

CEBS's response to the European Commission's Communication on an EU Framework for Cross-Border Crisis Management in the Banking Sector

General remarks

1. CEBS welcomes the European Commission's Communication on an EU Framework for Cross-Border Crisis Management in the Banking Sector, published on 20 October 2009.
2. Following a request by the Commission, CEBS has already produced a mapping of supervisory objectives and powers, including intervention measures and sanctioning powers. The report was published on the CEBS website on 6 March 2009¹.
3. CEBS welcomes the Commission's initiative to review the existing intervention mechanisms against the background of the lessons learnt from the financial crisis and to remove or mitigate, as far as possible, gaps and obstacles.
4. CEBS has already provided advice to the Commission in this area, on 11 March 2009².

Scope and objectives

Objectives in developing the policy framework

5. As set out in CEBS' earlier advice, CEBS supports the Commission undertaking work in this area. It has become apparent in the current crisis that there are some gaps and obstacles in the EU regulatory framework that should be addressed.
6. CEBS agrees that one of the key objectives of this work should be to ensure that all national supervisors have adequate tools to identify problems in a bank at an early stage and to be able to take appropriate action (to prevent further decline, or to restore it to a viable condition). Accordingly, CEBS has focussed in this response on the issue of a common toolbox available to competent authorities in each Member State.

¹ <http://www.c-eps.org/News--Communications/Latest-news/CEBS-publishes-its-report-mapping-supervisory-obje.aspx>

² CEBS's comments to European Commission's considerations regarding Intervention measures (CEBS 2009 61 rev1, 11 March 2009).

7. CEBS also agrees with the objective of making it possible to allow all banks, including cross-border banks, to fail in an orderly fashion that does not cause material disruption to the banking system or financial stability. In pursuing this objective, CEBS would expect the future framework to reduce moral hazard and increase market discipline. CEBS has, therefore, also commented on the tools that should be available to competent authorities in this area. The option to allow an institution to fail or to use the available tools to remedy a situation should always be assessed by the authorities on a case by case basis.
8. Both of these objectives should be underpinned by an objective to improve the exchange of information and co-operation between competent authorities.
9. However, in pursuing both of these objectives CEBS considers that, from a supervisory perspective, it will be important to consider carefully the costs and impact in 'normal' times of any changes on (a) firms and (b) the effectiveness of supervision.

Objectives in operating the framework

10. CEBS believes that in operating the framework for early intervention and bank resolution there should be a small number of objectives. CEBS does not believe that these can or should be ranked; they are all important and the relative importance of the objectives needs to be judged on a case by case basis. The framework should also recognise that the balance of these objectives may vary across Member States and that, for the largest cross-border banking groups, it is likely to be difficult to make an assessment (of the relative importance of the objectives) in relation to the group as a whole. It should remain possible for individual competent authorities to reach their own conclusion on how best to balance the objectives in respect of the legal entities for which they are responsible. This would ensure that responsibility for a legal entity is aligned with accountability for the legal entity. However, the exercise of such powers should take account of the EU dimension of the national authority's mandate. It may be appropriate for this concept to be extended to non-supervisory authorities that make decisions within this framework which could have an impact on financial stability in other Member States.

11. The objectives should include:

- maintaining the stability of the financial system;
- preserving critical banking functions;
- protecting depositors; and
- maintaining and enhancing public and market confidence in the stability of the financial system.

All these objectives are interconnected, do not oppose each other, and may be affected simultaneously.

12. In pursuing these objectives competent authorities should seek to:

- avoid moral hazard and promote market discipline;

- cooperate effectively and exchange information with relevant authorities across Member States;
 - minimise the overall costs, with a strong preference for private sector solutions; and
 - minimise interference with property rights.
13. These objectives should apply both in times of stress when the tools are likely to be operated and in normal times. This is important because the creation and maintenance of the framework for times of stress should be undertaken in such a way that it does not have an adverse impact on financial stability and market confidence in normal times.

Scope of the framework

14. CEBS recognises that most financial services groups – in particular cross-border groups – contain a variety of business types. This would point towards the need for a single regime that can eventually accommodate all aspects of financial services. CEBS also recognises that there have been failures of non-deposit-taking institutions, which have had a significant market impact in some jurisdictions.
15. However, CEBS also recognises the complexity of creating a framework that can be applied across financial sectors. Objectives may be different between sectors: in dealing with a deposit-taking business the focus is likely to be on the protection of deposits; in dealing with a securities trading business the focus is more likely to be on an orderly unwinding of market positions. Similarly, tools that are applicable in one sector may not be relevant in another.
16. In the present comments, CEBS will focus on the banking sector and suggests that the Commission should use this work as a catalyst for promoting greater cross-sectoral convergence in respect of cross-border groups as a whole, not just their banking entities (but see paragraph 30 for comments on groups).
17. CEBS believes that the tools made available to competent authorities through an EU framework should be available in both cross-border and domestic cases. This will ensure that there are no 'level playing field' issues between different types of banking institution and it will mean that there is no incentive for institutions to find ways to avoid being classified as 'cross-border'. This reflects CEBS' view that while the framework should aim at ensuring that Member States have consistent powers available; competent authorities would retain the discretion to deal with troubled institutions as they deem appropriate.
18. For similar reasons, CEBS does not believe that an EU framework should be limited to systemic institutions. A hard-edged distinction would require the boundary to be policed and risk institutions trying to game the system. It would also not reflect the fact that an institution's systemic importance will vary along a scale of different degrees of systemic importance. Criteria to identify systemically relevant institutions are not easy to define ex ante and may change over time, depending on the type of crisis with which institutions are confronted.

