution objectives. Pursuant to the SRB's MREL policy, developed prior to the 2019 Banking package, for institutions for which liquidation is the preferred resolution strategy, MREL will be set at the level of the loss absorption amount (LAA) [183] only.[184] There will be no recapitalization amount[185] and no Market Confidence Charge, [186] reflecting the gone concern status of the institution in case of failure. However, the SRB is committed to an 8% benchmark for MREL in all cases, including liquidation, so that, if necessary, there would be access to financing arrangements such as the Single Resolution Fund.[187] This suggests that resolution planning, at least in accordance with the SRB's MREL policy, could take care of the 8% minimum contribution problem. However, it may well occur that an institution primarily funded by capital and deposits does not meet the 8% MREL requirement at the time of failure in which case losses would have to be imposed on depositors with potentially adverse effects for financial stability (runs on other banks). For cases where the risk of contagion is unlikely to be high, it may well be argued that there is no justification for generally insulating the holders of unsecured senior debt, including deposits, from bearing any losses.[188] However, this would likely weaken the competitive position of smaller banks as compared to GSIBs contrary to the rationale of tackling the 'too-big-to-fail' problem. Conversely, an outright removal of the 8% minimum loss contribution requirement, which is not mandated by international standard setters, would open the door for generous in-resolution bailouts resulting in increased moral hazard and reduced market discipline.

[183] BRRD, Art 45(c)(3)(b)(i) and (a)(i); SRMR, Art 12d(3)(b)(i) and (a)(i).
[184] In accordance with BRRD, Art 45c(2) subparagraph 2; SRMR, Art 12d(2) subparagraph 2; SRB, Minimum Requirement for Own Funds and Eligible Liabilities (MREL): SRB Policy for 2017 and Next Steps (December 2017) para 26; SRB, Minimum Requirement for Own Funds and Eligible Liabilities (MREL): 2018 SRB Policy for the first wave of resolution plans (November 2018) para 10; SRB, Minimum Requirement for Own Funds and Eligible Liabilities (MREL): 2018 SRB Policy for the second wave of resolution plans (January 2019) para 17.
[185] BRRD, Art 45(c)(3)(b)(ii) and (a)(ii); SRMR, Art 12d(3)(b)(ii) and (a)(ii).
[186] BRRD, Art 45(c)(3) subparagraphs 7 and 8; SRMR, Art 12d(3) subparagraphs 7 and 8.
[187] SRB, Introduction to Resolution Planning (September 2016) 39; SRB, MREL: Approach taken in 2016 and next steps (2016) para 31; SRB (2017) (n 184) para 30; SRB (2018) (n 184) para 14; SRB (2019) (n 184) para 21. This is in line with BRRD, Art 45c(3) subparagraph 4; SRMR, Art 12d(3) subparagraph 4.
[188] Martin Hellwig, 'Precautionary Recapitalization: Time for Review,' European Parliament In-Depth Analysis (July 2017) (available at http://www.europarl.europa.eu/RegData/etudes/IDAN/2017/602089/IPOL_IDA(2017)602089_EN.pdf) para. 2.5.

In order to allow the absorption of losses by financing arrangement in the liquidation context[189] without having to encroach on depositors' entitlements, a sensible way around the 8% minimum loss contribution requirement has to be found for smaller institutions. This could take the form of an exemption based on a certain threshold below which the 8% minimum loss contribution does not apply. Short of an outright exemption, the 8% clause could perhaps be 'teleologically reduced' by way of interpretation so that it would not apply to banks below the threshold. Such thresholds are already being considered for different purposes. For example, according to the Bank of England, for institutions providing fewer than around 40,000 to 80,000 transactional bank accounts (modified) insolvency would likely be the appropriate resolution strategy, rather than the application of stabilisation powers.[190] Similarly, with a view to reducing legal uncertainty and the risk of litigation, it has been suggested to develop (indicative) thresholds above which resolution should be assumed to be in the public interest.[191] However, if, as suggested here, the public interest requirement would be removed, this idea could be utilized for developing a threshold that would exempt those institutions from the 8% minimum loss contribution whose business and funding models, notably their access to capital markets, would be incompatible with stringent MREL requirements in form of subordinated debt instruments. These institutions could then be resolved by, for example, transferring their viable deposit business to a private sector purchaser and liquidating the residual entity, with both transfer and liquidation financed by the resolution fund with an adequate contribution from the relevant deposit guarantee scheme.

IV. Conclusion

[189] Resolution financing arrangements would have to be made available for the funding of not just resolution tools, as currently stipulated in Art 101(1), but also for liquidation purposes. This could be addressed by replacing the term 'resolution tools' in Art 101(1) with the term 'resolution tools and powers'. According to the BMF (n 1) 2-3, non-systemic institutions should not be able to rely on the Single Resolution Fund, any financing of resolution and/or liquidation measures should come from deposit insurance funds. However, the appropriate allocation of burdens between resolution funds and deposit guarantee funds could be achieved through a calibration of BRRD, Art 109.
[190] Bank of England, The Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL) (June 2018) 5.
[191] Lastra et al (n 22) 11.

The most straightforward option for harmonizing bank insolvency law would be extending the BRRD resolution framework so as to cover all institutions regardless of whether their failure would have a systemic impact. This would reduce current opportunities for gaming the system, and enhance legal certainty and transparency for stakeholders and the taxpaying public. A further alignment of creditor hierarchies and also of the claims process would be necessary to achieve the maximum effect. In order to cater for institutions with limited capacity to issue subordinated debt instruments as part of MREL, an exception to the 8% minimum loss contribution requirement should be introduced. The result would be a single rulebook with much reduced gaps, addressing many of the weaknesses of the current system.