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# The crisis management framework for banks in the EU: what can be done with small and medium-sized banks?*

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*In her speech to a workshop on small and medium-sized banks organised by the Bank of Italy in Rome on the 15 January 2021, Elke König, Chair of the Single Resolution Board explains the remit of the SRB and how it functions, and also looks at the challenges and opportunities for dealing with the so-called 'middle class' of banks in Europe. She outlines some of the obstacles to a fully-fledged Banking Union to help promote financial stability and protect the taxpayer from future bail-outs.*

* Keynote speech held by Elke König, Chair of the Single Resolution Board, at the Banca d'Italia workshop on the crisis management framework for banks in the EU on 15th January 2021 (virtual event).

I want to look at a two main areas in my speech today.

**The first**: The role of the SRB in ensuring financial stability across the system.

**The second**: The potential issues with the small and medium-sized entities in the financial sector because of the current framework, and what solutions might be put forward to improve the situation.

## 1. The role of the SRB / When do we resolve?

So, to the first part of my speech - a look at the SRB's job in ensuring financial stability.

The SRB's role is to develop resolution plans and ensure they are ready to be put into action at very short notice, for the banks under its remit. **At present, the SRB covers 128 banking groups within the Banking Union – this includes the largest banks, that is to say, those under SSM supervision as well as certain smaller cross-border groups**. The logic for this by legislators in framing the BRRD and the SRMR was simple – the largest banks in each member state when getting into trouble can create problems across Europe, so they should be managed at EU level. Many of them are active cross-border in Europe or internationally.

There is sound logic to this. It made sense to ensure a strong European regulatory framework for these banks, since the economy and thus also smaller banks rely heavily on stability in larger banks, too. Incidentally, this is also the reason why every institution – even the smaller ones – must pay a contribution to the Single Resolution Fund. All institutions benefit from the additional stability the fund - and soon its backstop – provide and so this is why everyone contributes.

The plan for **almost all banks under the SRB remit is resolution and not insolvency**. I have said in the past that resolution is 'for the few and not for the many'. This is correct, since the SRB deals with 128 banking groups out of the more than 3,000 banks across the Banking Union. For the **banks under the SRB's remit, in general, we expect and plan for the use of resolution tools**. Even for those banks where we firmly believe that National Insolvency Procedures would be the solution in case of failure, we have to ensure their resolvability.

The decision to put a failing institution into resolution depends on the outcome of a **"public interest assessment"** or PIA, determining in particular if the preservation of a bank's critical functions is required to maintain financial stability. If the PIA's outcome is negative, a failing bank will be sent into national insolvency, and I'll come back to this in a moment.

**Resolution is not a magic wand - losses will still be inherent in any resolution**, it's just that they will be distributed more fairly than before and that there is less uncertainty or ambiguity and thus less risk to financial stability. Please let us keep in mind that in any failing business in a market economy it is for equity and creditors to foot the bill.

Banks whose failure poses much less of a risk to financial stability **can be dealt with under national insolvency proceedings, however the basic rule holds that banks need to be resolvable and have enough loss-absorption capacity to avoid any adverse effects. This is the argument for MREL – in case of banks that go into resolution to allow the necessary funds for loss absorption and recapitalisation; in case of banks that can be put into insolvency there is still the need to set an adequate amount for loss absorption**.

## 2. Challenges and possible solutions for small and medium-sized banks

This brings me to the **second part** of my speech this afternoon: the challenges and possible solutions for dealing with small and medium-sized banks.

I suppose the first thing to say is that in Europe, we have no common definition as to what 'mid-sized' or 'middle-class' bank actually means. There is a huge variation across the 21 Banking Union states. A mid-sized bank could be an LSI, but it might also be an SI. However, for the purposes of the discussion today, **I think we can say that a mid-sized bank is a bank of small to medium-size in relation to the market it operates in, heavily reliant on deposit funding**. No matter what the size of the bank, and what tier we might have it categorised in, to ensure financial stability, there is need for an implementable solution should that bank get into difficulty.

Of course, our immediate concern at the SRB is for **those banks that must become resolvable, that is the 128 banking groups I mentioned.** These are the largest banks, but within those 128, we have a huge variety of shapes and sizes, and as I said, these 'mid-sized' or 'middle class' banks can be SIs, which is where I will turn my attention now.

I want to state clearly that there is no easy way out: **All SIs have to become operationally resolvable** and need to build the necessary MREL to allow a resolution scheme to be executable.

Resolution tools vary and in particular, 'Sale of Business' and Asset Separation tools might be best suited for these banks. However, they come at a cost, as they need to be prepared and made implementable.

MREL in these banks might often mean equity only. This provides an added **challenge**, because we are faced with the risk that this might have been, or rather most likely has been, depleted at the point of FOLTF leaving little room for resolution.

At the same time, it is absolutely clear that we cannot have a layer of banks that is considered too big for one of the Banking Union's twenty-one plus national insolvency procedures but making it resolvable is considered unfeasible. This could mean these banks get a free ride in 'going concern' and possible manage to distort competition, and in a 'gone concern' situation they end up with the taxpayer or the industry footing the bill.