Identifying systemic institutions ex ante would, furthermore, increase moral hazard.

Intervention tools

19. As mentioned in its earlier advice, CEBS supports the Commission's efforts to complete the intervention toolbox, as it considers the identification and implementation of a common minimum set of tools across the EU as one of the most effective ways forward in promoting financial stability within the banking sector.
20. Building on the tools already provided for in Art. 136 of Directive 2006/48/EC, a minimum set of tools (set out in paragraphs 52-80) should be developed to be available to all authorities across the EU. However, as each bank and situation is different and needs to be dealt with on its own merits, CEBS believes it to be essential that supervisors retain a sufficient degree of discretion in considering when and how to make use of intervention tools. So CEBS considers that the intervention toolbox should be established:
 - as a common minimum;
 - as a range of tools available to the authorities;
 - independently of the different national institutional architectures.
21. *As a common minimum:* to facilitate cooperation and understanding between authorities in different Member States. Each Member State should retain the capacity to establish additional tools when deemed necessary.
22. *As a range of tools available to the authorities:* authorities should have the right to rely on their own judgment in deciding when it is necessary to take action and which tool they may choose to use taking into account the situation. No tool should be given priority or considered inherently better than any other, and several tools might have to be used at the same time. Conversely, authorities should never be expected or compelled to use any particular tool. The legal framework must be clear that there is no presumption that the authorities will always try to use certain tools before moving on to other tools.
23. *Independently of the different national institutional architectures:* different supervisory frameworks coexist throughout the EU, so it should be left to the Member States to assess which authority is in a better position to use the powers and to implement them, according to the national institutional framework.

Tools - effectiveness

24. CEBS agrees with the Commission's assessment that the recent crisis has exposed the lack of an effective crisis management framework at EU level, and has highlighted weaknesses in the cooperation between Member States, and that a strong regulatory framework that covers prevention, early intervention and bank resolution is needed. However, CEBS would like to stress that, when introducing the new enlarged minimum toolbox, timeliness and effectiveness of the tools are of

paramount importance. The Commission should propose tools that can be effectively implemented in a reasonable time frame.

25. It is crucially important that any revised arrangements which are put in place are credible and robust, especially in crisis situations. Any gap or obstacle that might hinder authorities' ability to manage crisis situations should be removed.
26. CEBS is of the opinion that the tools to be included in the minimum toolbox should be sufficiently robust. Any legal uncertainty would render them useless to the authorities, whilst the public might view their non-application as an unused resource by negligent authorities. Furthermore, it is possible that there are tools which would be, in practice, unusable by the authorities: CEBS would prefer that these not be included in the toolkit. It must not be possible in any situation for stakeholders to challenge the action of the authorities on the grounds that the authorities should have used another tool, but especially where that second tool, for legal or other reasons, is unusable.
27. Several legal obstacles dealing with company law, insolvency and national legislations have been pointed out in the Commission's Communication and Staff Working Paper. CEBS believes that not only these legal obstacles, but also others, should be overcome. The Commission should consider more broadly other aspects of current EU legislation that may impede effective intervention in ailing firms. Particular issues which should be considered further include:
- disclosure requirements arising from the Transparency and Market Abuse Directives, in order to ensure that these directives provide firms and competent authorities with sufficient ground for exemptions to disclosure requirements when it is necessary to maintain financial stability;
 - amending the Financial Collateral Directive to allow a brief delay on close-out rights to facilitate orderly resolution of an ailing bank³.
28. In addition, CEBS notes that further clarity may be needed with regard to the application of State Aid rules in relation to certain measures (e.g. bridge bank, provision of financial support by the Deposit Guarantee Scheme (DGS)), since they may not necessarily be covered in the recent Communications adopted by the Commission in the specific context of the global financial crisis. Also, given the temporary nature of the Communications on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State Aid rules, there is a need for a more permanent framework.
29. CEBS would also like to raise a Contract Law issue which can inhibit the effectiveness of supervisory tools. Financial contracts generally provide for automatic termination in the event of a default of a contracting party. Such close-out clauses protect counterparties from the default of a market participant and contribute to avoid contagion. However, too broad a definition of default events in large numbers of contracts can

³ This is possible under the regime in the USA, where the FDIC can require a delay for a 48 hour period.

also aggravate a crisis or prevent a supervisor from taking action. If a measure taken by the authorities could be deemed to constitute an event of default, the closing out of large numbers of contracts as a result of the measure taken by the authorities could render the measure counterproductive and undermine an effective early intervention in a bank or a resolution. In order to ensure a level playing field, CEBS is in favour of a solution at the EU level. As a possible solution, the use by the authorities of any specific tool should not, in itself, be allowed to be treated as an event of default.

