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NOTE

from:	Presidency
to:	Council
Subject :	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 and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010 - G*eneral approach*

I. INTRODUCTION

1. The above mentioned Commission proposal (hereinafter "BRRD Proposal") was transmitted to the Council on 6 June 2012[1]. The proposal provides a common framework of rules and powers to help EU countries manage arrangements to deal with failing banks and investment firms at a national level, as well as cross-border banks. The proposed Directive provides for three stages of crisis prevention and management: a preventative stage, an early intervention stage, and a resolution stage.

[1] Doc. 11066/12 EF 136 ECOFIN 552 DRS 91 CODEC 1600

2. The file was examined by the Permanent Representatives' Committee on 2 and 8 May 2013 in preparation for the discussion held on 14 May in the ECOFIN Council, which focussed on the issue of bail-in. The President concluded that the political direction given would provide a sound basis for an agreement on the remaining elements of the proposal. Following further meetings of the Working Party of Financial Attaches and three discussions in Coreper on 12, 17 and 19 June, the Presidency has tabled the compromise set out in the attached document.

II. STATE OF PLAY – "THE RESOLUTION TRIANGLE"

3. The discussion in Coreper showed a broad measure of support for the Presidency compromise in particular the framework it establishes around preparatory and preventative measures, early intervention, resolution tools and the various legal safeguards. The Presidency also believes that home-host issues for cross-border banks and depositor preference have been satisfactorily addressed.

4. Member States acknowledged that the key to achieving a Council General Approach at the upcoming Ecofin was achieving the optimal balance between three interlinked elements of the Directive - " THE RESOLUTION TRIANGLE":

   A. The design of the bail in tool, in particular the balance between harmonisation and flexibility (Article 38)
   B. Minimum requirements for own funds and eligible liabilities (Article 39)
   C. Financing (Articles 92 and 93)

5. These three elements are closely connected and any text of the Directive must represent a workable balance between the three. Should any one of the elements (the "angles") in the "resolution triangle", see Annex, be changed, the other two will need to change correspondingly: if more flexibility is desired, then this will have to be reflected in higher resolution funding requirements for institutions and /or higher levels for the minimum requirements for own funds and eligible liabilities (MREL).

6. There have been a number of discussions in Coreper on the balance between the elements in the resolution triangle on which a range of views have been expressed. The Presidency has considered these views by presenting its "mixed approach" proposal as well as an alternative proposal with a higher degree of flexibility compensated by a higher target level for the fund and stricter requirements for the MREL. Taking account of the views expressed at Coreper on 19 June, the Presidency has moved back closer to its "mixed approach" model but has taken on board elements of flexibility and a higher resolution target level from the alternative text. In addition the concept of a minimum percentage of MREL for global SIFIs will not be pursued.

A. AN APPROPRIATE BALANCE BETWEEN HARMONISATION AND FLEXIBILITY IN BAIL-IN (ARTICLE 38)

7. In its compromise before Ecofin the Presidency has adapted its 'mixed approach' model for the purpose of striking a balance between those delegations favouring harmonisation, to ensure legal certainty and a level playing field in the single market, and those who would prefer a larger degree of discretion in order to ensure that Member States' authorities can deal appropriately with the circumstances of each individual resolution case.

8. The discussions in Coreper showed that many delegations have concerns about having too much flexibility built into the proposal, as they fear the fragmentation of the single market through different approaches being adopted by different Member States. There is however an acceptance of a need for an element of flexibility so long as the use of any discretion is framed within a carefully crafted EU framework ("framed flexibility").

9. The Presidency adjustments to the "mixed approach" centres around trying to facilitate those delegations who are requesting a more flexible approach while at the same time not moving too far way from the balance originally struck in this model.

10. The Presidency proposes a balance between harmonisation and flexibility with three main elements:

(i) A discretionary exclusion for derivatives which only applies in particular circumstances and only where it is necessary to achieve the continuity of critical functions and core business lines or it is strictly necessary and is proportionate to avoid widespread contagion (Article 38(3)).

(ii) An additional power for the resolution authority, which is only available in extraordinary circumstances, to exclude certain liabilities where it is not possible to bail them in within a reasonable time, or for financial stability reasons (Article 38(3c)). A safeguard confines the use of this exclusion to an amount equal to 2.5% of the total liabilities of the institution. In addition, this discretion, if higher than 1% of the total liabilities of the institutions, can only be applied after the Commission has been notified and has not prohibited or required amendments to the proposed exclusion (Article 38(5a)). Such exclusions are to be financed by passing the losses to other creditors or where this is not possible through contributions by the resolution fund.

(iii) As a further safeguard, the Commission is empowered to adopt delegated acts in relation to both discretionary powers in order to specify further the circumstances when exclusion is necessary to achieve the objectives of paragraphs 3 and 3c in Article 38 (Article 38(5)).

B. MINIMUM REQUIREMENT FOR OWN FUNDS AND ELIGIBLE LIABILITIES (ARTICLE 39)

11. Throughout the negotiations, there has been a general consensus around the need for an adequate MREL in order to ensure that institutions have sufficient loss absorbing capacity to facilitate the application of the bail-in tool. Several Member States have called for a harmonised MREL level to ensure that each institution has adequate loss absorbing capacity. A number of Member States, however, while acknowledging the importance of MREL and the need for harmonisation, find that setting a harmonised level in the Directive is inappropriate for two main reasons: first, due to the difficulty in defining an appropriate level of MREL and the base at which it should be set in the absence of any quantitative analysis basis; and following on from this, the difficulty in finding a level appropriate to different banking activities and different business models.

