EUROPEAN
COMMISSION

Brussels, XXX
[...](2013) XXX draft

**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS**

# Completing the Banking Union

## COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS

### Completing the Banking Union

### 1. INTRODUCTION

As outlined in the Commission's Blueprint and in the Four Presidents' reports in 2012, an integrated financial framework or "Banking Union" is a vital part of the policy measures to put Europe back on the path of economic recovery and growth. Inadequate supervision of parts of the European banking sector have allowed problems to build up while uncoordinated national responses to the failure of banks have intensified the fragmentation of the Single Market in bank lending and funding. As a result the transmission of the common monetary policy is impaired and lending to businesses and consumers is impeded.

This is particularly damaging within the Euro Area. With little room to use monetary tools to deal with weaknesses in the banking sector, reliance on national fiscal resources in managing bank failures continues to link banks and sovereigns in a negative feedback loop. Businesses in Member States with a lower perceived ability to rescue ailing banks in their territory are at a severe competitive disadvantage. Moreover, as seen in the current crisis, problems in some Euro Area Member States can rapidly spread via doubts and financial links to others perceived by markets to be vulnerable to similar risks.

Despite recent improvements in funding conditions for sovereigns and banks in vulnerable Member States, monetary policy remains impaired and economic recovery is held back. Recent developments to restore financial stability and ensure sustainable growth in Cyprus have also generated concerns over how specific creditors, especially depositors, could be treated in future bank failures. These concerns, if not properly addressed, could result in renewed market tensions.

Deeper and more integrated financial markets are needed to restore the efficient functioning of the Single Market. This depends on swift progress towards a Banking Union. Single mechanisms for the supervision and, when necessary, restructuring of Euro Area banks are needed to boost confidence, financial stability and growth. Building on the strong regulatory framework common to the 28 EU Members States applicable across the Single Market (single rulebook), it is imperative to anchor expectations that future bank crises in the Euro Area will not create unsustainable burdens or disproportionate economic impacts for individual Member States and will follow the same rules applicable equally to all.

Completing the Banking Union is a crucial step to overcome the current fragmentation and uncertainty, to ease funding conditions for vulnerable sovereigns and banks and break the link between the two, and to re-launch cross-border banking activity in the Single Market to the benefit of both Euro Area and non-Euro Area Member States. The European Commission has taken an inclusive approach and proposed a roadmap for the Banking Union in stages, open to all Member States but in any case including the 17 currently within the Euro Area. This Communication establishes a comprehensive roadmap to complete the Banking Union by setting out its constituent elements and their sequencing.

## 2. THE COMPONENTS OF THE BANKING UNION

To be fully effective, the Banking Union should consist of a Single Supervisory Mechanism (SSM), a Single Resolution Mechanism (SRM), and an appropriate fiscal backstop at the level of the Euro Area. Concluding these steps should however not be conditional on one another. In order to avoid delays in setting them up, it should be possible to reach agreement on them via separate procedures but in a mutually consistent way. The integrity of the Banking Union relies on all of its components applying fully in participating Member States. There can be no opt-outs. Progress on one element without the others may have significant implications for the effectiveness of the supervisory and crisis management framework in the Banking Union and across the EU.

In March 2013, the European Council committed to complete the Banking Union via the following steps. First, the remaining legislative procedures to set up the Single Supervisory Mechanism (SSM) conferring the ECB with powers to supervise Euro Area banks should be concluded as a priority. Second, agreement should be reached in the summer months on how the European Stability Mechanism (ESM) could, following the establishment of the SSM and a review of bank balance sheets including the definition of "legacy assets", recapitalise banks directly. Likewise in summer 2013, agreement should be reached on the Commission's proposals for a Bank Recovery and Resolution Directive (BRRD) and a Deposit Guarantee Scheme Directive (DGS). Finally, the Commission's proposal for a Single Resolution Mechanism together with appropriate and effective backstop arrangements should be examined as a matter of priority with the intention of adopting them during the current parliamentary cycle.

As established, the Banking Union will cover all Euro Area Member States and those non-Euro Area Member States that choose to join. The same EU-wide single rulebook of prudential requirements[1] and rules on bank resolution[2] will apply within the Banking Union and in all other Member States. The integrity of the Single Market will thus be preserved. The enhanced financial stability generated by the Banking Union will also boost confidence and the prospects for growth across the Single Market. Central and uniform application of prudential and resolution rules in the Member States participating in the Banking Union will benefit all Member States. By overcoming the fragmentation currently hampering economic activity, it will help ensure fair competition for and remove obstacles to the free exercise of fundamental freedoms not only in the participating Member States but in the whole of the Single Market.

