RESOLUTION PLANNING FOR CREDIT INSTITUTIONS IN SPAIN AND IN THE EURO AREA

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Abstract

This article presents the planning process for the resolution of Spanish credit institutions. In particular, it sets out the content of the resolution plans prepared by the Banco de España since 2015, in its capacity as the national preventive resolution authority under the European Union's regulatory framework. The Banco de España participates actively, whether exclusively or in collaboration with the Single Resolution Board (SRB) and with other resolution authorities belonging to the Single Resolution Mechanism (SRM), in resolution planning for 79 credit institutions.

Resolution planning is an essential component of the Banking Union framework, providing for the actions required in the event that credit institutions should need to be resolved.

The authors explain in some detail the key components of resolution plans. In particular, they offer a detailed analysis of banks' business models and other key aspects such as the resolution strategies and tools to be applied in each case, the identification of obstacles to executing these strategies and tools, and the adoption of the measures needed to remove or minimise such obstacles.

Resolution planning does not seek to anticipate when and how future bank crises will arise, nor to estimate the probability of a crisis at specific financial institutions. The main aim of such planning is to have action plans in place for immediate and coordinated action if the time comes for a bank's obligatory resolution. In that way, the adverse effects on financial and economic stability are minimised.

1 Introduction

The international financial crisis, with its epicentre in the United States, affected many developed countries, particularly in Europe, entailing a high cost for these countries' taxpayers. This, along with a very high opportunity cost of public funds since the financial crisis coincided with a very severe economic crisis, led to reconsideration of the possible solutions for countering bank crises. Through the political impulse from the G20 and via the FSB (Financial Stability Board), the crisis-resolution paradigm for systemic banks was changed. There was a switch from the bail-out (a bank rescue using public funds) to the bail-in (an internal rescue instrumented on the basis of shareholder and creditor hierarchy).

It should be clarified that neither the G20 nor the FSB have called into question the need to rescue or recapitalise a systemic bank, or a group of such banks, in the event of non-viability. Provided, that is, that this is necessary to avoid major costs for the banks' depositors and the emergence of negative externalities for the other stakeholders, for other financial institutions and for the economy in general. What was reconsidered is who should bear the cost of the rescue; under the new resolution arrangements the aim is that the first agents to defray the costs of the rescue will be the shareholders and debt-holders, following the related hierarchy, and taxpayers only in the last resort.

The possibility of using public – namely taxpayer – funds in bank rescues is not entirely ruled out provided that, in the common interest, the social costs of not bailing out the ailing bank were higher than the value of the public funds used in the bail-out if put to alternative uses. Prior to the current bail-in strategy for bank resolution, expectations that systemic banks could not fail gave rise to a situation of moral hazard under which systemic

institutions benefited from lower funding costs owing to the implicit public guarantee; and they were able, in turn, to assume more risks, passing them through indirectly to society as a whole. By ensuring that shareholders and debt-holders are the first in line to assume the costs of financial insolvency, it is sought to redress and, if possible, eliminate conduct constituting moral hazard.

The G20 and the FSB strove to develop a resolution framework for systemic institutions, published in the document "Key attributes on effective resolution regimes for financial institutions",[1] along with highlighting the capital and liability requirements to be used in resolution procedures[2] (TLAC, or Total Loss-Absorption Capacity). The aim hereby was, as earlier stressed, to minimise moral hazard at systemic institutions, to lessen the probability of them going into insolvency and to limit the impact any such insolvency might have on the rest of the banking system and the economy. In short, it is sought to achieve greater market discipline in the exercise of shareholders' control functions in respect of the bank's management team. Discipline acts directly – as shareholders are the first to forgo capital if the bank goes into insolvency – and indirectly, owing to the demands in terms of risk premia and the oversight of the bank's behaviour by the debt-holders, mindful of the risk they run as the following agents in the loss-bearing hierarchical order under insolvency proceedings. That alignment removes or substantially reduces, at least in theory, the advantage in terms of lower funding that systemic banks have enjoyed in the past.

The banking resolution authorities have considered it vital to have recourse to appropriate resolution for systemic institutions, both in practical terms and with a view to the design of an optimal regulatory policy. Hence regulators and public authorities are concerned with squaring two elements: the rule whereby the bulk of the costs caused by bank insolvencies fall on those who directly or indirectly influence the decisions leading to such insolvency; and safeguarding the general interest. That is in contrast to the scant attention dedicated by the academic community to this key question for economic efficiency and the safeguarding of taxpayers and, generally, of public funds. Traditional bank theory and management textbooks barely touch on optimal bank resolution, beyond the role of the lender of last resort or deposit guarantee schemes, in contrast to the academic interest in the causes of bank instability and systemic risk.[3] Much attention has focused on the causes behind bank runs and how to resolve them, assuming this will always be possible. Yet appropriate research has been lacking on what happens if the bank run is not stopped and/or if the bank becomes non-viable, beyond general references to the fact that, if extreme situations are reached, there will be resort to a bail-out using external funds.

An exception to this lack of bank resolution analysis is Dell'Ariccia et al (2018), who analyse the trade-offs between different resolution systems or tools (e.g. between bail-out and bail-in). Their paper defends the use of bail-in (shareholders and debt-holders assuming

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1 See FSB (2014).

2 See FSB (2015).

3 For instance, the classics by Berger et al. (2010), Sironi and Resti (2007) and Saunders (1997) scarcely broach the various alternatives to bank resolution, practically ignoring them. Schinasi (2005) and Barth et al. (2006) have hardly any references to the various options for bank resolution, despite focusing on the safeguarding of financial stability and reflecting on the optimal banking regulatory environment. Freixas and Rochet (1997) and Repullo (2000) are notable exceptions to the lack of academic interest in banking resolution. By contrast, broad-based corporate finance textbooks do address bankruptcy costs and shareholder/debt-holder conflict in the event of a company being wound up, and the impact on the financial structure of companies [see, for example, Grinblatt and Titman (1998)].

the bulk of the costs of keeping the financial institution running) in most circumstances, albeit leaving the door open to bail-out (public funds being contributed to maintain the institution's viability) in the event of systemic crises. Bail-in reduces moral hazard and thus the incentive for banks to take on excessive ex ante risk; however, the authors consider that bail-out may be warranted where spillover effects derived from a bail-in could heighten financial instability and potentially lead to systemic crisis. The paper is consistent from the standpoint of regulatory policy since it argues that there should be sufficient leeway at each bank to absorb losses (capital and convertible debt) and that these instruments should be in the hands of those able to absorb losses. In short, the authors argue that bail-outs should be the exception rather than the rule and that their use is only justified as a last resort when financial stability is seriously endangered.

Zhou et al. (2012) explain the paradigm change from bail-out to bail-in and go on to describe the characteristics and potential advantages of bail-in, the prerequisites for its application and the essential elements for its proper design. They compare bail-in with other alternative tools such as the sale of the distressed bank or a bridge bank, and conclude that bail-in is preferable for global systemically important banks with solvency problems because of the lower risk this strategy entails compared with the alternatives.

Of interest from the viewpoint of the potential problems posed by bank resolutions affecting various countries is the discussion in Quarles (2018). He points out the need to take into account the perspective of both the home and host authorities when planning the resolution of a cross-border systemically important bank, and emphasises the need for appropriate cooperation between these two authorities.

