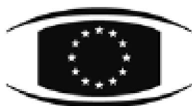

COUNCIL OF
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NOTE

From:	Presidency
To	Council
Subject:	Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010 - Presidency compromise

1. The Presidency submitted a compromise regarding the above mentioned Proposal for a Directive, the BRRD Proposal, to ECOFIN on 21 June 2013, see document 11148/13 EF 132 ECOFIN 572 DRS 121 CODEC 1511.

2. The “BRRD Proposal” was on the agenda of the ECOFIN Council on 21 June 2013, where the Council decided to adjourn the meeting until 26 June 2013 to continue the discussions especially on the level of flexibility to be allowed for within bail-in.

3. The Presidency has since reflected on the concerns raised by delegations and has decided to amend its compromise proposal as set out in this addendum to the original compromise.

   This addendum sets out A) our proposed revised legal text (Annex I) and B) an explanatory note of the main changes (Annex II).

A. PROPOSED LEGAL TEXT

I. Bail-in

Article 38

Scope of bail-in tool

1. Member States shall ensure that the bail-in tool may be applied to all liabilities of an institution or entity referred to in points (b), (c) or (d) of Article 1 that are not excluded from the scope of that tool pursuant to paragraphs 2 or 3c.

2. Resolution authorities shall not exercise the write down and conversion powers in relation to the following liabilities:

(a) covered deposits;

(b) secured liabilities including covered bonds;

(c) any liability that arises by virtue of the holding by the institution or entity referred to in points (b), (c) or (d) of Article 1 of client assets or client money, or a fiduciary relationship between the institution or entity referred to in points (b), (c) or (d) of Article 1 (as fiduciary) and another person (as beneficiary), provided that such client or beneficiary is protected under the applicable insolvency or civil law;

(d) liabilities to institutions, excluding entities that are part of the same group, with an original maturity of less than seven days;

(e) liabilities arising from a participation in a system designated according to Directive 98/26/EU which have a remaining maturity of less than seven days;

(f) a liability to any one of the following:

(i) an employee, in relation to accrued salary, pension benefits or other fixed remuneration, except for the variable component of remuneration that is not regulated by law or collective bargaining agreement;

(ii) a commercial or trade creditor arising from the provision to the institution or entity referred to in points (b), (c) or (d) of Article 1 of goods or services that are critical to the daily functioning of its operations, including IT services, utilities and the rental, servicing and upkeep of premises;

(iii) tax and social security authorities, provided that those liabilities are preferred under the applicable insolvency or civil law.

Point (b) of paragraph 2 shall not prevent resolution authorities, where appropriate, from exercising those powers in relation to any part of a secured liability or a liability for which collateral has been pledged that exceeds the value of the assets, pledge, lien or collateral against which it is secured. Member States may exempt from this provision covered bonds as defined in Article 52(4) of Council Directive 2009/65/EC and liabilities in the form of financial instruments used for hedging purposes which form an integral part of the cover pool and which according to national law are secured in a way similar to covered bonds.

Point (a) of paragraph 2 shall not prevent resolution authorities, where appropriate, from exercising those powers in relation to any amount of a deposit that exceeds the coverage level provided for in Article 7 of Directive 94/19/EC.

3. [deleted]

3a. [deleted]

3c. In exceptional circumstances, where the bail-in tool is applied, the resolution authority may exclude or partially exclude certain liabilities from the application of the write-down and conversion powers where:

(i) it is not possible to bail-in that liability within a reasonable time notwithstanding the good faith efforts of the resolution authority; or

(ii) the exclusion is strictly necessary and is proportionate to achieve the continuity of critical functions and core business lines in a manner that maintains the ability of the institution under resolution to continue key operations, services and transactions; or

(iii) the exclusion is strictly necessary and proportionate to avoid giving rise to widespread contagion that would severely disrupt the functioning of financial markets in a manner that could cause a serious disturbance to the economy of a Member State or of the Union; or

(iv) the application of the bail-in tool to these liabilities would cause a destruction in value such that the losses borne by other creditors would be higher than if these liabilities were excluded from bail-in.

