Planning for EU bank resolution still missing some key elements

The Single Resolution Mechanism (SRM) is the EU system for the orderly winding-up of failing banks within the Banking Union, to avoid costly bail-outs. Since its establishment in 2015, the SRM has progressed in preparing for bank resolution, according to a new European Court of Auditors (ECA) report. However, the auditors find that further steps are needed in certain crucial areas. The Single Resolution Board (SRB) should put in place all relevant policies shaping resolution actions, and address weaknesses in the quality, timeliness and consistency of its own resolution planning. Other essential issues, such as funding in resolution and harmonisation of national insolvency proceedings for banks, need to be resolved by the legislators.

The SRM legal framework provides tools for winding up banks, once the resolution authority - the SRB in the case of significant and cross-border banks, and the national resolution authorities (NRAs) in that of less significant banks in their respective jurisdictions - has decided that a failing bank cannot undergo normal insolvency proceedings under national law. To prepare for such an eventuality, the authorities are required to draft resolution plans for every bank and, as a general rule, update them annually.

“The SRM has made progress over the last years but further steps are needed to properly plan the orderly winding-up of failing banks”, said Rimantas Šadžius, the ECA Member responsible for the report. “We found that the policies did not yet address all relevant areas and revealed weaknesses. The resolution plans improved in quality but weren’t always in line with the requirements. Moreover, the SRB has not properly identified and dealt with obstacles to a bank’s resolvability. Remediing these shortcomings would help to ensure that taxpayers do not foot the bill once again”.

The choice of resolution tool and its effectiveness depend on, among other things, whether the substantive impediments to a bank’s resolvability have been addressed or removed. Yet, the auditors observe, the SRB has refrained from determining any such impediments to date, thus failing to comply with the harmonised rules. In April 2020, the SRB issued its “Expectations for Banks”, requiring them to “Expectations for Banks”, requiring them to strengthen certain aspects of their resolvability by the end of 2023. However, the legislators have not specified any such timeline.
Meeting liquidity needs in resolution remains an issue of concern and may restrict the options for resolving a bank in the most efficient manner. Even though the Eurogroup recently decided to reform the European Stability Mechanism and set up a common backstop for the Single Resolution Fund, the backstop might be insufficient to provide funding. The SRB is also yet to adopt its associated policy on “financial continuity”.

Important policies missing at SRB level include solid governance and information-sharing during bank resolution, given the need for extremely urgent decision-making. According to the auditors, consistent treatment of banks is yet to be achieved, owing to divergences in, for instance, assessing critical functions and the public interest. Moreover, despite the recommendation in the auditors’ report on their 2017 audit of the SRB, policies were still not binding on internal resolution teams (comprising SRB and NRA staff), allowing them considerable discretion in drafting resolution plans. There were also delays in the SRB’s adoption of resolution plans for banks under its remit.

The auditors point to other key issues concerning the legislators: the need for better alignment between the resolution framework and the various national insolvency frameworks applicable to banks; the fact that the rules on burden sharing and State aid differ according to the option chosen (resolution or insolvency) to deal with a failing bank. Lastly, the auditors recommend that the legislation lay down objective and quantified thresholds for triggering early intervention measures and reaching the decision that a bank is failing or likely to fail.

Background information

This audit followed up on issues identified in the ECA’s first report on the SRB’s resolution planning policies, while focusing specifically on resolution plans for less significant banks, and is available at eca.europa.eu in 23 EU languages.

The ECA is required to report annually on any contingent liabilities arising from the SRM’s performance under the SRM Regulation, and the 2019 report is here. EU oversight of State aid to banks is also the subject of a recent ECA report.

A recent publication by the Contact Committee of the EU supreme audit institutions outlines the findings of parallel national audits on banking resolution carried out in seven Member States.

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