Lastly, World Bank Group (2016) gives a list of examples of the approaches taken in dealing with banking crises in the European Union, many of them prior to the approval and entry into force of the Bank Recovery and Resolution Directive (BRRD). These examples help the reader to understand the complexity of these processes, the costs and trade-offs faced by the authorities, the practical difficulties of bail-in and the preference for resolution rather than liquidation as a less costly alternative. Further, they show, in short, the need to prepare for the eventuality of a bank resolution by drafting a suitable plan for each bank, removing obstacles to resolution and setting in place at each bank an appropriate level of capital and debt convertible into capital to recapitalise the bank in the event of resolution (making it "bailinable").

The engine driving this process of preparation for bank resolution is none other than the need to reduce the high cost (and adequately align the incentives) which bank crises impose on the banking systems, economies and communities where they occur.[4]

At the regulatory level, as from 2012 the idea arose in Europe to create the so-called Banking Union in response to the problems described. The main aims of the Union are to minimise, as far as possible, future banking crises and/or provide for their more efficient management, and to limit their impact on financial stability, on the real economy and, ultimately, on taxpayers.

To achieve these aims the Banking Union has, to date, two fundamental components: the Single Supervisory Mechanism (SSM), created in November 2014, and the Single Resolution Mechanism (SRM), which commenced operating in January 2015. Concurrently,

4 Saurina (2018) offers information on the costs of the last international banking crisis.

a single regulatory code was introduced, characterised most notably by the capital requirements framework set by Regulation (EU) 575/2013 and by Directive 2013/36/EU, Directive 2014/59/EU on the resolution of credit institutions and investment services firms, and Directive 2014/49/EU on deposit guarantee schemes.

The traditional insolvency proceedings through legal channels are of no use, in many cases, for addressing the non-viability of a credit institution. This is because there are differential factors in the case of banks compared with other companies, such as the complexity and singularity of their funding sources, which include legally guaranteed deposits of the general public, and the interconnection with other institutions. Faced with the non-viability of the bank, such factors might entail irreparable damage to the financial system, to payment systems and/or to the economy of the country in question. Thus, the winding-up of a credit institution will be applicable exclusively in those cases in which it is susceptible (because of its small size, simplicity and scant interconnections) to be treated under this regime, while respecting the public interest. However, for other credit institutions there is a need to apply an administrative process, namely resolution, geared to managing the situation of non-viability and to minimising the potential harmful effects of insolvency on economic and financial stability.

Set against the broad aim of winding-up, which involves obtaining the maximum protection possible for the creditors affected by the insolvency proceedings, the specific goals of bank resolution are:

- to maintain the continuity of the core functions performed by the bank concerned;

- to prevent adverse repercussions for financial stability and the risk of contagion;

- to safeguard public funds;

- to safeguard depositors and investors covered by Directives 2014/49/EU and 97/9/EC, respectively; and

- to safeguard customers' funds and assets.

Insofar as knowledge of the objectives, contents and preparation of resolution plans is provided, the significance, information requirements and challenges of the task involved will be better understood, as will the essential role that close collaboration with the authorities plays in successfully seeing resolution through.

Experience shows that, on many occasions, the speed with which the effects of the crisis on banks manifest themselves precludes achieving the aims of resolution established in the regulations if, beforehand, there has been no suitable analysis and planning in relation to the actions to be taken as and when needed.

The following sections set out, firstly, the legal and institutional framework in which resolution planning tasks and their distribution among the various institutions comprising the SRM are prepared. Secondly, the aim and content of resolution plans are detailed, along with the processes pursued up to their final approval. Finally, a summary of some of the challenges still to be addressed is included, and some conclusions are drawn from the intensive work performed in the past three years.

- Directive 2014/59/EU (BRRD) of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of European credit institutions and investment firms.
- Law 11/2015 of 18 June 2015 and its implementing Royal Decree 1012/2015 of 6 November 2015 transpose the Community regulations into Spanish law.
- Regulation 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund.

In the euro area the Single Resolution Board (SRB) is the central body of the SRM, which comprises the SRB and the national resolution authorities of the euro area countries, with the following distribution of tasks.

- *The SRB* is tasked with devising the resolution plans for the banks that fall within its scope, i.e. basically banks considered significant from the standpoint of the European Central Bank.
- *The national resolution authorities* draw up the resolution plans for the banks considered less significant (the LSIs). Further, the SRB may, for the banks within its purview, call on the national resolution authorities to prepare draft resolution plans. Thus, since commencing operating, the SRB has used this power with the Spanish significant institutions (SIs), meaning that the Banco de España, in addition to drafting LSI's' resolution plans, has also annually devised resolution plans for SIs, covering all those areas assigned in the distribution of tasks agreed annually with the SRB.

In this legal framework, Spanish regulations institute a model that distinguishes between two functions:

- Preventive resolution, which is the responsibility of the Banco de España and of the CNMV, for credit institutions and investment services firms, respectively.
- Executive resolution, the responsibility for which falls on the FROB, in relation both to credit institutions and to investment services firms.

2 Frequency and content of resolution plans

The resolution plans of credit institutions should be prepared and updated at least annually, unless:

- A change in the institution's legal or organisational structure or in its financial position significantly affects the effectiveness of the current plan, and is considered necessary to amend it significantly. This need will be determined by the preventive and/or executive resolution authorities.
- The preventive resolution authority deems it advisable, on its own initiative or on that of the executive resolution authority (the FROB in Spain's case).

As an exception to the annual frequency, the regulations also envisage the possibility of establishing simplified obligations for certain institutions, regarding both the minimum content of the resolution plans, and the foreseeable frequency at which they are updated. In this respect, in the attention to, among other factors, the lesser complexity, size or interconnections of the institution, content might be cut back. Also, in these cases, the frequency at which plans are updated might be greater than the one-year period generally set.

It should be stressed in any event that, under Article 13.2 of Law 11/2015, institutions will be obliged to co-operate in the preparation and updating of plans with the preventive resolution authority. The latter may require of institutions the information needed to prepare, approve and update the plans and, at the very least, the information specified in annex II of Royal Decree 1012/2015.

THE CONTENT OF RESOLUTION PLANS

BOX 2

If and when simplified obligations are not applied, the minimum content of resolution plans is listed in Article 25 of Royal Decree 1012/2015, and is structured around the following sections:

1 Analysis of the structure and business model of the institution/groups.

2 Analysis of strategy and the preferred/alternative resolution tool.

3 Loss-absorption capacity and minimum requirement for own funds and eligible liabilities (MREL).

4 Analysis of financial continuity.

5 Analysis of business continuity.

6 Necessary information and communication plan in the event of resolution.

7 Assessment of resolvability of institutions/groups.

Once the resolution plan has been approved by the pertinent authorities, the latter will communicate to the institution to be resolved a summary of the key elements of this plan and, where appropriate, the need to adopt the measures deemed necessary to ensure, with reasonable security, that the institution can be resolved if necessary.

The content of the resolution plans is developed in conformity with the SRB's common criteria and guidelines, to seek to ensure a level playing field and uniformity with respect to all the institutions located in the euro area.

A non-exhaustive description follows of the content and end-purpose of each of the sections cited in Box 2.