Where a resolution authority decides to exclude or partially exclude an eligible liability or class of eligible liabilities under this paragraph, the level of write down or conversion applied to other eligible liabilities may be increased to take account of such exclusions, provided that the level of write down and conversion applied to other eligible liabilities respects the principle in point (f) of Article 29(1).

3ca. [deleted]

3caa. Where a resolution authority decides to exclude or partially exclude an eligible liability or class of eligible liabilities pursuant to this Article, and the losses that would have been borne by these liabilities have not been passed on fully to other creditors, the resolution financing arrangement may make a contribution to the institution under resolution to:

(i) cover any losses which have not been absorbed by eligible liabilities and restore the net asset value of the institution under resolution to zero in accordance with point (a) of Article 41(1); and / or

(ii) purchase shares or other instruments of ownership or capital instruments in the institution under resolution, in order to recapitalise the institution in accordance with point (b) of Article 41(1).

3cab. The resolution financing arrangement may only make a contribution referred to in paragraph 3caa provided that:

(i) a contribution to loss absorption and recapitalisation equal to an amount not less than 8% of the total liabilities including own funds of the institution under resolution, measured at the time of resolution action in accordance with the valuation provided for in Article 30, has been made by shareholders and the holders of other instruments of ownership, the holders of relevant capital instruments and other eligible liabilities through write down, conversion or otherwise;

(ii) the contribution of the resolution financing arrangement does not exceed 5% of the total liabilities including own funds of the institution under resolution, measured at the time of resolution action in accordance with the valuation provided for in Article 30; and

(iii) the contribution of the resolution financing arrangement does not exceed the sum of:

(a) the means available to the resolution financing arrangement which have been raised through contributions by institutions in accordance with Article 94; and

(b) the amount that can be raised through ex post contributions in accordance with Article 95 within a period of three years.

For the purposes of calculating 8% of total liabilities including own funds, losses which have been absorbed prior to the resolution action shall not be taken into account.

In extraordinary circumstances, the resolution authority may seek funding from alternative financing arrangements either:

(a) after the 5% limit specified in point (ii) of this paragraph has been reached; or

(b) after the amount specified in point (iii) of this paragraph has been exceeded.

3cb. When exercising the discretions under paragraph 3c, resolution authorities shall give due consideration to:

(i) the principle that losses should be borne first by shareholders and next, in general, by creditors of the institution under resolution in order of preference;

(ii) the level of loss absorbing capacity that would remain in the institution under resolution if the liability or class of liabilities were excluded; and

(iii) the need to maintain adequate resources for resolution financing.

3d. Exclusions under paragraph 3c may be applied either to completely exclude a liability from write down or to limit the extent of the write down applied to that liability.

4a. [deleted]

4b. [deleted]

5. The Commission shall be empowered to adopt delegated acts adopted in accordance with Article 103 in order to specify further the circumstances when exclusion is necessary to achieve the objectives specified in paragraph 3c.

5a. Before exercising the discretion to exclude a liability under paragraph 3c, the resolution authority shall notify the Commission. The Commission may, within 24 hours of receipt of such notification, or a longer period with the agreement of the resolution authority, prohibit or require amendments to the proposed exclusion if the requirements of this Article and delegated acts are not met.

II. Financing

Article 91

Requirement to establish resolution financing arrangements

1. Member States shall establish financing arrangements for the purpose of ensuring the effective application by the resolution authority of the resolution tools and powers. Member States shall ensure that the financing arrangements are under the control of a designated public authority. The financing arrangements shall be used only in accordance with the resolution objectives and the principles set out in Articles 26 and 29.

2. Member States shall ensure that the financing arrangements have adequate financial resources.

3. For the purpose provided for in paragraph 2, financing arrangements shall in particular have:

(a) the power to raise ex ante contributions as specified in Article 94 with a view to reaching the target level specified in Article 93;

(b) the power to raise ex post extraordinary contributions as specified in Article 95, and

(c) the power to contract borrowings and other forms of support as specified in Article 96.