30. Tools also need to be effective where a bank is part of a larger group, and may be operationally dependent on other group companies. Powers to allow the competent authorities to require other companies in the same group to continue to provide essential technical services to the bank being resolved would be necessary. As other parts of the group may be in some form of insolvency procedure, this may require modifications to national insolvency laws, though the precise changes will vary depending on national legal regimes.
31. When considering such legal obstacles, it is important to bear in mind that some of the new powers will be exercised at a time when an institution is in severe distress and as an immediate alternative to liquidation and deposit refunding, with a view to ensuring the stability of the financial system, public confidence in the financial system, and the protection of depositors.
32. It is important to provide tools which enable the authorities to carry out their responsibilities, and prevent legal actions by stakeholders from precluding or delaying the measures that need to be implemented, in particular by preventing or undoing reorganisation measures. The stakeholders' right to judicial review and compensation should not be affected by these measures (as discussed in paragraphs 48-49 and 86-88).

Financing intervention measures

33. From a financial point of view CEBS considers it to be of the utmost importance that, whatever the amount and source of the needed funding, there are arrangements available within Member States so that intervention can be financed from the very early stages in order to reduce the final costs of any reorganisation.
34. CEBS shares the Commission's strong preference for funding to come from the private sector, be it on an individual or collective basis, as a way to reduce costs to the public sector.
35. CEBS notes that, as well as a pure investment motive, private sector banks can gain a wider benefit from the improved financial stability resulting from the orderly resolution of a troubled bank's problems. They also benefit where the use of an intervention tool avoids the need for a more costly deposit guarantee scheme payout which they would otherwise have needed to finance. CEBS considers that the banking sector as a whole is, therefore, the preferred source of finance for intervention tools. While public funds may have to be used to provide liquidity for an intervention or resolution action, in principle the

banking sector should always contribute to these costs. CEBS recommends that further work is needed to consider this.

36. Different models for organising such contributions have been adopted in different Member States. The main models are:

- financing through the national Deposit Guarantee Scheme, either at the scheme's own initiative (e.g. in Spain) or at the instigation of the national authorities (e.g. in the UK);
- financing through an industry fund separate from the Deposit Guarantee Scheme (e.g. Det Privat Beredskab in Denmark, which guaranteed the potential losses of the Danish National Bank in lending to Roskilde Bank);
- ad hoc consortia of banks closely related to or affected by the troubled institution (e.g. the consortia formed for intervention in Hypo Real Estate Holding AG in Germany or Constantia Privatbank in Austria).

37. Given the substantial differences in industry structure and in the organisation and financing of deposit guarantee schemes across Member States, CEBS is not in a position to recommend one of these models as best, but notes that:

- contributions through an established deposit guarantee scheme or other industry fund provide the benefits of a clear and transparent allocation of costs, discouragement of free-riding, and hence of increasing the incentives for private banks to monitor each others risks;
- contributions from only those banks most closely affected, on the other hand, ensure that those institutions which benefit most from intervention also bear the greatest costs, but this may only be possible in Member States where the industry structure allows those banks to be clearly identified; and
- the establishment of separate funds would lead to the unnecessary duplication of resources and reduce the size of funds available for intervention.

38. CEBS considers that Member States should ensure that there is a mechanism in place for national banking sectors to contribute to the cost of intervention measures. The Commission is encouraged to consider how such mechanisms could be designed best, taking into account the relationship with the national DGS.

39. The recent review of the Deposit Guarantee Schemes Directive (DGSD) revealed no current consensus on how national DGS should be funded. CEBS notes that the Commission has proposed to submit a report on the harmonisation of funding mechanisms of DGS and the possible introduction of a Community scheme. CEBS has already said that it believes that the Commission should examine the case for national DGS to be able to contribute to the costs of non-payout measures⁴.

⁴ See CEBS's comments to European Commission's considerations regarding Intervention measures (CEBS 2009 61 rev1, 11 March 2009) and CEBS's comments on the Review of Directive 94/19/EC on Deposit-Guarantee Schemes (CEBS 2009 155, 24 July 2009).

Any proposal for greater harmonisation should at least ensure that the ability of national DGS to contribute to intervention measures is not reduced, but may strengthen the case for harmonisation of related industry funds.

40. CEBS notes that the Commission raises the possibility of an EU-wide crisis resolution fund. CEBS notes that although such a resolution fund would allow the benefits of greater risk-sharing between Member States, establishing each Member State's contribution to it would require a solution to the problem of burden sharing, which has in the past been the subject of extensive discussions with no clear solution. The issue of decision making and governance matters would need to be addressed. If this were to be pursued, there would be a need to explain how to articulate this with the role of the DGS. Another - perhaps better - solution would be to optimise the role of DGS, and make best use of DGS funds. The introduction of a multilateral re-insurance mechanism among DGSs could also be explored, provided that a sufficient degree of harmonization has been achieved throughout the EU: existing national DGSs could support each other when needed, thereby creating a mechanism of solidarity among themselves.