2.1 ANALYSIS OF THE STRUCTURE AND BUSINESS MODEL OF THE INSTITUTIONS AND GROUPS

This section analyses, among other matters, the structure and composition of the group in question, in order to identify the main group institutions and the distribution of tasks and business therein. The most significant companies are identified by their contribution to the business and/or on the basis of which of them provide essential services for the fulfilment of its functions, for instance, the technological support needed to sustain activity. These will be subject to particular attention in the event of resolution to prevent business continuity problems.

Further, it is examined whether the institution or group institutions perform critical economic functions, understanding as such those provided to third parties which probably have a significant impact on them in the event of an acute shock, or those which were liable to prompt contagion or undermine the general trust of market participants. This aspect is of particular importance, since critical economic functions should be retained in a resolution process, given their systemic character or potential for the contagion of problems to the economy and/or to financial stability.

Also considered are the main interdependencies – essentially, financial, legal and operational, both within the group and with third parties – in order to assess the possible effects that a sudden interruption in activity at any of the institutions might exert on the rest of the group or on the financial system as a whole.

The analysis of all the foregoing information will, on the basis of the institution's business model, enable the preferred resolution strategy to be determined. And within this strategy, the resolution tool best suited to the characteristics of the institution or group in question may be selected, so as to achieve compliance with the resolution objectives set in the regulations.

Under current resolution plans, an analysis is made not only of which resolution tool would be preferred in terms of the institution's or group's characteristics, but also of possible alternatives that might be set in place if the circumstances prevailing at the time of resolution so advise. It is hereby sought to cover different scenarios of possibilities in order to smooth execution of the resolution as much as possible. In Spain, it is the FROB which will ultimately decide on the resolution tool to be applied, if any, in light of the circumstances prevailing at the time of resolution.

2.2 ANALYSIS OF STRATEGY AND THE RESOLUTION TOOL.

2.2.1 Resolution strategies

Resolution plans include an assessment on the public interest of institutions. Assessing whether the institution or group subject to analysis are of public interest is the first factor to be taken into account for deciding on the most appropriate resolution strategies. If this element is missing, the ordinary insolvency proceedings established under Law 22/2003 of 9 July 2003 shall be applied.

There will be deemed to be public interest if it is concluded that the winding-up of the bank as part of an insolvency procedure does not enable the resolution objectives to be reasonably achieved to the same extent as under the administrative resolution procedure. To conduct this analysis, assessment is made of the best procedure to attain these objectives, whether through resolution or insolvency proceedings. By way of example, if a bank is identified to be providing critical economic functions, it might be concluded that its resolution would better enable the objective of maintaining the continuity of such functions to be secured than would its winding-up under regular insolvency proceedings.

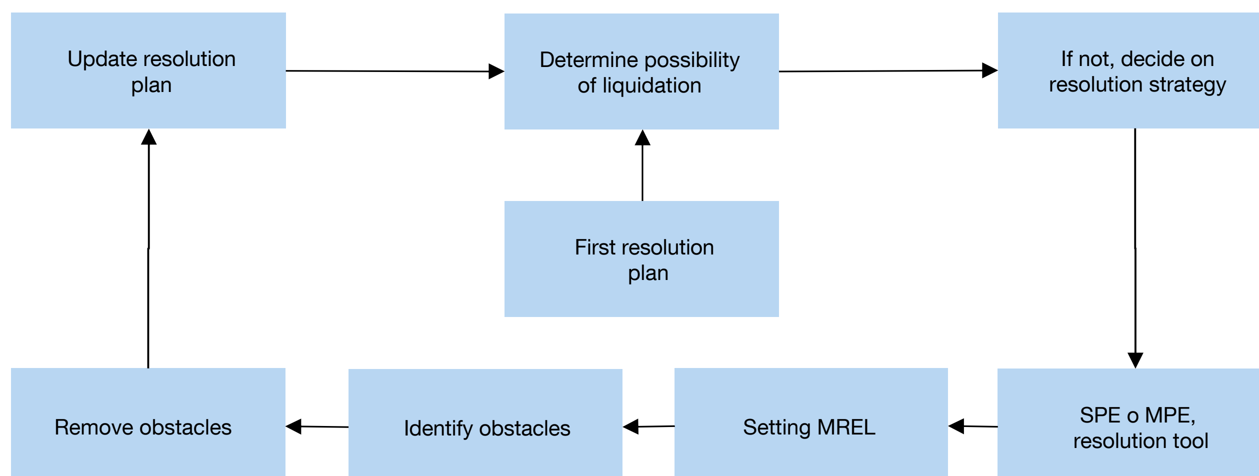
In the event of an absence of public interest, a simplified plan shall be drawn up to cover basically the following sections:

- Analysis of the structure and business model of the institutions and groups.
- Aspects denoting an absence of public interest.
- Proposal for the application of normal insolvency proceedings.
- Analysis of loss-absorption capacity and MREL.
- Communication in the event of winding up.
- Assessment of possible obstacles to winding up and measures, if any, to be adopted.

If the resolution authorities conclude that there is public interest, they should assess the possible resolution strategies to be applied. In that connection they should take into account the structure and business model of the bank or group in question and, as will subsequently be analysed, assess the possible obstacles to practical implementation and, where necessary, propose measures to remove such obstacles. The main stages to be followed in resolution planning are included in Scheme 1:

STAGES IN RESOLUTION PLANNING

SCHEME 1



SOURCE: Own elaboration.

Resolution strategies are divided chiefly into single and multiple point of entry (SPE and MPE, respectively) strategies. In practice, there may also be mixed models, with a single point of entry strategy for a part of the group located in specific geographical areas, and a multiple point of entry for that part located in other jurisdictions, depending on the organisation, configuration, geographical presence and applicable legal regime in the different countries in which the groups of credit institutions operate.

The points of entry refer to those banks in which it is planned to apply resolution actions if necessary. Thus, in the case of a single point of entry the resolution tools would be applied only in one institution of the group, normally the main one, or the group parent. In the case of a multiple point of entry, by contrast, these tools would be applied to several institutions within the group.

To be able to assess which is the most suitable resolution strategy regarding point of entry, regard should be had, in accordance with Commission Delegated Regulation (EU) 2016/1075, to the following factors:

- Which resolution instruments would be used according to the preferred resolution strategy, and whether the legal persons to which the strategy plans to apply these instruments have access thereto.

- The amount of qualifying eligible liabilities (MREL), the risk that they do not contribute to loss-absorption and recapitalisation, and the legal persons that issue them.