3a. Save where permitted in paragraph 3b, each Member State shall establish its national financing arrangement through a fund controlled by its resolution authority which is to be used for the purposes set out in Article 92(1).

3b. Notwithstanding paragraph 3a, a Member State may, for the purpose of fulfilling its obligations under paragraph 1 of this Article, establish its national financing arrangement through mandatory contributions from institutions which are authorised in its territory, which contributions are based on the criteria referred to in Article 94(7) and which are not held through a fund controlled by its resolution authority provided that all of the following conditions are fulfilled:

(a) the amount raised by contributions is at least equal to the amount that is required to be raised by Article 93;

(b) the Member State's resolution authority is entitled to an amount that is equal to the amount of such contributions, which the Member State will make immediately available to that resolution authority upon the latter's request, for use exclusively for the purposes set out in Article 92(1). The Member State shall notify the Commission of that amount at least annually; and

(c) where a Member State avails of the discretion to structure its financing arrangement in accordance with this paragraph 3b it shall notify the Commission and it shall, save as expressly set out in this paragraph 3b, be required to comply with the requirements of Articles 90, 91, 92, 93, 94(1) to (4), 94(6), 95, 96, 97, 98, 98a and 99.

The available financial means to be taken into account in order to reach the target level specified in Article 93 may include mandatory contributions from any scheme of mandatory contributions established by a Member State at any date between 17 June 2010 and the [date of publication of this Directive in the Official Journal] from institutions in its territory for the purposes of covering the costs related to the failure and resolution of institutions, provided that the Member State complies with this Title VII. Contributions to deposit guarantee schemes shall not count towards the target level for resolution financing arrangements set out in Article 93.

Article 98a

Ranking of deposits and multilateral development banks in insolvency hierarchy

1. Member States shall ensure that in national law governing normal insolvency proceedings:

   (i) eligible deposits from natural persons and micro, small and medium-sized enterprises shall have a higher priority ranking than the claims of ordinary unsecured, non-preferred creditors;

   (ii) covered deposits shall have a higher priority ranking than that part of eligible deposits from natural persons and micro, small and medium-sized enterprises which exceeds the coverage level;

   (iii) the ranking of the deposit guarantee scheme subrogating to the rights and obligations of covered depositors in insolvency shall correspond to the ranking of covered deposits provided for in point (ii); and

   (iv) liabilities to the European Investment Bank shall have a higher priority ranking than the claims of ordinary unsecured, non-preferred creditors.

III. Other issues

Article 84

Agreements with third countries

1. In accordance with Article 218 TFEU, the Commission may submit to the Council proposals for the negotiation of agreements with one or more third countries regarding the means of cooperation between the resolution authorities and the relevant third country authorities, inter alia, for the purpose of information sharing in connection with recovery and resolution planning in relation to institutions, financial institutions, parent undertakings and third country institutions, with regard to the following situations:

   (a) in cases where a third country parent institution has subsidiary institutions or significant branches in two or more Member States;

   (b) [deleted]

   (c) in cases where a parent undertaking established in a Member State and which has a subsidiary or a significant branch in at least one other Member State has one or more third country subsidiary institutions;

   (d) in cases where an institution established in a Member State and which has a parent undertaking, a subsidiary or a significant branch in at least one other Member State has one or more branches in a third country.

2. [deleted]

2a. The agreements referred to in paragraph 1 shall not make provision in relation to individual institutions, financial institutions, parent undertakings or third country institutions.

3. Member States may enter into bilateral agreements with a third country regarding the matters referred to in paragraphs 1 and 2 until the entry into force of an agreement referred to in paragraph 1 with the relevant third country to the extent that such bilateral agreements are not inconsistent with the provisions of this Title VI.

Article 114

Review

1. By 1 June 2018, the Commission shall review the implementation of this Directive and report thereon to the European Parliament and to the Council. It shall assess in particular the following:

   (a) on the basis of the report from EBA referred to in Article 39(6), the need for amendments with regard to minimising divergences at national level;

   (b) on the basis of the report from EBA referred to in Article 4(3), the need for amendments with regard to minimising divergences at national level.