Conditions for using the different tools

41. Another important aspect regarding the completion of the intervention toolbox refers to the conditions that need to be met before tools may be used. CEBS concurs with the Commission that *"any intervention which affects the interests and rights of shareholders and creditors needs to be proportionate to the seriousness of the problems in the institution and driven by the legitimate considerations of public interest"*.
42. When implementing such a proportionality principle, authorities across Member States rely on general discretionary powers and their own judgment in deciding when it is necessary to take action, and how to do it; CEBS does not believe in "hard triggers". Obviously, to safeguard proportionality and public interest, authorities' decisions should always be made on an appropriate legal basis and reasons stated which can be subjected to judicial review.
43. Regarding timeliness, supervisors' experience has shown that certain powers, which may curtail the normal control rights of management or shareholders, should become effectively exercisable earlier than they would for non-financial companies. Ideally this should lead to broader crisis prevention and to a reduction in the overall cost of stabilising the situation.
44. As regards the use of quantitative thresholds that would trigger the use of intervention tools, it is important to realise that no one situation is identical to any other and so no automatic rule can be identified that would automatically lead to the use of a certain measure or action. The conditions for the application of any intervention measures have one common factor: the infringement of a legal or supervisory requirement (such as the financial situation or the risk management and control or the internal governance and organisation of the institution concerned)

connected to the individual situation of the institution which requires corrective action.

45. Within the current EU legal framework⁵, supervisory authorities are required to perform a common assessment of the financial situation and risk profile and the level of own funds of cross-border credit institutions on a regular basis.
46. Given a common understanding among college members of the risk profile and financial situation, the implementation of other prudential measures pursuant to Article 136(1) of the CRD may be eased, and agreed upon by the college of supervisors on a voluntary basis.
47. CEBS would also like to underline that some of the tools listed below can be potentially intrusive. Having a potential expropriatory nature, their use can materially impact on rights of shareholders and third parties (e.g. measures directed at shareholders, as later discussed).
48. In order to strike a balance between financial stability concerns and the protection of stakeholders' rights, where measures in the intervention toolbox imply expropriatory capacities (regardless of which authority the powers rest with) the supervisor should assess that additional qualitative preliminary conditions that act as a safeguard, but which do not compel the competent authority to use the powers in specific circumstances, are met. Such additional qualitative conditions could refer to "severely distressed institutions", with a view to achieving wider public policy objectives, such as "maintaining financial stability or protecting depositors' interests"⁶. This additional condition of severe distress would only be met when the supervisory authority would come to the conclusion that less intrusive measures are insufficient to remedy the situation, and consequently, authorities need to take more stringent measures which may imply expropriatory capacities.
49. It should also be considered that, where the relevant actions of the authorities inflict economic damage to stakeholders, compensation mechanisms should be established so that no shareholder or creditor is left worse off than they would have been had the bank been liquidated. However, the legal framework should clearly define the circumstances under which such compensation would be granted.

Liability of Authorities

50. The Commission's Communication does not consider the differences between Member States as regards the liability of authorities and the complications arising from these differences. In some Member States, supervisory authorities are granted statutory immunity from liabilities

⁵ Article 129(3) of the CRD.

⁶ Under the UK Special Resolution Regime the condition to exercise the "private sector purchaser" or "bridge bank" options is that the stability of the financial systems of the UK, or the maintenance of public confidence is jeopardized, or in order to protect depositors. The assessment that these conditions are met is made by the supervisory authority. In Spain to proceed to management intervention and/or substitution of management the bank must face exceptional problems regarding solvency, liquidity or stability, either evident or alleged; or present a violation of the opposition to 'relevant shareholders regime'.

in damages arising from acts or omissions when carrying out their supervisory responsibilities and functions under the CRD framework. In other Member States, that is not the case.

51. CEBS is of the opinion that such differences might create obstacles to cooperation in the cross border resolution of an institution. Assuming that authorities have access to an identical set of tools, their use would still be hindered if the legal consequences for supervisors using them are different. CEBS therefore considers that the liability of authorities should be harmonised throughout the EU, granting competent authorities statutory immunity from liabilities.

Minimum set of tools, specific proposals

52. Building upon the Mapping of Supervisory objectives and powers published in March 2009⁷, CEBS has developed a list of tools that should be made available to the authorities across the EU. Because of the underlying complexity of powers that may – on the surface – seem similar, CEBS is only presenting at this stage high level comments, without entering into detail. CEBS intends to provide further advice at a later stage.

53. CEBS wants to repeat that there is no fixed border between “normal” supervision, intervention and resolution, but rather a gradual move from one stage to the next accompanied by a gradual increase in the intensity of supervisory actions which can make it difficult to identify distinct stages. Although the classification of tools in different categories might be useful from an explanatory point of view, CEBS does not consider the distinction necessary for practical purposes. For practical purposes, tools should end once winding-up proceedings are initiated and the institution is no longer regarded as a going concern.

54. As a general rule, the tools set out below should be applicable to all credit institutions, whatever their corporate form. CEBS recognises that this will require further thinking in some areas, in particular their application to mutual organisations.

Measures aimed at restoring compliance, capital adequacy and soundness of an institution and ‘recovery and resolution plans’.