Just to avoid a misunderstanding: Supervision and resolution planning have to be proportional, and we take this very seriously. But at the same time the old argument of same business, same risk, same rules also implies that for example access to funding, be it from the DGS or the SRF cannot be different for small and mid-sized and large financial institutions.

The completion of the Banking Union through implementation of a Common European Deposit scheme, or the 'third pillar' of the Banking Union, with sufficient powers, in particular transfer tools, is a major part of the solution in order address the challenges around the failures of these banks.

**The lack of a harmonised EU liquidation regime is a major obstacle towards a fully-fledged Banking Union.** When we are looking at whether or not to resolve a bank, the SRB's assessment of the no-creditor-worse-off principle seeks to ensure that the treatment of creditors in resolution is not worse than the one they would have received under normal insolvency proceedings.

Currently, with **twenty-one plus different insolvency frameworks** in the Banking Union, the analysis of the insolvency counterfactual for a cross-border bank in resolution is a challenge, and results in diverging outcomes depending on the home country of the institution. Moreover, the 'failing or likely to fail' assessment is not always aligned to the criteria for liquidation at national level and may similarly lead to different conclusions.

**Bank insolvency procedures should be subject to common standards and practices at EU level.** This would solve the problem when larger banks are not to be resolved, but it would also solve problems when dealing with smaller banks. **The best solution would be EU-wide [administrative] rules on insolvency proceedings for the banking sector**. This harmonisation would have **five** distinct advantages for all sizes of banks:

- **First,** it would facilitate resolution planning for cross-border banking groups;
- **Second** it would level the playing field and eliminate wrong incentives;
- **Third** provide the industry and investors with the same level of certainty in liquidation as in resolution;
- Linked to that third benefit is number **four**: a stronger CMU, since investors would have more certainty when investing cross-border. For example, no matter if they invest in a medium-sized bank that then grows and falls under the SRB, or suddenly has its home in another state, the rules (and thus the risk) in regulation terms remain the same.
- **Fifth**, an efficient and effective insolvency framework would also help addressing **legacy assets** and avoiding the build-up of new non-performing loans, which by the way as we try to emerge from Corona, are only going to grow, but that is an aside and I won't dwell on this point this afternoon.

These ideas are not new. Way back in 2010, the European Commission's Communication on an EU Framework for Crisis Management called for "further harmonisation of bank insolvency regimes, with the aim of resolving and liquidating banks under the same procedural and substantive insolvency rules". Unfortunately, not much has changed eleven years on.

In the interim, while waiting for the Holy Grail, the SRB developed **National Handbooks** to define how to implement resolution schemes in each country, as well as national implementation steps for a decision not to adopt resolution. This was a step in the right direction, but is only a 'second best' option and not comparable to a harmonisation of bank insolvency procedures – **something only legislators can deliver.**

Proposals for harmonisation across the board will inevitably be fraught with political perils and resistance. An incremental approach – such as the one we saw in the harmonisation of the ranking of unsecured debt instruments in insolvency – may be a more pragmatic solution. The ultimate goal, however, must be to put in place an **EU liquidation regime alongside an EU resolution regime**, something akin to a European FDIC. Indeed, I will be interested to hear Art's insights from the FDIC later this afternoon.

## 3. Conclusion

Ladies and gentlemen, I am coming to a close. What is clear, is that the current resolution framework, for significant banks in Europe, is working. It is contributing to financial stability and it is helping to protect the taxpayer from future bail-outs, by ensuring more responsible management of risk in individual banks from the outset. What is also clear, is that the framework is set up to ensure that while all of the major banks – those ones under SRB remit – must be resolvable, the fact remains that resolution is for the few, not the many. And so, there is a gap in our financial stability framework that certainly does need to be plugged.

I thank all of you for your work on the various papers being discussed today. It is important we have research and reflection in this area in order to develop solutions capable of dealing with the "middle class" of banks. I am sure there are many ideas and solutions that are worth mulling over, and hopefully some of them may even be the basis for future legislative reforms in the EU. I can assure you that our team will look at them carefully.

Time really is of the essence, especially since I am more than aware of the pace of EU decision making. Lest there be any doubt, it is a long process! And yet, while this process is going to take time, it is vital. Vital to the success of our Banking Union, and vital to ensuring financial and economic stability right across Europe and further afield.

And I think that stability is something all of us can agree would be welcome in our world at this time.

## About the author

***Dr Elke König*** *is Chair of the SRB, responsible for the management of the organisation, the work of the Board, the budget, all staff and the Executive and Plenary sessions of the Board. The General Counsel, the Strategy, International Relations and Communications Unit and the Internal Audit function report directly to her.*
*She was President of the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) from 2012 until 2015. After qualifying in business administration and obtaining a doctorate, Dr König spent many years working for companies in the financial and insurance sector. From 1980 to 1990, she worked for KPMG Deutsche Treuhandgesellschaft in Cologne, auditing and advising insurance undertakings, from 1986 as a holder of a special statutory authority (Prokuristin) and from 1988 as a director and partner. From 1990 to 2002, Dr König was a member of the senior management of the Munich Re Group (Head of Accounting); she then moved to Hannover Rückversicherung AG as Chief Financial Officer. From 2010 to the end of 2011, Dr König was a member of the International Accounting Standards Board (IASB) in London. Dr König was also a representative of the Supervisory Board of the Single Supervisory Mechanism.*

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