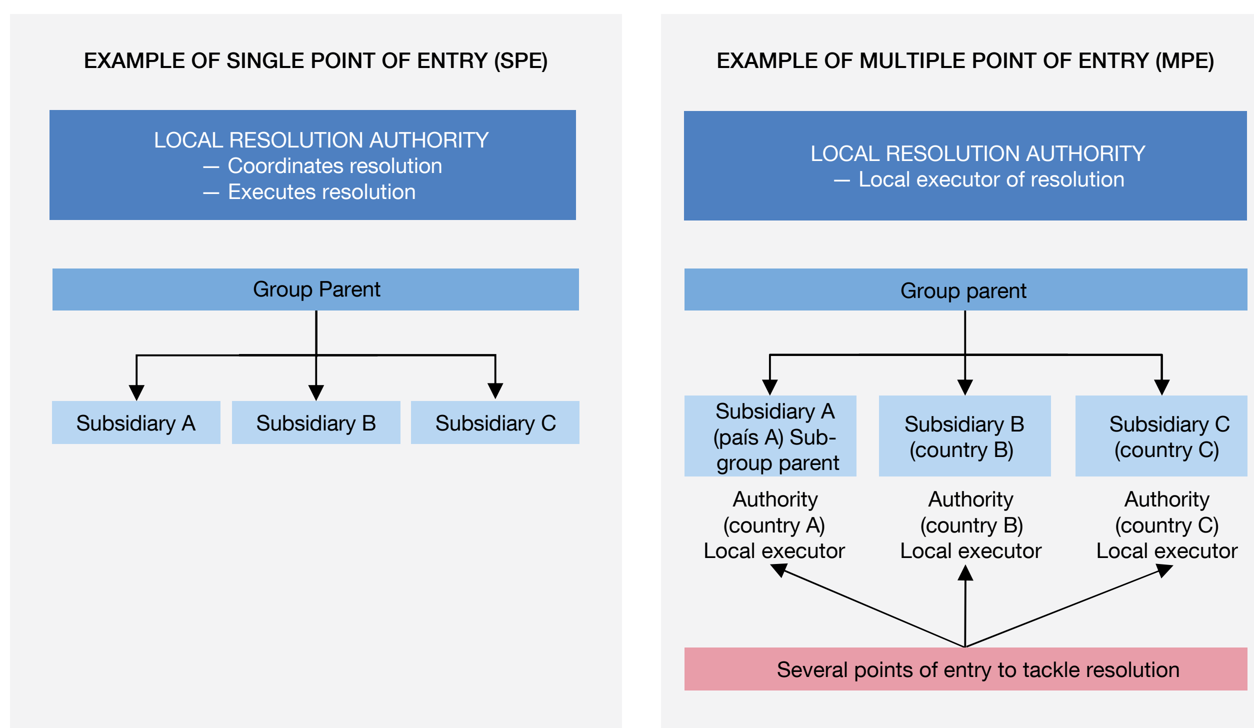
- The contractual or other provisions adopted for the transfer of losses between legal persons of a single group (e.g. domination agreements).

- Whether the operating structure and business model of the institution or group is highly integrated or has a decentralised structure.

- The effectiveness of the resolution instruments to be applied, in particular in third countries.

RESOLUTION STRATEGIES

SCHEME 2



SOURCE: Own elaboration.

- Whether the resolution strategy requires the application of support measures by other authorities, and whether such measures are feasible and credible for these authorities.

In the current regulations, there are no defined quantitative references or clear limits for adopting one strategy or another. However, a series of explanatory factors on which to base decisions in this regard can be listed.

In this connection, the single point of entry strategy will be more recommendable in banking groups with the following characteristics:

- The liabilities that should contribute to loss-absorption and recapitalisation have been issued by the last parent company or the group holding company.

- When the group operates with a high degree of integration and, in particular, when its liquidity management, risk management, treasury functions, IT services and other shared core services are centralised.

The multiple point of entry strategy will be more recommendable in banking groups where:

- The liabilities that should contribute to loss-absorption and recapitalisation have been issued by more than one institution or regional or functional sub-group of the group.

- The group's activities are divided into two or more clearly identifiable sub-groups that are predominantly independent from other parts of the group, from the financial, legal and operational standpoint.

2.2.2 Resolution tools

Along with the resolution strategy, the competent authorities should determine which of the resolution tools included in the regulations, or combinations thereof, are considered most suitable for achieving resolution objectives. The tools envisaged in the current legislation are the following:

– The sale of the bank's business.

– The transfer of assets or liabilities to a bridge bank.

– The transfer of assets or liabilities to an asset management company.

– Bail-in.

These tools may be applied individually or jointly, except for the transfer of assets or liabilities to an asset management company, in which case application should be jointly with another of the tools available.

The sale of the bank's business may be through the transfer of the shares, equity capital contributions or instruments representing share capital to an acquirer that is not a bridge bank, or through the transfer of all or part of its assets and liabilities.

The bridge bank is a public limited company controlled by the resolution authority, in which the FROB may have a stake. The ultimate objective of the bridge bank is its sale to a third party within the specific period stipulated by the regulations. To incorporate this bank, all or part of the shares, equity capital contributions or instruments representing share capital and all or part of the assets and liabilities of the bank in resolution shall be transferred to it. In this way, it may fulfil its purpose of pursuing fully or partly the activities of the bank in resolution, including the core functions it performs, and the management of the shares or other capital instruments and of all or part of its assets and liabilities.

As regards the asset management company, the executive resolution authority may oblige a bank in resolution or a bridge bank to transfer specific asset classes on the bank's balance sheet (normally impaired or problem assets) to one or several asset management companies. That provides for a ready return to viability of the bank in resolution, by unloading assets that do not generate revenue from its balance sheet.

Lastly, the bail-in enables the resolution authorities, once the pertinent loss-absorption has taken place, to transform creditors into shareholders and/or to reduce the nominal value of their debts, following the rules and procedures laid down in the regulations (in keeping with the creditor hierarchy).

Also, and wherever possible, the plans contain an analysis of the alternative resolution tools should the circumstances at the time of resolution so advise. Numerous factors are used for these analyses, including inter alia the complexity and size of the banks in question, their legal structure, possible purchasers in terms of business absorption capacity, their volumes or proportions of impaired assets and the structure of own funds and liabilities that would contribute to the loss-absorption and recapitalisation of the banks.

The plans also include a summary of the reasons recommending the use of certain resolution tools in preference to others. Once the tool considered most appropriate has

been chosen, the plans must include information on the necessary steps for practical implementation.

2.3 LOSS-ABSORPTION CAPACITY AND MREL REQUIREMENTS

One key aspect to analyse in resolution plans is banks' loss-absorption capacity and the availability of financial instruments that might contribute to recapitalisation if necessary. It is worth recalling that one of the essential aspects of the new regulatory framework is that the cost of bank crises should not fall on the public offers but be defrayed by shareholders and creditors. Only those creditors protected by the regulations to this end should be excluded, such as holders of guaranteed deposits, and for the legally stipulated amount.

To examine this basic aspect, the supervisory authority periodically requests information of banks (the so-called Liability Data Report). This includes a breakdown of the composition of its own funds and liabilities, maturities and amounts, the legal regulations to which they are subject, the nature of their holders, etc.

The Liability Data Report provides for a view of the financial instruments that:

- Are eligible for MREL requirements. Such instruments will basically be those which, owing to their characteristics (stable value, extensive term until maturity, non-guaranteed, etc.), offer reasonable security as to being used to absorb losses and recapitalise the banks if necessary.

- While not eligible for MREL, they might contribute to recapitalising the bank if necessary and, lastly,

- They are not susceptible to be considered either for MREL or contributing to the desired recapitalisation. Included in this category would be collateralised liabilities, among others.

In the process of preparing, evaluating and maintaining resolution plans, the preventive resolution authority will set the minimum MREL requirement for each bank and will check that banks meet this requirement at all times.

The methodology for determining MREL requirements depends, among other factors, on the resolution tools considered in resolution planning, with these differing in terms of the tools proposed.

