



**COUNCIL OF
THE EUROPEAN UNION**

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NOTE

from:	Presidency
to:	Permanent Representatives Committee (Part II)
Subject :	Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010 - <i>General approach</i>

I. INTRODUCTION

1. The above mentioned Commission proposal (hereinafter "BRRD Proposal") was transmitted to the Council on 6 June 2012¹. The proposal provides a common framework of rules and powers to help EU countries manage arrangements to deal with failing banks and investment firms at a national level, as well as cross-border banks. The proposed Directive provides for three stages of crisis prevention and management: a preventative stage, an early intervention stage, and a resolution stage.

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

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

II. STATE OF PLAY – “THE RESOLUTION TRIANGLE”

3. The discussion in Coreper on 12 June, showed a broad measure of support for the Presidency compromise text as set out in document 10532/1/13 REV 1 EF 116 ECOFIN 469 DRS 111 CODEC 1336.
4. Member States acknowledged that the key to achieving a Council General Approach at the upcoming Ecofin was achieving the optimal balance between three interlinked elements of the Directive:
 - A. The design of the bail in tool, in particular the balance between harmonisation and flexibility, (Article 38)
 - B. Financing (Article 93)
 - C. Minimum requirements for own funds and eligible liabilities (Article 39)
5. These three elements are closely connected and the Presidency finds that the current compromise represents **a workable balance between the three**. Should any one of the elements (the “angles”) in the “resolution triangle” be changed, the other two will need to change correspondingly: if more flexibility is desired, then this will have to be reflected in higher resolution funding requirements for institutions and /or higher levels for the minimum requirements for own funds and eligible liabilities (MREL).

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

6. As previously indicated, the Presidency's 'Mixed Approach' model aims to strike a balance between those delegations favouring harmonisation, to ensure legal certainty and a level playing field in the single market, and those who would prefer a larger degree of discretion in order to ensure that Member States' authorities can deal appropriately with the circumstances of each individual resolution case.
7. The use of the proposed discretions is framed within a carefully crafted EU framework ("framed flexibility"), with three main elements:
- (i) A discretionary exclusion for derivatives which only applies in particular circumstances and only where it is necessary to achieve the continuity of critical functions and core business lines or to avoid widespread contagion (Article 38(3) and (3a)).
 - (ii) An additional power for the resolution authority, which is only available in extraordinary circumstances, to exclude certain liabilities where it is not possible to bail them in within a reasonable time (Article 38(3c)). A safeguard confines the use of this exclusion to an amount equal to 5% of the total value of liabilities in a given class in the national insolvency hierarchy (Article 38(3c)). In addition, this discretion can only be applied after the Commission has been notified and has not prohibited or required amendments to the proposed exclusion (Article 38(5a)).
 - (iii) As a further safeguard, the Commission is empowered to adopt delegated acts in relation to both discretionary powers in order to specify further the circumstances when exclusion is necessary to achieve the objectives of paragraphs 3a and 3c in Article 38 (Article 38(5)).

8. The discussion in Coreper showed a broad support for the principles of this approach, including for the proposed model of depositor preference.² A significant number of Member States, however, indicated a preference for more discretion for resolution authorities to exclude certain liabilities from bail-in. There are two general views as to how more flexibility could be introduced; some of the advocates of flexibility favour one of these options only, while some favour both:
- (i) Provide resolution authorities with **the discretion to exclude certain liabilities** (views differ on whether such discretion should be applicable to *any* liabilities, or only those of a type listed in the Directive) for financial stability reasons. These would also be subject to the “framed flexibility” provisions above, possibly complemented by the State aid framework. Such exclusions would be financed by passing the losses to other creditors or where this is not possible through contributions by the resolution fund.
 - (ii) Enable Member States to **use the resolution fund as a complement to a “partial bail-in”**. Under this proposal, the bail-in tool would be applied to certain liabilities, but would stop at a certain point in the hierarchy where this was necessary for financial stability reasons. At this point, the resolution fund would be used to absorb the remaining losses and could recapitalise the institution in return for an equity stake.
9. As mentioned in paragraph 5, should any one of the “angles” in the “resolution triangle” be changed, corresponding changes in one or both of the other two angles would be necessary: if more flexibility is desired, there will be a need for higher resolution funding requirements and / or higher levels for MREL.

² The mixed approach provides for depositor preference for (i) covered deposits and (ii) certain eligible deposits, those of natural persons and micro and small and medium sized enterprises, above the €100,000 threshold. This means that these liabilities can still be bailed-in, but only AFTER other eligible liabilities (with a lower ranking in the new pecking order) have been bailed in.