The components of the Banking Union are set out in Sections 3-6. In addition, for the short-term a clear roadmap for the transition to the full Banking Union is needed, notably to clarify how a bank crisis would be managed before all the institutions are fully operational, how the possible direct recapitalisation of banks by the European Stability Mechanism could work, and how rules on State aid to the banking sector would apply. These are set out Section 7. Finally, in the long-term a possible strengthening of the SRM via changes to the Treaty should be foreseen and a single deposit guarantee scheme could be contemplated.

## 3. THE SINGLE SUPERVISORY MECHANISM

The SSM is the first necessary step towards a Banking Union. The Commission's proposal of September 2012 and its imminent final adoption by the co-legislators respond swiftly to the mandate of the Euro Area Summit of 29 June 2012. The ECB will assume ultimate

[1] Capital Requirements Regulation and Directive (CRR/CRDIV)
[2] Bank Recovery and Resolution Directive (BRRD)

responsibility for the supervision of all Euro Area banks in 2014 while national authorities will be in charge of the day-to-day supervision of smaller banks. It is neither efficient nor proportionate to foresee that all supervisory actions are conducted by the ECB. Hence it has been decided to pursue a differentiated approach whereby the ECB will directly supervise the largest and most internationally active banks with the possibility to "call up" direct responsibility for the others.

The independence and accountability of the supervisory function within the ECB are secured via appropriately balanced decision-making mechanisms. Finally, arrangements for non-Euro Area Member States to join the SSM voluntarily are provided for, while decision-making procedures in the European Banking Authority (EBA) in specific areas are adjusted to reflect fairly the interests of all Member States.

## 4. THE BANK RECOVERY AND RESOLUTION DIRECTIVE AND THE NEED FOR A SINGLE RESOLUTION MECHANISM

The reinforced regulatory and supervisory framework of the SSM and of the recently revised prudential rulebook will restore confidence in the health of banks. However, the risk of a bank experiencing a severe liquidity or solvency problem can never be totally excluded. It is therefore necessary to set out a framework that allows for the in-depth restructuring of banks by authorities whilst avoiding the very significant risks to economic stability and costs derived from their disorderly liquidation under national insolvency laws, and putting an end to the need to finance the process with public resources.

Resolution achieves this. It is a special procedure for banks in serious financial difficulties, providing for in-depth restructuring whereby vital functions for the real economy (deposit-taking, lending, payment systems) are kept open in order to protect financial stability, while losses and costs are allocated to the bank's shareholders, creditors and uninsured depositors instead of taxpayers. This is called bail-in, as opposed to taxpayer-funded bail-out. Resolution creates legal certainty, counters moral hazard and avoids the social and economic costs of ad hoc public bail-outs.

The Commission's proposal for an EU Directive on Bank Recovery and Resolution, currently under negotiation by the European Parliament and Council, will determine the rules for how EU banks in serious financial difficulties are restructured, how vital functions for the real economy are maintained, and how losses and costs are allocated to the banks' shareholders, creditors and uninsured depositors. As instructed by the European Council, the directive should be agreed soon.

A key instrument in resolution, under the directive bail-in would sequentially allocate losses and write down the claims of shareholders, subordinated creditors, and senior creditors. Whether depositors with €100 000 or more could suffer losses alongside senior creditors or after them is a key point to be decided in the on-going negotiations on the directive. Depositors below €100 000 are excluded from suffering losses, their claims being protected by national Deposit Guarantee Schemes.

The directive relies on a network of national authorities to resolve banks. While this is a major step forward to minimise differing national approaches and to protect the integrity of the Single Market, it is not sufficient for the Euro Area. As recognised by the European Council, in the Banking Union bank supervision and resolution need to be exercised by the same level of authority. Otherwise tensions between the supervisor (ECB) and national resolution authorities may emerge over how to deal with ailing banks, while market expectations about Member States' (in)ability to deal with bank failure nationally could continue, reinforcing feedback loops between sovereigns and banks and fragmentation and competitive distortions across the Single Market.