55. The Mapping of Supervisory objectives and powers has shown that Art. 136 CRD has been widely transposed into national law although not all Member States have implemented all measures listed. In addition, CEBS suggests introducing the powers to:

- require an institution to restructure activities;
- require an institution to cease practices;
- limit intra-group asset transfers and transactions; and
- limit asset transfers and transactions outside the group⁸.

⁷ Mapping of supervisory objectives and powers, including early intervention measures and sanctioning powers (CEBS 2009 47).

⁸ The powers to limit asset transfers inside and outside the group need to be read in conjunction with the section on asset transfers (paragraphs 83-85).

56. The power to require the submission of a restoration plan should also be included in the minimum toolbox. A restoration plan is required when an institution is facing actual difficulties, for the institution concerned to present to the authorities the measures it shall implement to remedy the situation. A restoration plan is a corrective response to a specific set of circumstances. It should be distinguished from "recovery and resolution plans", which are intended to facilitate contingency planning and contingency measures by the firm and the authorities ahead of a time when the bank faces difficulties.
57. In its Communication, the Commission has asked for specific comments on wind-down plans as a tool for crisis management.
58. CEBS sees merit in studying the impact of preventive 'recovery and resolution plans' (sometimes called "living wills" or "wind-down plans") for all banking institutions, although there is probably no "one size fits all" solution. For the sake of clarity, it should be mentioned that these plans should primarily be seen as a precautionary and contingency measure, since they are prepared in normal times, before a crisis occurs.
59. The objective of recovery and resolution plans is to make sure that firms can recover or be resolved in an effective way that minimises disruption to the provision of financial services and to the financial system, protects public funds, and maintains market discipline. They will reduce the probability and impact of firm failure, reduce moral hazard and serve as a useful management tool that can contribute to:
- a substantial reduction in risk taking and the determination of optimal levels of equity (in line with the philosophy of Pillar II);
 - take into consideration the long term perspective (in line with work on management compensation and remuneration presently being developed).
60. As mentioned, recovery and resolution plans should be produced before a firm gets into trouble (and would incorporate existing plans of this kind, like contingency liquidity plans). They represent strategies that institutions' senior management should develop, and submit to the supervisory authorities after considering their structure, business lines, and related risks. Such plans could help bank management to overcome many problems through risk reduction measures, recapitalisation or other steps.
61. In addition, we can highlight their possible contribution to reducing restructuring or winding-up costs in the event of a crisis. The resolution dimension of these plans aim at helping the authorities to resolve an institution in the event of a crisis. Undertaking the resolution of a firm or group is indeed the responsibility of the authorities. A resolution plan - in the sense of a document setting out likely responses if resolution is necessary - can only be owned by the authorities, as they would be responsible for deciding on any such course of action and then implementing it. In order to be able to undertake this role, the authorities need access to information and knowledge that only the firm holds. The authorities also need to understand the extent to which the financial, legal and operational

arrangements of each group act as constraints on the authorities' ability to select and implement resolution options for each specific group. This is the sort of material that the authorities will need firms to produce as a 'resolution plan'. These plans should, therefore, be kept confidential and be known to the senior management of the institution and the authorities only.

62. Finally, the mere existence of recovery and resolution plans in conjunction with appropriate supervisory tools should reduce moral hazard by making clear the willingness and ability of the authorities to act. It is important that authorities co-operate to discuss, and as necessary implement, recovery and resolution plans.
63. Such plans should be compulsory, and eventually implemented by supervisors, as an additional requirement to those which already exist in the CRD⁹. A possible outcome of recovery and resolution plans would be simplified structures of large complex financial institutions. Simple structures might facilitate cross border resolution and coordination of measures between competent authorities in crisis situations. However, CEBS considers that such an option should not affect the fundamental freedoms of any banking group to invest capital or provide services in any EU country, nor its strategy towards third countries.
64. It is important to consider that banking groups are different from one another; that fact also has a bearing on the kind of documents to be prepared. Moreover, the authorities should determine the specific action points that are to follow the discussion of the plans between banking groups and supervisory authorities on a case by case basis. Indeed, it should be the authorities' role to assess the plausibility of these plans and whether the plans are sufficiently robust. In the event that the authorities would identify problems or elements that could potentially cause problems in times of crisis, they should require the group to remedy the situation or use any other tool they deem appropriate. Such changes could well have strategic consequences.
65. Besides their advantages, the concept of recovery and resolution plans also raises some issues. The first relates to the assumption that the plans will be highly detailed. Developing and maintaining the plans up to date will require a considerable investment of time and resources from the institution concerned and also from the authorities, whereas the benefits of the plans in the event of a crisis or when an institution actually needs to be wound down remains uncertain. Also, circumstances in the next crisis will be different from previous crises, whereas plans tend to be biased towards the problems faced in the previous crises. Hence, CEBS considers that the level of detail of the plans should, as with the generality of provisions in the CRD, be applied in a proportionate manner.
66. Secondly, the plans may point to the need to restructure an institution, for instance in order to simplify its resolution. For some institutions this

⁹ Similar conditions also exist in other regulated sectors protecting different relevant interest. Such is the case of the common rules for the internal market in electricity (Directive 96/92/EC), setting limits to transmission activities, within the economic group structure.

may have significant consequences in terms of efficiency and profitability.