   Where appropriate, those reports shall be accompanied by a legislative proposal.

2. Notwithstanding the review provided for in paragraph 1, by 3 years from the entry into force of this Directive, the Commission shall specifically review the application of Articles 12, 15 and 39 as regards EBA's powers to conduct binding mediation to take account of future developments in financial services legislation. That report and any accompanying proposals, as appropriate, shall be forwarded to the European Parliament and to the Council.

Article 114 is accompanied by a recital:

(97c) The Commission shall review the general application of this Directive and in particular consider, in light of the arrangements taken under any act of Union law establishing a resolution mechanism covering more than one Member State, the exercise of EBA's powers under this Directive to conduct binding mediation between a resolution authority in a Member State that is participating in the mechanism and a resolution authority in a Member State that is not participating in the mechanism.

Other Recital amendments

(47) It is not appropriate to apply the bail-in tool to claims in so far as they are secured, collateralised or otherwise guaranteed. However, in order to ensure that the bail-in tool is effective and achieves its objectives, it is desirable that it can be applied to as wide a range of the unsecured liabilities of a failing institution as possible. Nevertheless, it is appropriate to exclude certain kinds of unsecured liability from the scope of application of the bail-in tool. In order to protect holders of covered deposits, the bail-in tool should not apply to those deposits that are protected under Directive 94/19/EC1 of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes. In order to ensure continuity of critical functions, the bail-in tool should not apply to certain liabilities to employees of the failing institution or to commercial claims that relate to goods and services critical for the daily functioning of the institution. To reduce risk to systemic contagion, the bail-in tool should not apply to liabilities arising from a participation in payment systems which have a remaining maturity of less than seven days, or liabilities to institutions, excluding entities that are part of the same group, with an original maturity of less than seven days

(48a) Resolution authorities should also be able to exclude or partially exclude liabilities in a number of circumstances including where it is not possible to bail in such liabilities within a reasonable timeframe, the exclusion is strictly necessary and is proportionate to achieve the continuity of crtical functions and core business lines or the application of the bail-in tool to liabilities would cause a destruction in value such that losses borne by other creditors would be higher than if these liabilities were not excluded from bail-in. Where these exclusions are applied, the level of write down or conversion of other eligible liabilities may be increased to take account of such exclusions subject to the "*no creditor worse off than under insolvency"* principle being respected. Where the losses cannot be passed to other creditors, the resolution financing arrangement may make a contribution to the institution under resolution subject to a number of strict conditions including the requirement that losses totalling not less than 8% of total liabilities including own funds have already been bailed in, and the funding provided by the resolution fund is limited to the lower of 5% of total liabilities including own funds or the means available to the resolution fund and the amount that can be raised through ex post contributions within a period of three years.

[1] OJ L 135, 31.5.1994, p. 5–14.

(48b) In extraordinary circumstances, where liabilities have been excluded and the resolution fund has been used to contribute to bail-in in lieu of these liabilities up to the permissible cap, the resolution authority may seek funding from alternative financing arrangements.

(68a) A general rule has been established that each Member State should establish its national financing arrangement through a fund controlled by its resolution authority to be used for the purposes set out in this Directive. However a strictly framed exception is provided which permits a Member State to establish its national financing arrangement through mandatory contributions from institutions which are authorised in its territory and which are not held through a fund controlled by its resolution authority provided that certain conditions are met.

ANNEX II

B. EXPLANATORY NOTE

I. Bail-in

Article 38

Introduction

Article 38 sets out a revised proposal on the scope of the bail-in tool. The proposal remains broadly in line with the flexibility model proposed by the Presidency during the ECOFIN of 21 June, with further clarity around existing discretionary exclusions, Commission ex ante approval, and the role of alternative financing arrangements.