10. For instance, any rebalancing in the direction of flexibility through the introduction of partial bail-in (paragraph 8(ii)), as advocated by a number of Member States, would need to be balanced by strong safeguards to ensure that the Directive did not replace an implicit guarantee by the State with another implicit guarantee by the resolution fund.
11. Such safeguards would need to include a minimum extent of partial bail-in, with the text prescribing the classes of liabilities which must in every case be fully bailed-in before the resolution fund could be used for absorption of residual losses or recapitalisation. Furthermore, it may be necessary to set out restrictions on the sources of or proportion of resolution funds which could be used for the purpose of partial bail-in. It would be necessary to prescribe further constraints in delegated acts, and make the action subject to Commission pre-approval as well as State aid rules. Any such an action would only be possible in extraordinary circumstances, where necessary to protect financial stability.
12. In addition, greater flexibility in bail-in would need to be accompanied by adequate corresponding shifts in the other corners of the “resolution triangle”. A substantially larger resolution fund would be necessary. Institutions would need to have more loss absorbing capacity, and it may be necessary to incorporate further guarantees in the Directive to ensure that this was the case.
13. Having reflected on the views expressed by Member States, the Presidency believes that it would be difficult to find a sufficient majority for these consequential changes. The Presidency therefore believes that, overall, the current compromise continues to strike the best achievable balance between the positions of Member States, and that a shift from the current balance in the direction of either harmonisation or flexibility could only happen if there was widespread support from the Council and if it would facilitate agreement at Council on the overall proposal.

B. FINANCING (ARTICLE 93)

14. The second element of the resolution triangle is the financing arrangements. The Presidency indicated at the last Coreper that it considers the provisions on financing arrangements, as set out in its compromise, to be broadly acceptable to most delegations. The key features are:
- (i) Member States should remain free to keep the DGS and the resolution funds separate or to merge them;
 - (ii) The resolution fund should have a minimum target level of 0.5% of covered deposits (where the resolution fund is kept separate from the DGS) or a combined fund size of 1% (where the resolution fund and DGS are combined).
15. As previously noted, ultimately the level of funding required will be determined by the outcome of the negotiations on: the scope of the bail-in tool; the role of MREL in ensuring appropriate loss absorbing capacity at the level of each institution; the uses of the resolution fund as discussed above.
16. The Presidency is aware of the views of one Member State on the need for an ex ante resolution fund and will continue to consider how this can be addressed in a way which is not inconsistent with the principles of the Directive.
17. There have been calls by some Member States to set each Member State's resolution fund target level with reference to the total liabilities of its banking sector. However, the Presidency, supported by a majority of delegations, took the view at the last Coreper that it was more appropriate for the target level to remain set with reference to covered deposits since it would constitute a harmonised basis for both resolution and DGS³ funding arrangements. The Presidency does not propose to change its position on this matter for Ecofin.

³ In the general approach on the revision of the DGS Directive, agreed in June 2011, the DGS funds should have a target level of 0.5 % of covered deposits.

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

18. Throughout the negotiations, there has been a general consensus around the need for an adequate MREL in order to ensure that institutions have sufficient loss absorbing capacity to facilitate the application of the bail-in tool. The Presidency proposal provides that the MREL of each institution should be determined by the appropriate resolution authority on the basis of specific criteria, including its business model, level of risk and loss absorbing capacity.
19. Several Member States believe it is important that the Directive sets a harmonised MREL level to ensure that each institution has adequate loss absorbing capacity. The majority of Member States, however, while acknowledging the importance of MREL and the need for harmonisation, appear to have concluded that setting a harmonised level in the Directive is inappropriate for two main reasons: first, due to the difficulty in defining an appropriate level of MREL and the base at which it should be set in the absence of any quantitative basis; and following on from this, the difficulty in finding a level appropriate to different banking activities and different business models.
20. Consequently, the Presidency proposed as a compromise the introduction of a review clause which would mandate the EBA to carry out monitoring and technical analysis and report by 2016 with proposals for harmonisation. On the basis of the EBA recommendations, the Commission would propose (if appropriate) minimum harmonised level(s) of MREL, taking account of the different business models of institutions. This is aligned with the approach taken to the leverage ratio in the CRR (a prudential ratio whose composition is very similar to the MREL). The views expressed by Member States at Coreper suggested that this compromise approach on MREL has the support of a large majority of Member States.

III. OTHER ISSUES

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

IV. CONCLUSION

22. The Permanent Representatives Committee is invited to:
- signal agreement to the Presidency compromise as set out in document 10532/1/13 REV 1;
 - approve the submission of the Presidency compromise text to the Council on 21 June, subject to small technical changes with a view to reaching agreement on a general approach;
 - and if they are unable to do this, to signal the key concern not allowing them to reach agreement.
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