- 67.Thirdly, some consideration should also be given to the fact that recovery and resolution plans will have international implications. Although plans would be made at the level of an individual institution, their potential impact also needs to be assessed from a macro-prudential perspective. In the context of a global crisis, the (combined) implementation of the wind-down plans of a number of large cross-border institutions could widen and deepen the crisis and, in turn, render these plans ineffective.
- 68.Fourthly, although they would aim at helping authorities to resolve an individual institution in a crisis, recovery and resolution plans on their own would not solve the issue of burden sharing in the event of a crisis.
- 69.Considering all the above, CEBS sees merit in having such a tool in the authorities' toolbox. At the same time, CEBS is fully aware that some potential consequences of such a tool on the EU single market would need to be considered, such as the risk of fragmentation, which would have an adverse effect on the integration trend in the internal market. CEBS is not yet in a position to provide details regarding the document structure, cooperation between authorities, action to follow each particular plan or other details. CEBS will consider the need for further advice and guidance in due course, taking into account the work undertaken in other international fora in this respect.

Measures directed at the management body of the institution

- 70.CEBS considers that the power to oppose the nomination of a board member or managing director, the power to replace or require a bank to replace a board member or a managing director, and the power to appoint a person/body with general or specific powers should all be included when designing the minimum toolkit.
- 71.CEBS considers these powers as complementary. Authorities should have the right to oppose the nomination (or the renewal) of a board member or of a managing director (as a result of the so called "fit and proper" test). Authorities should also be able to require the replacement of individual board members or managing directors where they deem it a necessary action to be taken as part of a broader range of measures to remedy the situation of an individual institution.
- 72.A more stringent measure would be the power to replace the management of the institution by appointing a person or a body that would take over the management of the institution. In some Member States, such a measure would be considered as "special administration" (e.g. BE, ES, FR, IT, NL). Such a power would be used when it appears that the whole management of an institution is not willing or not able to take the necessary measures to remedy the situation. CEBS is of the opinion that the effective control of the institution by the authorities (or rather by the person/body appointed by the authorities) may prove necessary in certain circumstances in order to take whatever decision is necessary to address the situation.

73. CEBS regards the power to require a change in the management or to appoint a person/body to manage the institution as appropriate tools for financial institutions. As bank intervention and resolution may require authorities to be in a position to act quickly and decisively in order to safeguard financial stability, a system which relies on court procedures may, unless special procedures exist, be insufficiently responsive in urgent situations and may not be able to take account of the particular characteristics of banks and of the consequences of bank insolvency.
74. Regarding the question raised by the Commission on administrative reorganisation and liquidity problems due to lack of confidence, although the reaction of the public and the markets cannot be predicted, and experience has shown that they can react in a very sensitive way, CEBS considers that the appointment of a new management or of an administrator would, in principle, not exacerbate confidence problems towards institutions, provided that such measure is communicated carefully to the public. Conversely, once action has been initiated, which may imply the provision of liquidity, creditors should be reassured and the markets should receive sufficient information and no longer depend on rumours.

Measures directed at the shareholders.

75. As already mentioned, capital injections from the private sector should always be preferred. The first source of capital should be the existing shareholders. CEBS considers that authorities should have the right to request the institution to ask its shareholders to support it, notably by issuing new capital.
76. This measure could be useful when authorities consider it a realistic solution and always under circumstances that would not lead to further deterioration in the situation of the institution by delaying action (e.g. it could be used together with other measures such as the substitution of the board of directors). Obviously, the subscription to additional capital by existing shareholders can only take place on a voluntary basis, in order not to create an unlimited liability for banking investors.
77. At the same time, and with due respect for the principle of proportionality¹⁰, CEBS considers that the ability to suspend the voting rights of shareholders in severely distressed banks may constitute a necessary precondition for the use of some other tools, both on an individual or collective basis (i.e. suspension of the voting rights of the general assembly). Such could be the case when considering measures taken in the context of a special administration, measures such as those discussed in the next paragraph, or requiring capital raising or mergers without a meeting of shareholders. This ability is necessary for two reasons. First, for a bank in severe distress¹¹, the interests of shareholders are likely to be significantly different from the interests of depositors and other stakeholders including the public authorities.

¹⁰ See paragraphs 41 and 42.

¹¹ As stated in paragraph 48, a bank would only be considered to be in severe distress when supervisory authorities had come to the conclusion that the use of less intrusive measures would be insufficient to remedy the situation.

Second, the need to obtain shareholder approval may pose problems where rapid action is needed.