Defined exclusions

The list of defined exclusions from bail-in in the ECOFIN draft has been retained, with one addition. The list has been expanded to so as to exclude inter-bank liabilities with an original maturity of less than one week (Art 38(2)(d)). This was agreed at the ECOFIN of 21 June following a proposal by the European Central Bank.

Flexibility – resolution fund use only after minimum bail-in

In line with the "minimum bail-in" model of flexibility proposed by the Presidency during the ECOFIN, Article 38(3c)[1] has been expanded into a "general" discretionary exclusion.

- *Grounds for discretionary exclusions*

  The resolution authority would have the discretion to exclude liabilities or classes of liabilities for reasons of (i) impossibility, (ii) preservation of critical functions, (iii) avoidance of contagion, or (iv) avoidance of value destruction that would leave other creditors worse off.

[1] Including Art 38(3caa) and Art 38(3cab).

- *Full and partial exclusions*

  These exclusions could be *full* exclusions (i.e., the liability would not be written down or converted at all) or *partial* exclusions (i.e., the liability would be written down or converted, but the haircut applied to the liability would be reduced).

  - Creditor substitution v resolution fund contribution

  The cost of such exclusions could be absorbed in one of two ways:

  1. **Creditor substitution:** the cost could be shifted to other creditors. There would not be a quantitative cap on such exclusions, or a minimum amount of bail-in that must be undertaken before such exclusions were used, but the "No creditor worse off than liquidation" principle would cap the amount of the burden that could be shifted to other creditors.
  2. **Resolution fund contribution:** the resolution fund could make a contribution to the institution under resolution to absorb the cost of the exclusion or partial exclusion. This contribution could be used to absorb losses (i.e., in lieu of creditor write down) and/or to recapitalise the institution (i.e., in lieu of creditor conversion).

- *Resolution fund contribution conditions – minimum bail-in and quantitative cap*

  The resolution fund could only make contributions in this way provided a certain "minimum bail-in" had first been undertaken: i.e., shareholders and creditors had absorbed losses of at least 8% of the total liabilities (including own funds) of the institution. In addition, as a further safeguard, the contribution of the resolution fund would be capped at the minimum of either: (i) 5% of the total liabilities of the institution, or (ii) the amount of resources available to the resolution fund that has been raised by levies plus the amount that could be raised by ex post levies within three years.

  For the avoidance of doubt, the text clarifies that the 8% of losses that must be absorbed are measured prospectively from the point of resolution. Losses that have been absorbed prior to resolution action (through, for example, the decline in the institution's own funds as its financial position deteriorates in the period before resolution) do not count towards the 8% minimum level of bail-in.

- *Extraordinary circumstances and alternative financing arrangements*

  In extraordinary circumstances, where liabilities have been excluded and the resolution fund has been used to contribute to bail-in in lieu of these liabilities up one of the permissible quantitative limits, the resolution authority may seek funding from alternative financing arrangements (Art 39(3cab)). This provides for the option of using ESM or other public monies in extraordinary circumstances.

- *"Framing" – role of the Commission*

  The circumstances in which exclusions would be permissible would be further specified by the Commission through delegated acts (Art 38(5)). For all exclusions, resolution authorities would have to notify the Commission which could with 24 hours prohibit or require variations to exclusions where they were not in compliance with the requirements of the Article or delegated acts (Art 38(5a)).

- *Old specific discretionary exclusions – derivatives, third country debt and impossibility*

  The ECOFIN text of 21 June had provided for specific discretionary exclusions for (i) derivatives (Art 38(3)) and (ii) pre-2013 debt instruments under third country law (Art 38(3ca)). The text had also provided for a standalone discretionary exclusion in relation to liabilities which were impossible to bail-in.

  All of these individual discretionary exclusions have now been subsumed into the general discretionary exclusion in Art 38(3c) *et seq*. It is important to emphasise that flexibility in relation to such liabilities below the 8% minimum bail-in is still available, provided that the cost of such exclusions can be shifted to other creditors without breaching the "No creditor worse off principle" (i.e., creditor substitution).