At the current stage, the SRB is determining MREL requirements at the consolidated level of significant banks. For the calculation of MREL requirements, a sufficient amount of own funds and eligible liabilities is required in order to be able to apply the resolution tool selected for each bank , and so that these amounts may comply with the capital requirements determined by the supervisor following resolution, ensuring continued market confidence.[5]

In the case of banks where it has been decided that the most appropriate resolution strategy is the application of normal insolvency proceedings, MREL requirements will be confined to those deemed necessary to absorb losses, with it not being necessary to

5 For banks with a bail-in resolution tool, see: https://srb.europa.eu/sites/srbsite/files/item_1_-_public_version_mrel_policy_-_annex_i_-_plenary_session.pdf.

a) The need to ensure the bank's resolution by means of the application of whichever resolution instruments.

b) The need to ensure that, when appropriate, the bank has sufficient eligible liabilities for the effective application of the bail-in instrument.

c) The need to ensure that the bank has sufficient eligible liabilities so that the bail-in may be effectively applied, if the resolution plan foresees specific exclusions in the amount of eligible liabilities for this bail-in.

d) Size, the type of company, the funding model and the bank's risk profile.

e) The extent to which the deposit guarantee system may contribute to financing resolution.

f) The extent to which the non-viability of the bank might have an adverse effect on financial stability.

recapitalise the bank as it is not foreseen that the bank will pursue its activity after being wound up.

Prior to the definitive setting of MREL requirements, the resolution authorities grant banks a hearing procedure and the possibility of expressing their opinion on the requirements made to them. The MREL requirements set are reflected in the resolution plan, along with the terms laid down, where necessary, to attain them. Here, banks may be required to submit credible financing plans demonstrating they are capable of attaining the requirements set.

During resolution planning, the preventive resolution authorities periodically review the MREL objectives, while closely monitoring developments in order to verify compliance.

2.4 ANALYSIS OF FINANCIAL CONTINUITY

The analysis of banks' capacity to ensure their financial continuity or of their capacity to meet payment obligations in crisis situations is also included in resolution plans. In particular, banks' capacity to meet the liquidity requirements that may arise, without having to envisage public liquidity support, is examined.

Generally, it will be very difficult to know what the exact liquidity needs in crisis situations are beforehand, since it will be affected by numerous factors, such as the type of crisis, the speed at which events unfold, the market situation as a whole, etc. Notwithstanding this, there is an in-depth study of aspects such as banks' availability of unencumbered liquid assets and their ability to generate additional liquid assets or obtain other funding sources swiftly and credibly, if necessary. To this end, stressed scenarios are used that help assess banks' ability to withstand complex situations, bearing in mind their business model and balance sheet composition.

Currently, moreover, the European authorities are working on the possibility of setting up a backstop mechanism to face liquidity needs of the institutions in a resolution process, if necessary.

2.5 ANALYSIS OF OPERATIONAL CONTINUITY

In a hypothetical case of resolution, particular attention should be paid to all those aspects that enable reasonable security to be had beforehand that, as a result of resolution, the

bank's critical activities will not be interrupted, as will neither those supporting the provision of critical economic functions for the economy.

In this connection, in the planning phase each bank's or group's operating model is analysed, and the providers of critical services and banks' agreements with them are identified. In this framework, banks are required to maintain a detailed repository of agreements, centralising all the information relating to the pertinent agreements. This simplifies the in-depth review of agreements by the preventive authority, so that clauses or provisions that might give rise to doubts over continuity in the event of resolution are detected. That means, if necessary, that banks may amend or adapt them, thereby ensuring operational continuity in resolution.

It is also assessed whether there may be access problems to market infrastructures that may prove critical for the bank during resolution. Possible alternatives to adopt should banks lose access to such infrastructures during a crisis are studied, as are contingency plans to withstand these situations.

2.6 INFORMATION AND COMMUNICATION PLAN IN THE EVENT OF RESOLUTION

One of the key aspects for ensuring that a resolution process is conducted effectively is the analysis of banks' capacity to swiftly provide all information that might be necessary for decision-making by the resolution authorities. This is one of the areas that will probably generate most work in the future, since banks' reporting systems currently focus on the ability to provide detailed information on their assets and, essentially, on all matters relating to lending. However, the new resolution framework requires detailed information on own funds and liabilities that may contribute to banks' loss absorption and recapitalisation, at the crucial time for decision-making, and not necessarily on pre-set reporting dates.

To this end, banks' governance structure is analysed with a view to the provision of information where necessary, and the quality of the information reported to the resolution authorities. When deemed necessary, stress tests are conducted to assess banks' responsiveness.

In a resolution process it is vital that the authorities should have a series of uniform, manageable and flexible data, most of which template-based, that support decision-making. Currently, the main templates used in resolution planning relate to the detailed information on:

- Composition and characteristics of liabilities and own funds (Liability Data Report);
- Identification and analysis of critical economic functions to be protected in resolution;
- Financial Market Infrastructures with which the bank operates, and
- Other templates developed by the EBA on aspects such as the groups' organisational structure, governance structure, information systems, contact data, etc.

In a resolution there must be coordinated communication between the resolution authorities and the banks affected, so as to avoid contradictory messages or confusion and in order to provide clear, timely information on the reasons behind the adoption of the resolution

decision and its effects on all those potentially interested and/or affected. The ultimate aim is to be prepared beforehand to provide all information that may contribute to increasing the transparency of the resolution process and obtaining a swift resumption of market confidence in the bank in resolution.

Further, with a view to smoothing the communication potentially needed to allow the resolution process to be implemented, those responsible for banks' communication, the various groups that might be affected, the main services providers, market infrastructures, etc. should be clearly identified beforehand.

2.7 ASSESSMENT OF THE RESOLVABILITY OF BANKS

The objective of assessing the resolvability of banks is to obtain reasonable security that, if subjected to resolution, their structure or means of functioning would allow this resolution to be performed without endangering financial stability and/or the economy as a whole. The authorities carry out this assessment not only during the resolution planning phase, but also during the phase in which banks' recovery plans are drawn up. The legislation thus makes it obligatory to consult with those responsible for supervision and resolution. The resolution authorities must review banks' recovery plans before they are approved by the supervisor so as to indicate whether any of the recovery measures included in the plans might adversely affect resolvability. With this process it is sought to prevent measures being adopted by the bank at an early stage of the crisis that might subsequently hamper its resolution, if this were ultimately necessary.

Once the preferred resolution strategies and tools have been determined, the authorities seek to identify the potential obstacles in the way of practical implementation, and to adopt the necessary measures to remove them. The obstacles identified to date are centred essentially on matters of business continuity with services providers, access to market infrastructures in the event of resolution, loss-absorption capacity and recapitalisation, and the capacity to swiftly generate the information needed for resolution.

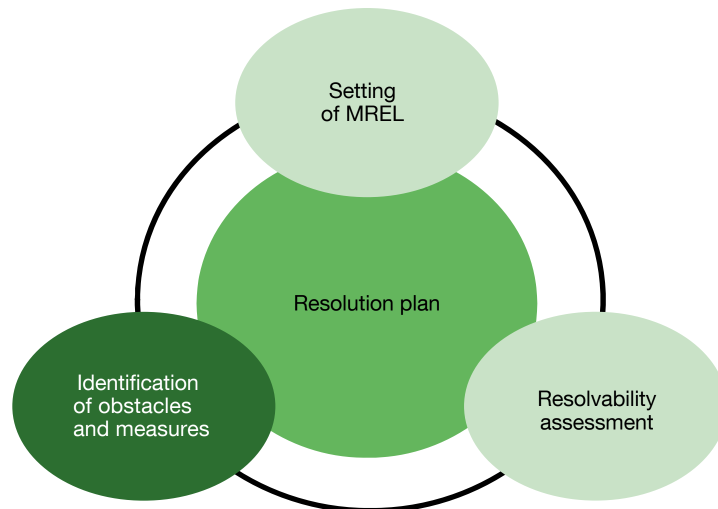
To try and ensure uniformity in the identification and treatment of obstacles to resolvability, the SRB is preparing common guidelines for action for the euro area national resolution authorities.