Therefore, the Banking Union needs a Single Resolution Mechanism. The common monetary policy and high degree of financial integration among Euro Area Member States entails that the network of national authorities and resolution funds set up by the Bank Recovery and Resolution Directive is not sufficient to effectively break the bank-sovereign link within the Euro Area and to effectively cover the resolution funding needs of banks in trouble. The recent crisis in Cyprus highlighted the need for swift and decisive action backed by EU-level funding arrangements to avoid nationally conducted bank resolution from having disproportionate impacts on the real economy, and to curb uncertainty and prevent bank runs and contagion to other parts of the Euro Area.

## 5. THE SCOPE AND STRUCTURE OF THE SINGLE RESOLUTION MECHANISM

To be credible and efficient, the SRM needs to cover all banks of the Member States participating in the Banking Union. The differentiated approach of the Single Supervisory Mechanism need not apply. Contrary to the on-going task of day-to-day supervision, only a number of banks are likely fail and be in resolution at any given time. Further, a comprehensive scope for the SRM is fully consistent with the logic whereby the ECB can assume direct supervision for any bank in case of problems, including in view of its possible resolution. Finally, the crisis has shown that it is not only the large international banks that require a resolution framework at European level. The existence of differentiated resolution authorities for different sizes of banks would also imply differentiated funding and backstop mechanisms. This could again entrench links between sovereigns and banks.

As outlined in the Commission's Blueprint, the Single Resolution mechanism is based on the following principles. The need for resolution should be reduced to the minimum, thanks to strict common prudential rules, and improved coordination of supervision within the Single Supervisory Mechanism. Where intervention by the Single Resolution Mechanism is necessary, shareholders and creditors should bear the costs of resolution before any external funding is granted, in accordance with the Commission proposal on Bank Recovery and Resolution. Any additional resources needed to finance the restructuring process should be provided by mechanisms funded by the banking sector, instead of using taxpayers' money.

Under the proposal, the Single Resolution Mechanism is to consist of the Commission, a Single Resolution Authority, and a Single Bank Resolution Fund. Resolution decisions by the Commission would be prepared and monitored centrally by the Single Resolution Authority to ensure a uniform approach. The Single Bank Resolution Fund financed by banks would pool resources at European level so that they can be used across participating Member States where needed to cushion against disproportionate impacts. This increases financial stability throughout the participating Member States and beyond, and ensures that the link between the fiscal standing of individual Member States and the commercial prospects of banks and undertakings operating there is definitively eliminated.

### 5.1. Decision-making structure

The functioning of the SRM ensures that its decision-making structures are legally sound and effective in times of crisis. They are also designed to ensure that the decisions are European and involve Member States in view of the significance of bank resolution for national economies. Responsibility for supervision, resolution and funding are aligned at the same level and decisions adopted at the European level would be implemented at the national level by national authorities. In case they fail to properly implement them, the European level could take decisions directly addressed to the individual institutions.

### *5.1.1. Tasks to be exercised jointly within the SRM*

In order to ensure that effective resolution action is implemented across the Euro Area, the decision on whether resolution of any bank is triggered and on the key elements of the resolution scheme should be taken jointly at the European level. Recognising the important implications of bank resolution on Member States, the decision-making should provide for the appropriate involvement of all directly affected Member States.

The implementation of the resolution scheme would remain with national resolution authorities in conformity with national company and insolvency law (where not harmonised at the EU level). National resolution authorities would normally address the necessary decisions to banks, which would be appealable at national level. The SRM would oversee implementation and have the necessary powers to ensure that national resolution authorities fully carry out the resolution decisions decided at EU level.

### *5.1.2. Tasks and functioning of the Single Resolution Authority*

Under the proposal, the Single Resolution Authority would prepare, propose and ensure the enforcement of resolution decisions. It would prepare the resolution plans for bigger banks and coordinate the preparatory work of national resolution authorities for smaller ones.

In order to ensure an effective and accountable decision-making process, the decisions of the Single Resolution Authority provide for the appropriate involvement of all directly affected Member States, without however giving them a veto over decisions. An executive board chaired by a permanent chairperson and consisting of appointed representatives of the Commission (as final decision-making authority), the ECB (as bank supervisor), and of a limited number of representatives of directly affected Member States would take all operative decisions regarding what resolution action to propose to the Commission to undertake in each case. In addition, it would decide autonomously on less discretionary actions involving for instance information gathering from banks and on-site inspections. A general board involving all resolution authorities from participating Member States would oversee the functioning of the authority and decide on all general matters.