78. CEBS agrees that a regime which permits authorities to facilitate or operate a resolution of a bank should be introduced. The main necessary powers would be:

- a power to transfer a failing bank's property, assets and liabilities (in full or in part) to a private or public sector purchaser, or to a temporary bridge bank in order to ensure the continuation of the activities. These should allow the same range of assets and liabilities to be transferred that may take place under normal commercial circumstances. In addition, to ensure that the Authorities have control over any transfer, and to accelerate the processes where necessary, these powers should include the ability to transfer property that would not otherwise be transferable, for example where a contract includes a prohibition on transfer or requires consent of a third party;
- a share transfer power which may be used to transfer a failing bank to a private sector purchaser, or to take the bank into temporary public ownership. The powers would allow for the transfer of all or specified classes of the securities of a bank. Securities would be defined widely to reflect the diverse nature of banks' capital instruments and extend to preference shares and debt instruments with equity characteristics potentially conferring control (for example, innovative Tier 1 capital resources).

Measures related to pre-insolvency situations and insolvency proceedings

79. CEBS considers that the power to withdraw all or part of the licence, the power to suspend the exercise of all or part of the institution's activities, the power to initiate a reorganisation or a winding-up and the power to coordinate a rescue plan should all be included when designing the minimum toolkit. CEBS is aware that some of these powers may require modifications to national insolvency law.

80. The power to impose a moratorium is seen as a residual measure, frequently used immediately before compulsory liquidation; however it can help clarify the situation. One option could be to include in the toolbox the power to suspend, for a short period of time, payments to creditors. Such a suspension would nevertheless not apply to payments entered into the payment systems, where the protection in the Settlement Finality Directive should be maintained, and should not be considered as insolvency. To prevent interference with deposit protection, partial transfer of assets and liabilities to another bank might be envisaged, or even a partial moratorium not affecting retail banking activities.

Other tools and issues not covered under this advice

81. Currently there are a number of issues being dealt with in different EU and international fora which might be seen as supervisory powers, namely:

- compensation to directors and senior executive officers;
- prohibit/limit the distribution of profits to shareholders;

- capital-related measures.

In addition, CEBS supports the Commission's work with regard to the powers of the host authorities under Article 33 of the CRD.

82. Although such instruments should be included appropriately in the EU toolbox, CEBS would rather leave aside their specific assessment until the other work is finalised, submitting its advice in relation to their use for intervention and resolution purposes once the outcome of the specific work-streams is known.

Asset transfers¹²

83. As CEBS noted in its March 2009 response, it is possible that the ability to transfer the assets of a banking group will be an important element in dealing with an ailing banking group. This should be available when the group as a whole is still solvent and when restoring the group's soundness is viable. In times of liquidity crisis, asset transferability may enable, in some circumstances, a cross-border group in difficulty to survive, whereas ring-fencing, because of cross-border issues, may lead to the group's failure. Without prejudice to the possibility for central banks to provide liquidity in emergency situations, it is worth considering whether to set up an EU legislative and regulatory framework for asset transfers, if and when such transfers are necessary for stabilising part of a group, without jeopardising the whole group. In the long term, a clearer legal framework would greatly help to improve the legal certainty of asset transferability.

84. CEBS believes that if a specific regulatory framework regarding asset intra-group transfers is investigated, it would be necessary to be alert to and pay due regard to the powers to limit or prohibit intra-group asset transfers, at both domestic and cross-border level in the case the transfer is likely to lead to a breach of prudential requirements (see paragraph 55).

85. However, CEBS considers that the competent authorities should not be asked to judge whether a transfer was appropriate nor to 'approve' or 'oppose' such transfers. An approval process is likely to sit best with judicial authorities. However, if an action by a group to transfer assets was potentially or actually in breach of a regulatory requirement, authorities would expect to intervene, as stated above, either to prevent the transfer or to require it to be undone.

Safeguards for stakeholders

86. CEBS agrees that adequate safeguards are a crucial factor in ensuring that official actions do not magnify financial instability and do not generate unnecessary uncertainty in 'normal' times.

87. CEBS reiterates the points it made in its March 2009 response, that an EU regulatory framework should strike an appropriate balance between the different interests involved in an ailing bank situation:

¹² In its March 2009 response, CEBS also noted that "asset transfer" is not a defined term and that it would be helpful to have a clear explanation of what these terms include. In particular, the question arises whether they would also encompass the transfer of capital.

- it is important to remember that supervisory powers potentially affecting shareholders' rights are exercised at a time when an institution is in severe distress. The underlying intention in using the powers is to seek to ensure financial stability and, to protect depositors' interests;
- given this, CEBS proposes that consideration should be given to permitting derogations to EU company law rules as part of a banking intervention framework. For example, under defined circumstances (see paragraph 48), derogations should be introduced regarding pre-emption rights and shareholders' approval, with the intention of facilitating the authorities' ability to act in a timely manner;
- CEBS recognises that it is important that appropriate redress and compensation arrangements should be established for third parties affected by expropriatory forms of intervention (see paragraphs 48-49). Also, CEBS proposes that the consistency of compensation arrangements across the EU should be a factor to consider;
- however, in CEBS' view it will be important that EU legislation delivers measures and protections which enable the authorities to carry out their responsibilities. A common resolution procedure would not be helpful in situations where (i) actions by stakeholders defeat the intention of the supervisory intervention, in particular by preventing or undoing reorganisation measures, or even where (ii) inappropriate claims from third parties affected by supervisory actions delay the intervention from its objective.