In this process to analyse and enhance resolvability, the resolution authorities attempt to have banks incorporating into their day-to-day management ongoing reflection on the possible obstacles that might arise in a resolution process, and the need to head them off beforehand. Some courses of action here would involve requiring banks to appoint managers, both at senior and middle levels, to oversee resolvability, maintain contact with the resolution authorities and submit work plans on specific projects to improve resolvability, whenever necessary. In this way, the authorities would subsequently conduct periodical monitoring of the attendant suitability, developments and implementation in practice, calling for the changes they consider appropriate.

Finally, if the analysis of resolvability were to infer the existence of considerable impediments to resolution, the normal planning process would be suspended; i.e. a plan cannot be approved without the necessary measures being approved for removing the major obstacles to resolvability beforehand. If banks do not contribute to minimising the major obstacles identified or do not adopt the appropriate measures, the legislation envisages a broad and categorical set of measures.[6] These include, if necessary, the resolution authority being

6 See Articles 17 and 18 of Law 11/2015.

PREVENTIVE RESOLUTION MECHANISM SCHEME 3



SOURCE: Own elaboration.

able to impose on banks the adoption of structural, organisational or any other types of changes to ensure that resolution is orderly and entails no cost to taxpayers should the bank become non-viable.

3 Number and frequency of plans to be drawn up

The Banco de España currently carries out preventive resolution tasks. It does so exclusively and/or sharing them with the SRB and other national resolution authorities for a total of 79 credit institutions, including both individual banks and groups.

In December 2018 this group comprised 12 significant institutions (SIs) and 55 less significant institutions (LSIs). Moreover, the Banco de España cooperates, by providing analyses and timely information, with the SRB, the FROB and the national resolution authorities of other euro area Member States in the preparation of resolution plans for 12 credit institutions headquartered in one of the Member States and that have significant subsidiaries and/or branches in Spain.

As set out in section 6.2, the Banco de España participates actively in nine resolution colleges in the resolution plan preparation cycle.

4 Consultation processes and approval of resolution plans

The approval of resolution plans and of the other elements making up the preventive resolution mechanism (analysis of resolvability and determination of the MREL requirement) is preceded by an *extensive consultation process* in which both the competent supervisory authorities and the national resolution authorities of the Member States where there are significant subsidiaries and/or branches participate.

In the case of SIs, the consultation process includes the European Central Bank and the national resolution authorities affected.

Of particular importance in this consultation process is the role of the *supervisory authority.* Hence, the ultimate objective of the supervisory and resolution framework is a common one, and is aimed at ensuring the stability of the financial system. That said, in striving for this objective, the supervisory authority pursues a “going concern” principle, focused on

ensuring the existence of solvent institutions, as opposed to the "gone concern" convention adopted by the resolution authority, which seeks to ensure resolvability, if necessary.

This dual approach means that, on occasion, measures adopted in the resolution framework might affect the viability or performance of going-concern institutions and, conversely,[7] that supervisory measures might impact resolvability. By way of example:

- The resolution plan may envisage measures aimed at improving the separability of institutions in an eventual resolution, e.g. the need to keep critical services providers separate or the setting of restrictions on the movement of funds between institutions. These measures may affect their business model and their cost structure; accordingly the supervisor, in its consultation process, should assess their scope.

- Determining the MREL requirement has a direct effect on banks' financial structure and financing costs, and it may even entail changes in the business model, the consequences of which should be painstakingly studied by the supervisor.

Along with this, and on a lower scale of importance, the supervisor will draw on its knowledge of the institution to assess its appropriate reflection in the resolution plan, essentially in that part relating to the description of the structure and business model.

As regards the *resolution authorities of the Member States* where there are significant subsidiaries and/or branches, the objective of the consultation is two-pronged: on one hand, it is sought to ensure the appropriate coordination and harmonisation of measures; and on the other, to prevent disproportionate impacts on the financial stability of any of the States affected, which might not have been properly detected by the resolution authority of the group.

In this respect, a distinction should be drawn between:

- Resolution authorities of Member States not belonging to the Banking Union, for which the consultation and approval process is essentially structured around the resolution colleges.[8]

- Resolution authorities of Member States belonging to the Banking Union. In these cases, the SRB is the competent resolution authority for preparing and *approving* the resolution plan. This approval will come about in the so-called Extended Executive Session, in which the SRB members themselves and the national resolution authorities affected by the decisions to be adopted participate. Irrespectively, the preparation of the resolution plans for SIs is done by the so-called Internal Resolution Teams (IRTs), work teams comprising SRB and national resolution authority representatives. These two mechanisms – approval in the Extended Executive Session and formation of the IRTs – promote the observance of the objective of coordination between authorities, even though the competent resolution authority is the SRB and there is no formal consultation process, such as that established in the resolution colleges.

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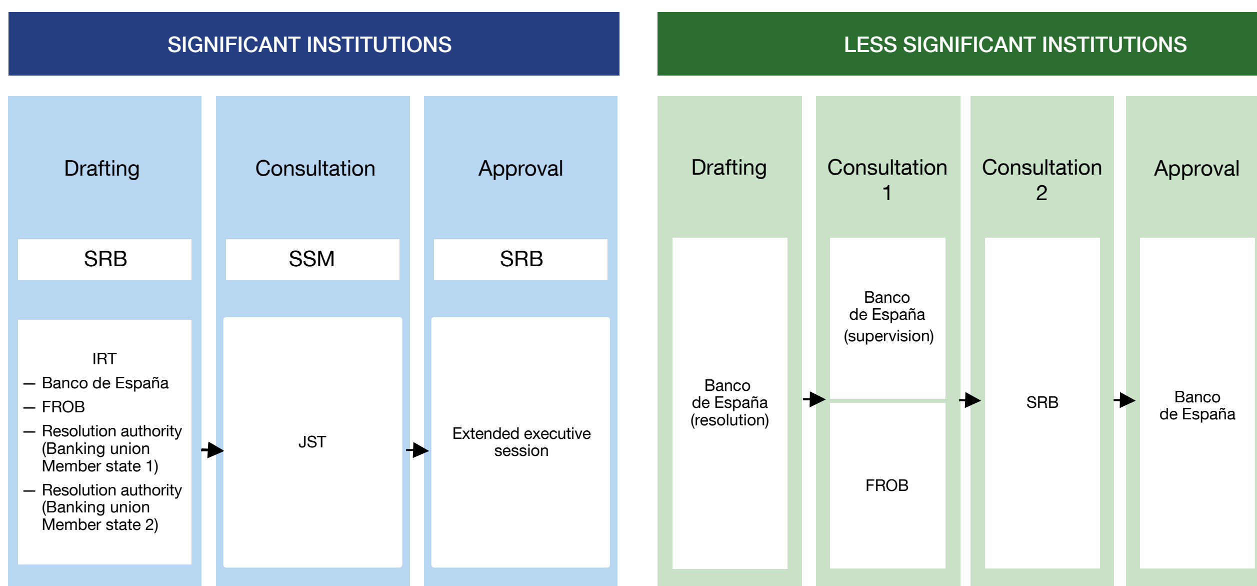
7 In this connection, see the section on the analysis of resolvability and the role of the resolution authority in the review of recovery plans.