### *5.1.3. Commission role*

Under the current EU Treaty, at the European level only an EU institution has the power to decide on matters such as when to trigger the resolution of a bank, how to restructure it, and how to allocate losses and costs in accordance with the Bank Recovery and Resolution Directive.

There is no obvious choice as to which institution should take such decisions. The profile and mandate of several EU institutions does not equip them to play this role effectively. For instance, adding resolution powers to the ECB's monetary and supervisory roles could accumulate too much power in the institution and cause harmful tensions in the performance of its tasks. However, as supervisor under the Single Supervisory Mechanism and in view of their in-depth knowledge of the banks, the ECB is set to play an important role in the SRM context, not least by making the proposal to trigger resolution. Giving the powers to the Council could excessively politicise resolution decisions and cause tensions with its role as EU legislator.

Therefore, in the framework of the current Treaty, the Commission is best placed to take the resolution decision, following the input from the Single Resolution Authority. The Commission has considerable experience of bank restructuring during the crisis under State aid control.

## 5.2. Resolution funding and the Single Bank Resolution Fund

The question of who pays and assumes losses when a bank is resolved is critical. Losses cannot be legislated away. The order in which shareholders and creditors, including uninsured depositors, would contribute to absorb losses and ensure an appropriate funding of the resolution process is set to be harmonised across the Single Market by the Bank Recovery and Resolution Directive.

Beyond the allocation of costs to these private resources internal to a bank, additional external funding is normally needed to ensure financial stability and the maintenance of critical functions of the bank in the process. Whereas liquidity assistance should be provided by central banks on their terms, a resolution fund sourced over time from the banking sector creates another private external layer which can provide mid-term funding to the bank and avoid or minimise the use of public money. Therefore, in resolution losses should primarily be covered by the bank itself; a resolution fund mainly steps in to provide support funding to help ensure that the resolution action achieves its aims.

The SRM is therefore to be equipped with a Single Bank Resolution Fund financed by contributions from the banking sector. This provides substantial synergies compared to a network of national resolution funds, prevents coordination problems arising in the deployment of national funds and is instrumental in breaking the link between sovereigns and banks.

The Fund will not rely on public money. Banks' contributions are to be based on their risk profile. If necessary additional ex post contributions can be raised and advanced to the moment when the funding is needed. Besides this the Fund would be able to borrow from the market or from third parties. The backstop and the guarantee of the Fund are thus the assets of Euro Area banks.

Therefore, the Fund is set to have robust access to private backup funding. During the transition while it is built up, these features ensure its full operability for the purposes which it is designated for under the bank recovery and resolution directive and ensure that the exposure of the public backstop to the Fund would remain fiscally neutral over the medium term (see below).

The Single Bank Resolution Fund is to be managed by the Single Resolution Authority (i.e. outside the EU budgetary framework), replacing the national resolution funds of Member States participating in the Banking Union. Its use by the Authority for ensuring successful resolution would be set by the mandate of the resolution decision of the Commission.

Existing national funds would be progressively transferred to the Single Bank Resolution Fund and the banks concerned would begin to contribute once this transfer is completed, thereby avoiding double contributions and ensuring fair treatment based on the same criteria for all banks in the participating Member States.

Under certain circumstances, State aid control could need to apply to decisions pertaining to the use of the Single Bank Resolution Fund. In order to protect the level playing field within the Single Market, the Commission as the final decision-making authority within the SRM and under its Treaty obligations in relation to the control of State aid will develop a process that ensures the consistency of resolution decisions with State aid policy.