88. In addition to safeguards that focus on compensation or the rights of creditors, CEBS believes that an EU framework would need to be accompanied by a set of safeguards intended to limit market disruption by official action. In particular, these would need to apply in cases of partial transfers (of property or of shares), as there would otherwise be a risk of market counterparties being unsure as to their risk exposure at any given point in time if standard risk management techniques could be disrupted. For instance, this could cover protections for set-off and netting arrangements; secured liabilities; capital market arrangements; and contracts on a financial market.

Process of cooperation

89. As set out in its March 2009 response, CEBS agrees that the relationships between authorities need to be streamlined, while at the same time acknowledging that there is already a considerable amount of work under way regarding cooperation, including on the establishment and functioning of colleges of supervisors.

90. CEBS's starting point is that it does not believe that, at this stage, it is desirable or feasible to pursue the development of an EU Resolution Authority. It is not clear what value such a body would add. It would be more feasible to focus first on making more effective colleges and the 2008 Memorandum of Understanding. In particular, CEBS would like to highlight the importance of having the relevant supervisory body involved at all stages of dealing with troubled firms, in order to ensure that their knowledge and understanding is factored into

decision-making. The role of the supervisor in these circumstances is to consider not only the troubled firm but the impact of any official actions on other firms and the wider market. Also, supervisory decisions are needed to ensure the implementation of resolution measures (e.g. licensing and authorisation of a bridge bank).

91. CEBS believes a feasible model to try to develop would be one in which a 'lead' authority for a group is identified for intervention and resolution purposes and whose role is that of acting as co-ordinator and as a central point for the exchange of information¹³. This would be consistent with the idea that the division of formal responsibilities reflect fiscal responsibility.
92. Also, CEBS considers that harmonised tools will allow authorities to better prevent and manage crisis situations. However, harmonised tools do not suffice as such. To be efficient, tools need to be activated, in a timely manner, by the competent authority. In a cross-border context, the efficiency of the tools does not only depend on an early activation but also on the ability of authorities to coordinate their action and cooperate closely.
93. It is CEBS view that the harmonisation of tools needs to be coupled with an enhanced cooperation framework/process for coordinated action by the authorities. To that end, host and home authorities (subsidiary and parent) should be legally obliged:
- to consult each other before taking measures on a legal entity of the group¹⁴;
 - to consider (but not necessarily apply) joint measures which would be to the benefit of the group as a whole. Any such measures would need to ensure the equitable treatment of creditors across different jurisdictions. It may be the case that national measures at entity level would be deemed more appropriate.
94. The crisis has shown that the 2008 Memorandum of Understanding (The 'MoU') has shortcomings. The MoU leads to too many parties being involved in crisis management work. If the numbers of parties involved could be streamlined this may be a useful practical step, though CEBS recognises that this could be sensitive for those not represented. The risk could be mitigated if it was clear that streamlined crisis management was focussed on co-ordination and could not impose a decision on another authority.

Insolvency law

95. In terms of making amendments to insolvency law, CEBS recognises that this would be an extremely complex undertaking. CEBS also recognises that the insolvency piece of an EU framework is very important: it must be an objective to be in a position in which it is a credible option to allow banks to fail, in order to avoid moral hazard and enhance market discipline.

¹³ This role could be similar to the one envisaged for the Cross-Border Coordinator in the 2008 MoU.

¹⁴ Cfr, *mutatis mutandis*, the legal obligation of supervisory authorities to consult each other under Article 132(3) of the CRD.

96. If this were to be pursued, CEBS would underline that it would be mostly needed in relation to cross-border banks. This would minimise the impacts on other financial institutions (and the non-financial sector) or the need to make major changes to company and insolvency law.
97. Of the changes that could be made in respect of insolvency law, CEBS believes that the greatest value is likely to be found in coordinating national measures across jurisdictions. Furthermore, EU law could also encourage national authorities involved in insolvency proceedings to cooperate closely and find ex-ante agreements with third country authorities, in the context of cross-border groups with activities outside the EU.
98. Should a '28th regime' be pursued, CEBS does not think it is feasible to think that existing corporate structures could be moved into such a regime without enormous market upheaval from having to amend and re-negotiate contracts that have been entered into under existing national legal structures. If new banks were established within such a regime, CEBS is unclear as to the practical impact this would have on supervision. For instance, in what ways would such banks be different from a single entity operating through branches, if the creditors of one subsidiary of the group would in reality be a creditor of the group as a whole? Consideration would also need to be given to the additional complexity this would introduce for investors.

Consistency with EU and international initiatives

99. CEBS considers that any reforms should be fully consistent with the proposed new EU financial supervision architecture, in particular with regard to the Commission's proposal of a Regulation establishing the European Banking Authority (EBA). Once the negotiations in the Council and the European Parliament on the proposed Regulation establishing the EBA have been completed, CEBS may provide further advice to the Commission where relevant to the EU framework for cross-border crisis management in the banking sector.
100. Given that cross-border financial firms often operate both within the European Union and in non-member state jurisdictions, CEBS believes that it is important that any reforms adopted within the European Union are consistent with the broader global initiatives which are currently under way in a number of international fora with membership beyond the EU, including the G20, the FSB, and the Basel Committee on Banking Supervision.

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