12. The Presidency's proposal therefore provides that the MREL of each institution should be determined by the appropriate resolution authority on the basis of specific criteria, including its business model, level of risk and loss absorbing capacity. The Presidency is also introducing a review clause which would mandate the EBA to carry out monitoring and technical analysis and report by 2016 with proposals for harmonisation. On the basis of the EBA recommendations, the Commission would propose (if appropriate) minimum harmonised level(s) of MREL, taking account of the different business models of institutions.

C. FINANCING (ARTICLES 92 AND 93)

13. The third element of the resolution triangle is the financing arrangements. The Presidency has adjusted the provisions on financing arrangements, as compared with its “mixed approach in order to take account of the additional degree of flexibility in its revised proposal. The key features are now:

    (i) Member States should remain free to keep the DGS and the resolution funds separate or to merge them;

    (ii) The resolution fund should have a minimum target level of 0.8% of covered deposits (where the resolution fund is kept separate from the DGS) or a combined fund size of 1.3% (where the resolution fund and DGS are combined).

14. The Presidency is aware of the views of one Member State on the need for an alternative to an ex ante resolution fund and is still considering how this can be addressed in a way which is not inconsistent with the principles of the Directive.

15. There have been calls by some Member States to set each Member State’s resolution fund target level with reference to the total liabilities of its banking sector. However, the Presidency, supported by a majority of delegations in the Coreper, considers that at this stage it is more appropriate for the target level to remain set with reference to covered deposits since it constitutes a harmonised basis for both resolution and DGS[2] funding arrangements. In that regard, a review clause has been introduced for the Commission, in 2016, to consider the appropriateness of using either covered deposits or total liabilities as the reference point for the target level, to be accompanied by any appropriate proposals (Article 93(3a) and 3b)).

[2] In the general approach on the revision of the DGS Directive, agreed in June 2011, the DGS funds should have a target level of 0.5 % of covered deposits.

III. OTHER ISSUES

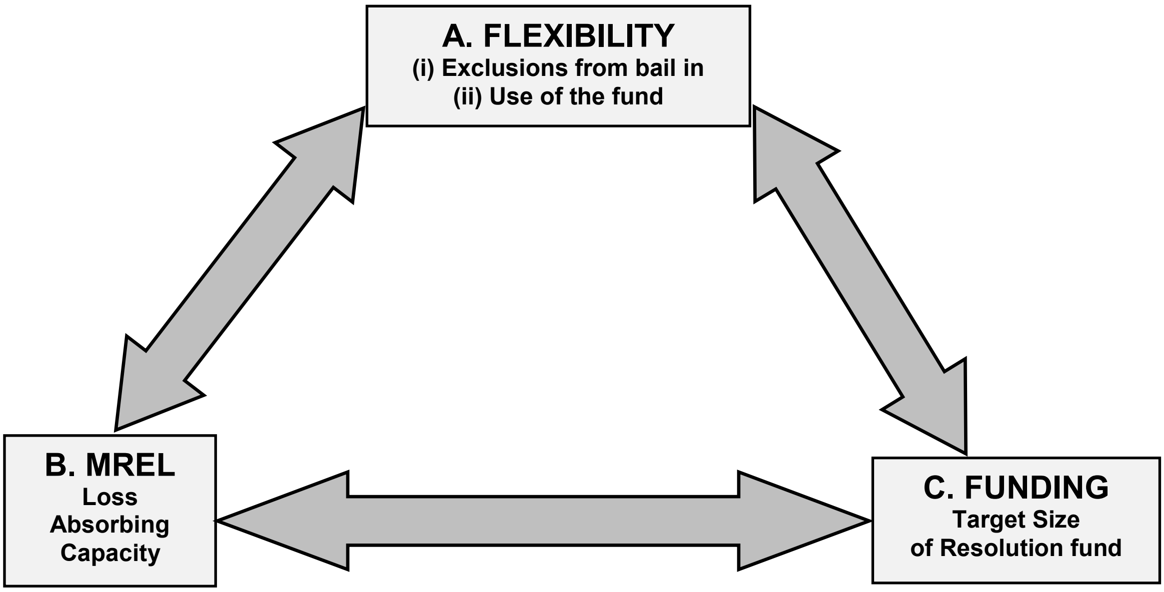
16. Finally, some Member States would prefer that the date of application of bail-in be brought forward to 2015. The Presidency proposes maintaining the current date for bail-in, which is 2018, and advises delegations that any change here would need to consider the necessary counterbalancing measures to ensure that the bail in tool could operate effectively and on a level playing field in the interim period of 2015-2018, while other elements of Banking Union are being put in place.

IV. CONCLUSION

17. The Council is invited to:

- agree the Presidency compromise as set out in document 11148/13;
- mandate the Presidency to undertake negotiations with the European Parliament with a view to reaching an agreement in first reading as soon as possible.

THE RESOLUTION TRIANGLE



1. As mentioned in the report should any one of the "angles" in the "resolution triangle" be changed, corresponding changes in one or both of the other two angles would be necessary: if more flexibility is desired, there will be a need for higher resolution funding requirements for institutions and /or higher levels for the minimum requirements for own funds and eligible liabilities (MREL).

2. Any rebalancing in the direction of flexibility would need to be balanced by strong safeguards to ensure that the Directive did not replace an implicit guarantee by the State with another implicit guarantee by the resolution fund.

3. In addition, greater flexibility in bail-in would need to be accompanied by adequate corresponding shifts in the other corners of the "resolution triangle". A substantially larger resolution fund would be necessary. Institutions would need to have more loss absorbing capacity, and it may be necessary to incorporate further guarantees and safeguards in the Directive to ensure that this was the case.