## 5.3. Triggering resolution

The central decision for the SRM is when to place a bank into resolution, how to carry it out (sale to a viable bank; bad bank/good bank split; bridge bank; bail-in), and how financial burden-sharing between the different private stakeholders should apply (namely bail-in of creditors, and intervention of resolution funds sourced from the banking sector). Pursuant to the rulebook of the Bank Recovery and Resolution Directive, resolution would be triggered when the supervisor (ECB) or resolution authority determines that a bank is failing or likely to fail, when no private sector arrangement can avert failure, and when resolution is in the public interest because the bank is systemic in that its failure would damage financial stability. The process in the SRM for triggering resolution would be as follows:

- The ECB as bank supervisor (directly or via the national bank supervisor) notifies that a bank is failing to the Commission, to the Single Resolution Authority and to relevant national resolution authorities and ministries;
- The Single Resolution Authority assesses if there is a systemic threat and no private sector solution;
- If so, it recommends to the Commission to trigger resolution and proposes the necessary resolution and funding measures;
- The Commission decides to trigger resolution and instructs the Single Resolution Authority to execute the proposed measures. The Commission can also trigger resolution without a prior proposal or can deviate from the proposal, for example to uphold State aid rules;
- The Single Resolution Authority ensures the implementation of the measures by relevant national resolution authorities.

## 6. PUBLIC BACKSTOP

Resolution aims to fund the restructuring of a bank using first the available internal resources (absorption of losses by capital, sale of assets and bail-in of creditors), and second a common resolution fund prefunded by the banking sector. As outlined, the Fund would from the outset have the possibility to raise contributions from the banking sector. However, a transitional period of 10 years is foreseen before it reaches its full pre-funded level. The existence of a credible public backstop is therefore needed to ensure access to additional backup funding in the transitional phase. Moreover, short term funding by the ECB will also be needed to ensure the continuity of systemic functions of the bank throughout the restructuring process.

The Single Bank Resolution Fund should have a guarantee and/or credit line from a public backstop. This could match the target size of the Fund the first year and be progressively reduced so as to cover only the difference between the target size of the Fund and its actual size. Any credit from the public backstop would be recouped from the bank under resolution (via the repayment of loans or the selling of capital instruments), and if this were not possible from the Fund, which could raise additional ex-post contributions from banks for these purposes. This will ensure that the backstop is fiscally neutral in the medium-term. As banks develop stronger loss absorbing capacity and the resolution fund builds up, this active backstop role would progressively diminish as resolution by self-sustained private means would become the norm. It would evolve into one of ultimate backstop to underpin the functioning and oversight of the banking sector in the Banking Union.

As outlined in the Four Presidents' reports, the only credible entity to perform this backstop function is the ESM. However, the SRM Regulation does not explicitly identify the ESM as the final backstop. Since the logic of resolution is that banks should be resolved by private means, any public role for the state or the ESM should be implicit, possible notably in crises of systemic magnitude and subject to the parameters laid out in the Bank Recovery and Resolution Directive. The ESM is also an intergovernmental instrument. Its alignment with this role in relation to the SRM should therefore be carried out in a separate procedure, including how to secure the backstop for non-Euro Member States joining the Banking Union. This could for example be solved either via changes to the ESM Treaty, allowing non-Euro States to join the relevant parts of the ESM, or via bilateral arrangements between the ESM and the Member States concerned.

## 7. TRANSITION TO BANKING UNION

The Single Supervisory Mechanism is set to enter into force in mid-2014. The Single Resolution Mechanism meanwhile should commence operations in January 2015, when the Bank Recovery and Resolution Directive which will provide the rulebook governing bank resolution across the Single Market is set to enter into force. The SRM would thereafter apply the rules for Member States participating in the Banking Union, while national authorities would do so for those outside.

It remains to be seen whether the legislative negotiations on the directive provide for a further phase-in period until 2018 for the full entry into force of bail-in as proposed by the Commission. For example, precluding fully bailing in senior creditors before 2018 could provide a means to avoid disproportionate impacts in some Member States in the short to medium-term.

Nonetheless, as of 2015 the conditions for State aid and support by ESM resources to banks would be determined by the rules of the Directive. Namely, depending on the final outcome of the legislative negotiations, national and ESM resources would essentially backstop resolution funds (i.e. the Single Bank Resolution Fund in the Banking Union and national resolution funds outside) sourced from the banking sector. That is… [*to complete with some details on whether they could cover losses only, recapitalise banks and up to what level etc. based on how things evolve in the coming weeks*.]

However, until 2015 bank resolution would continue to be carried out under national regimes. As already seen in various cases, these should continue to approximate and anticipate the provisions of the Bank Recovery and Resolution Directive where possible and appropriate in order to promote consistent approaches and enhance legal certainty. This applies especially to bail-in, notably how losses and costs are allocated to creditors and depositors, and how public resources could complement loss absorption and recapitalisation by private creditors.