8 See section 5.

DRAFTING, CONSULTATION AND APPROVAL OF RESOLUTION PLANS

SCHEME 4



SOURCE: Own elaboration.

In the case of LSIs and their groups, whose resolution plans are the competence of the Banco de España, the consultation process will include both the supervisory authority and the FROB and the SRB. Given the particular configuration of competences in resolution in Spain, with a preventive resolution authority (Banco de España) and an executive resolution authority (FROB), the consultation process should also include this latter authority.

The objectives of the consultation to the supervisory authorities and the resolution authorities of other Member States will coincide with those set out earlier for the SIs.

In the case of the FROB, the consultation process seeks to ensure that the preventive resolution mechanism does not include measures or actions that hamper effective execution.

The last step of the consultation process involves sending the plans to the SRB, which seeks to ensure a level playing field in the preparation of the resolution plans for the different Member State institutions.

The approval of the plans and of the other components of the preventive resolution mechanism in relation to LSIs is the competence of the Banco de España.

5 Resolution colleges

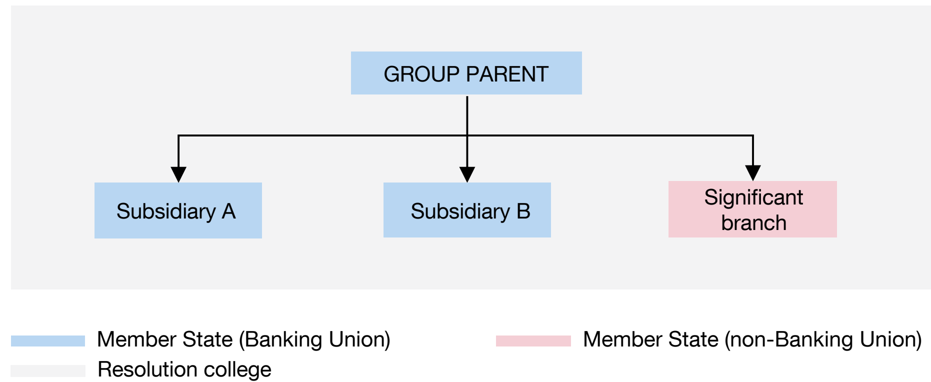
5.1 CONCEPT, TYPES AND COMPOSITION

For the effective resolution of credit institutions – or groups thereof – operating in different European Union countries, cooperation is required. It is necessary between the competent and resolution authorities within the framework of the colleges of supervisory and resolution authorities (hereafter, “resolution colleges” or “colleges”), and indeed at all stages of resolution, from the preparation of the plans until the effective resolution of the institution.

Given the background to the last financial crisis, where the absence of a harmonised resolution framework led to different forms of management by different countries, the new

RESOLUTION COLLEGES

SCHEME 5



SOURCE: Own elaboration.

regulatory framework has sought to promote cooperation between different authorities in such a way as to prevent fragmented national responses. In this respect, the regulations envisage two different *types* of resolution colleges:

1 Resolution Colleges

These colleges are foreseen for *cross-border European groups,* i.e. for those cases where the parent of the group of credit institutions is domiciled in an EU Member State and has, in turn, one or more significant subsidiaries and/or branches in another or other Member States.

In particular, for those institutions under the remit of the SRB (essentially SIs) there is understood to be a single resolution authority, irrespective of whether the group has significant subsidiaries and/or branches in different Member States within the Banking Union. Therefore, there would only be an obligation to set up these resolution colleges if the group of credit institutions were present in other EU countries not belonging to the Banking Union.

These colleges would be chaired by the group-level resolution authority (GLRA).

2 European Resolution Colleges

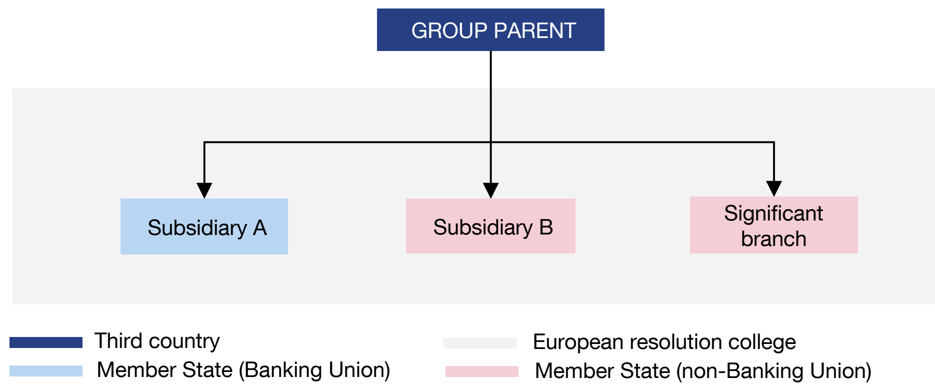
These are conceived as colleges reserved for *third-country* cross-border groups, despite their confusing name. Their focus is on situations in which a group of credit institutions, whose parent is situated in a non-EU Member State, has two or more significant subsidiaries and/or branches in Member States.

As in the case of the colleges of resolution authorities, if an institution present in several Member States is under the resmit of the SRB, there is understood to be a single resolution authority for all Member States within the Banking Union, which will be a member of this college.

The college chair will be occupied by the resolution authority of the Member State where the supervisor on a consolidated basis is located.

EUROPEAN RESOLUTION COLLEGES

SCHEME 6



SOURCE: Own elaboration.

5.2 FUNCTIONS OF THE COLLEGES IN THE PLANNING PHASE AND DECISION-MAKING PROCEDURE

The functions are structured around three major objectives:

1. To ensure appropriate collaboration and cooperation between resolution authorities, from both the EU and third countries, promoting a fluid exchange of information.

2. To establish a discussion forum for all matters affecting cross-border resolution groups.

3. To carry out the tasks laid down in the regulations, both for the resolution planning and execution stages.

Focusing on the planning phase, the resolution college's competences include, apart from the continuous exchange of information, the approval of the preventive resolution mechanism, which comprises:

- The resolution plan.

- Assessment of the institution's resolvability.

- Where appropriate, exercise of the powers needed for the removal of the obstacles to resolvability detected.

- Setting the MREL requirement, both at the consolidated and solo levels.

These four tasks would be subject to a joint decision-making process structured around different *stages:*

- First, to agree on the working schedule, upon the proposal of the GLRA.

- Once the time schedule is agreed, the necessary information will be gathered to prepare the draft resolution plan, and the resolvability analysis, which will be submitted to initial consultation among the members.

- Subsequently, the college will have an internal dialogue on the resolution plan and the resolvability analysis, and it will discuss a joint decision proposal and the schedule for approving this.

COMPOSITION OF THE COLLEGES

BOX 4

The resolution colleges shall be made up of the following members:

a) The GLRA and the supervisor on a consolidated basis.

b) The resolution authorities of the Member States in which the significant subsidiaries or branches are established and their national supervisory authorities.

c) The competent ministries and the authorities responsible for national deposit guarantee schemes, if these authorities are not included under b).

d) The EBA (without the right to vote).

e) On their own request, and as observers, the resolution authorities of subsidiaries or branches in third countries that are classified as significant in the EU may be invited.