  Flexibility to exclude derivatives or third country debt and make a contribution from the resolution fund in lieu of these liabilities is also available, but is subject to the same restrictions that applies generally to other liabilities: it must be preceded by a minimum bail-in up to 8% of total liabilities; the resolution fund contribution is capped at the minimum of 5% of total liabilities or the amount in the fund plus three years' ex post levies from institutions.

  The former paragraphs 4a and 4b – which addressed "burden shifting" to other creditors the resolution fund covering the losses of excluded creditors – have also been incorporated into Art 38(3c) *et seq*.

II. Financing

Article 91

Issue

Requirements to establish resolution financing arrangements

Proposed Changes

The main proposed changes are the addition of new paragraphs 3a and 3b which relate to the structure of financing arrangements.

Article 91(3a) establishes a general rule that each Member State shall establish its national financing arrangement through a fund controlled by its resolution authority to be used for the purposes set out in Article 92(1).

Article 91(3b) establishes a strictly framed exception to that general rule. This exception permits a Member State to establish its national financing arrangement through mandatory contributions from institutions which are authorised in its territory which contributions are based on the criteria referred to in Article 94(7) and which are not held through a fund controlled by its resolution authority provided that certain conditions are met. These conditions include (i) the amount raised must be at least equal to the target level in Article 93, (ii) the Member State's resolution authority is entitled to an amount that is equal to the amount of such contributions which the Member State will make immediately available to it upon its request for specified resolution purposes and the Member State shall notify the Commission of that amount at least annually and (iii) the Member State shall, save as expressly provided in Article 91(3b) comply with other financing provisions of the directive.

Article 91(3b) also acknowledges that mandatory contributions from any scheme of mandatory contributions established by a Member State between 17 June 2010 and the date of publication of this directive in the Official Journal from institutions in its territory for the purpose of covering the costs related to failure and resolution of institutions may count towards the target level for resolution financing arrangements in Article 93. It clarifies that contributions to deposit guarantee schemes shall not count towards the target level for resolution financing arrangements set out in Article 93.

Article 91(1) clarifies that Member States must ensure that financing arrangements are under the control of a designated public authority.

Article 98a

Issue

Preference in insolvency in Article 98a has been extended to cover liabilities owed to the European Investment Bank.

Proposed Changes

The amendment was made following a request by the European Investment Bank (EIB). The EIB requested that its loans to banks, which are aimed at supporting small business lending and strengthening jobs and growth are a key element of EU Policy, be fully excluded from the scope of bail-in.

The Presidency considers that while complete exclusion from bail-in is not supportable, extending the list of preferred liabilities in Art 98a to include liabilities to the EIB (similar to the preference granted to deposits of natural persons and SMEs) will strengthen the EIB's ability to perform its role effectively.

III. Other issues

Article 84

We have made some technical amendments to Article 84 to clarify the circumstances when the Commission may submit proposals to the Council for the negotiation of agreements with one or more third countries regarding cooperation in this area. This includes:

- addition of a reference to Article 218 of the Treaty on the Functioning of the European Union pursuant to which the Council may impose certain parameters on negotiation of agreements with third countries at the time the Commission submits a proposal for entering into negotiations with a third country;

- the addition of a reference to such agreements being inter alia, for the purpose of information sharing in connection with recovery and resolution planning;

- the deletion of paragraph (2) as this is sufficiently covered by paragraph (1).

These amendments have been reviewed by the Commission and the Commission has confirmed that they are acceptable to it.

Article 114

Issue

The review clause has been amended to clearly specify that the Commission's review of the Directive shall include a review of EBA's role in conducting binding mediation on disagreements between resolution authorities (Articles 12, 15 and 39).

Proposed Changes

The purpose of this amendment is to ensure that the EBA's role in binding mediation is examined in light of any future legislative changes establishing a resolution mechanism that covers more than one Member State.

This review clause is aimed at addressing the concerns expressed by several Member States at the last ECOFIN.

Recitals

All recitals added or amended serve to clarify the text.