At the European level, this process of convergence is to be furthered on the one hand by the forthcoming revised State aid guidelines for support to banks and, on the other, agreement on how the European Stability Mechanism could recapitalise ailing banks. The revised State aid guidelines would impose stricter requirements to allocate losses to shareholders and junior creditors in any Member State providing public support to their banks. This would counter the on-going fragmentation of the Single Market depending on the strength of the sovereign and the presence of legacy assets. The ESM guidelines would meanwhile specify under what conditions, and subject to State aid rules, Member States unable to provide public support to banks could get loans or if necessary how bans could directly recapitalised by the ESM. In the run up to 2015 and depending on the exact outcome of the legislative negotiations on the Bank Recovery and Resolution Directive, both sets of guidelines should be updated to take account of its provisions.

### 7.1. Revised State aid guidelines for the restructuring of banks

Throughout the crisis, the control of State aid by the Commission has been instrumental in helping preserve financial stability and in minimising competitive distortions across the Single Market. Member States have taken emergency measures in relation to banks in difficulties to the tune of €1,6tn since 2008 (including guarantees) in the context of a common framework of rules laid out in a series of Commission Communications[3].

These rules cover inter alia how losses and costs are to be first allocated among the private stakeholders of a bank (its shareholders and creditors) before State aid is granted. They have helped reduce the overall amount of taxpayer funds required, to limit moral hazard, and to prevent different levels of aid by Member States from fragmenting the Single Market further. They have also helped to restore market confidence and enable restructured banks to regain access to funding markets on affordable terms.

In the first phases of the crisis, no Member State went beyond the minimum requirements to impose losses on private stakeholders provided for by State aid rules. As the financial crisis evolved, and the tensions in the sovereign debt market became more prominent, the contributions from owners and creditors to the restructuring costs have gained importance. In the context of financial assistance programmes, the Eurogroup has insisted on a larger private sector contribution. Some Member States went beyond the State aid minimum requirements and enforced by way of public national law a stricter degree of ex-ante burden sharing among owners and creditors. Today, while burden sharing in most Member States is still closely aligned with the minimum requirements under State aid rules (with the exception of some interventions in the Netherlands and Denmark) in others it has been strengthened, as shown in the cases of Spain (bail-in of subordinated debt) and Cyprus (bail-in of uninsured depositors).

This situation jeopardises the level playing-field in the Single Market. Markets are taking into account these developments as a result of which funding costs for banks in countries with perceived weaker sovereigns have increased. Moreover, given the prevailing uncertainty about the rules, all banks now pay a "risk premium". The danger these de facto differing bail-in requirements represent for the Single Market can hardly be overstated.

Therefore, as indicated the Commission intends to revise the State aid framework to shift the allocation of bank losses and costs of bank recapitalisation increasingly from bail-out to bail-in, that is in the direction of the EU-wide regime which will apply as from 2015 with the bank recovery and resolution directive. Before then, public support would be conditional on banks exploiting all private capital enhancing measures including allocating losses in full to capital instruments under the Capital Requirements Regulation. The revised framework will thus pave the way for a smoother transition towards the new regime and towards the full Banking Union. It will establish the same burden sharing rules in order to ensure a level playing field in restructuring all banks resorting to State aid, irrespective of their geographical location. In addition, the revised guidelines will clarify some guiding principles for bank restructuring, codify some elements of the Commission's case practice, and take account of the changing regulatory environment.

---

[3] The Commission has issued four Communications which provided detailed guidance on the criteria for the compatibility of State support to financial institutions. The Communications in question are the Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis (Banking Communication); the Communication on the recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition (Recapitalisation Communication); the Communication from the Commission on the treatment of impaired assets in the Community banking sector (Impaired Assets Communication) and the Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules (Restructuring Communication). The rules have been extended on the basis of two prolongation communications (the latest dates 1.12.2011, OJ C 356 of 6.12.2011).

Requiring banks to cover losses and recapitalise using private means including the write-down of shareholders and conversion of subordinated debt holders as a condition for access to State aid will save significant public resources. Based on past bank rescues and depending on the size of losses, it is estimated that it could cut the contribution of State aid by 25-50%, and in many cases even avoid recourse to State aid entirely. The revised rules should be applicable by August 2013.