In the case of global systemically important banks (GSIBs), crisis management groups (CMGs) have also been created. These are fora in which it is sought to reach specific agreements, exchange information and coordinate action with the resolution authorities of third-country non-EU members in which the institution or group in question has a significant presence.

– Communication of the joint decision outcome to the parent company.

– In any event, if the resolvability analysis were to infer there were major impediments to resolvability, the joint decision process for the Resolution Plan would be suspended. Before that, the joint decision on the existence of major obstacles to resolvability and, where appropriate, the measures to be adopted, would be approved.

In the case of the setting of the MREL requirement, the phases of the process will be similar to those above. Consequently, the resolution college will generally take advantage of the same meeting to also propose the joint decision on the MREL requirement.

Throughout this process, the EBA will contribute to promoting and overseeing the correct functioning of colleges, focusing on cross-border aspects, monitoring the proper application of the related EU regulations and standards, and cooperating on identifying major impediments to resolvability.

With a view to achieving these objectives, a mediator role is reserved for the EBA, in light of the potential disagreements there may be among the various European resolution authorities involved in the process.

Currently, the Banco de España participates in nine resolution colleges. Three of these relate to institutions with a parent in Spain, and six to institutions with their central headquarters in other Member States.

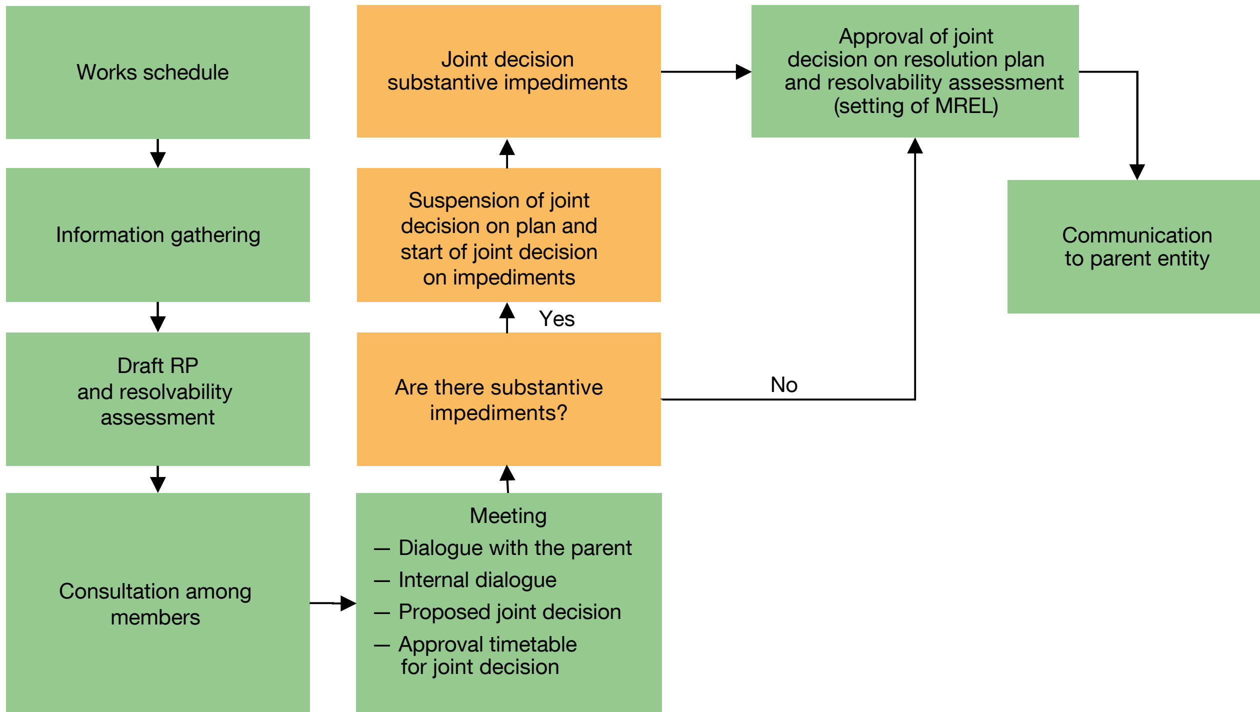
6 Challenges pending

In the current context, and despite the considerable advance the new SRB regulatory and institutional framework represents for facing future crises, a series of challenges remains pending, including most notably:

– The need to have a stable regulatory framework. In this respect, the Directive on the recovery and resolution of credit institutions and investment services firms,

RESOLUTION COLLEGE PROCESSES

SCHEME 7



SOURCE: Own elaboration.

which is one of the regulatory reference points in the field of resolution, has already been subject to revision just a few years after its adoption. This will probably entail changes in various aspects relating to resolution planning, e.g. as regards MREL requirements.

- Headway must continue to be made on ensuring the resolvability of institutions through the removal of any major obstacles, and on the progressive setting of MREL requirements that will enable banks' loss absorption capacity and recapitalisation to be ensured whenever necessary.

- Mechanisms must be reinforced or new ones created so that the liquidity requirements that may arise in cases of resolution may be effectively addressed. In that way, the resolution arrangements adopted will be effectively implemented.

Admittedly, the challenges indicated are not minor ones. But foreseeable regulatory stability in the near future and active involvement by the most significant institutions at the European level will surely contribute to strengthening and overcoming the difficulties inherent in the creation of new regulatory and institutional frameworks, as is the case of the new resolution framework.

7 Conclusions

Since 2015 the Banco de España has been preparing resolution plans for Spanish banks and collaborating with other resolution authorities in the preparation of resolution plans for foreign credit institutions with a presence in Spain.

Thanks to this it has been able to: obtain detailed information on the complexities of banks' internal structures and interdependencies, especially in the case of banking groups; identify the core functions performed by banks that should be maintained in the event of

resolution; and explore the resolution strategies and tools that best fit each particular case. Further, it has been possible to identify potential obstacles to the practical implementation of the plans proposed, with work under way on adopting measures for their elimination. In turn, MREL requirements are being quantified and the terms for attaining compliance therewith are being determined.

In Europe, some regulatory aspects are admittedly still pending implementation. But notable progress is being made on numerous fronts that will contribute to attaining those resolution objectives already established and, ultimately, to the credibility of the regulatory commitment whereby bank losses should be borne by their shareholders or capital instrument-holders and by their creditors, depending on hierarchy. It is wished hereby to minimise or avoid costs for the public coffers arising from future bank crises and, moreover, to contribute to lessening the likelihood of a crisis occurring. It should be borne in mind, within the framework of the bail-in, that it is those responsible for decision-making on assuming risks who must also most directly and immediately bear the consequences.

Despite the fact that there is a learning curve and that improvement-related aspects will require some time, both the authorities and financial institutions are progressively assigning greater resources and means to allow for the planning of any future resolution. Work is under way on identifying, minimising and removing the obstacles that might affect resolution in various areas. This includes ensuring business continuity, improving the preparation and reporting of information needed for decision-taking in the event of resolution, the simplification of complex legal structures, the establishing of MREL requirements that enable the effects of the crisis to be absorbed, etc. All these factors are contributing to improving the resolvability of institutions and to smoothing the practical implementation of the new regulatory framework, which reasonably ensures that, if necessary, banks may be resolved without significantly affecting financial stability and the economy.

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