National legislation will need to be updated to provide for burden sharing along these lines where relevant. It should be noted, however that the revised framework can only establish minimum requirements. To protect the integrity of the Single Market to the fullest, a political agreement among Member States would be needed to establish the same requirements as a maximum.

Under the revised State aid rules and before the entry into force of the Bank Recovery and Resolution Directive, senior creditors and depositors would not be asked to contribute to the cost of restructuring banks. Therefore before 2015, in case bail-in and other capital boosting measures under the revised State aid rules would not be sufficient to meet the capital needs of a bank, recapitalisation via the public sector would be required. Public funds would come first from the Member State concerned.

### 7.2. Role of ESM

In the Banking Union as of 2015, the ESM could become the backstop for a single resolution fund. In the interim, it could provide financial assistance if a Member State could not provide public support as above. This could be in the shape of a loan to a Member State or, subject to the agreement Euro Area Member States, directly recapitalise banks provided the eligibility criteria are met.

[When the ESM Member concerned addresses a request for financial assistance, the Commission (in liaison with ECB and where appropriate, the International Monetary Fund) assesses whether the eligibility criteria are met. While elements of the eligibility criteria are common to the instruments 'loan for bank recapitalisation' and 'direct recapitalisation' (i.e. the bank must be systemic and must be unable to finance its needs by tapping the market, there should be a risk for the financial stability of the euro area and its Member States), the main difference comes from the eligibility requirements related to the fiscal situation.

To obtain an ESM loan for bank recapitalisation, the Member State concerned must demonstrate its ability to repay the loan in full, even if it cannot recover the capital injected in the bank. The *loan must not jeopardize public debt sustainability* (as, in such a case, a macroeconomic adjustment programme with a banking-sector envelope would be a more appropriate instrument).

To obtain ESM assistance in the form of direct recapitalisation of a bank, the Member State concerned must be *unable to recapitalise the bank without very adverse effects on its own public debt sustainability*. The use of the direct recapitalisation instrument can also be considered if it is established that other alternatives would endanger the Member State's continuous market access and require the financing of its sovereign needs by the ESM. In short, the Member State must have relatively sound public finances to obtain a loan for bank recapitalisation and will qualify for a direct recapitalisation only if its public finances are very seriously at risk.

The total ESM envelope available for direct recapitalisation of banks is expected to be capped at EUR60 billion. Taking into account negative leverage effects, a minimum of EUR 210 billion would, therefore, be available for ESM loans - an amount that should increase to EUR 270 billion by the end of 2013 when the programme for Spain ends.]

## 8. CONCLUSION

Completing the Banking Union by way of the timeline and transitional steps set out above is essential to boost market confidence, mitigate moral hazard, overcome the destructive economic fragmentation perpetuated by sovereign-bank links and foster economic recovery. The Banking Union should be in place in 2015, complete with a nascent but fully operational Single Bank Resolution Fund and a single, effective and fiscally neutral backstop arrangement at the level of the Banking Union.

In the long term perspective, further improvements to the Banking Union could be made. The scope for a single deposit guarantee scheme could be explored. Based on a Treaty change, the Single Resolution Authority could be transformed into a fully independent EU body.

# ANNEX

## Indicative timetable

| | June 2013 | July 2013 | August-December 2013 | Jan-July 2014 | July 2014 | 2015-2017 | 2018 |
|---|---|---|---|---|---|---|---|
| SSM | | EP final vote and OJ Publication | | Comprehensive Balance Sheet Assessments and EBA Stress Tests | Implementation | | |
| SRM | Commission proposal June 2013 | | Political agreement in Council December 2013 | Final agreement EP/Council before April 2014 | | Implementation | |
| ESM role: Direct recapitalisation/ backstop | Agreement in Eurogroup | | Completion of necessary processes for parliamentary approval | | | Backstop to Single Bank Resolution Fund | |
| CRDIV | | OJ Publication and entry into force | | Implementation 1 January 2014 | | | |
| BRRD | General approach Council in June, start of trilogies with Parliament | | Final agreement EP/Council | | | Implementation 1 January 2015 | Possible phase-in of full bail-in |
| DGSD | General approach June 2011 | | Final agreement EP/Council | | | Implementation | |
| Revised Financial sector State Aid guidelines | Consultation of Member States | August 2013 | | | | Entry into force of updated SA guidelines | |