Opinion of the European Economic and Social Committee on the 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the European Central Bank on Bank Resolution Funds'

COM(2010) 254 final

(2011/C 107/03)

Rapporteur: **Ms ROUSSENOVA**

On 26 May 2010 the Commission decided to consult the European Economic and Social Committee, under Article 304 of the Treaty on the Functioning of the European Union, on the

Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the European Central Bank on Bank Resolution Funds

COM(2010) 254 final.

The Section for the Single Market, Production and Consumption, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 1 February 2011.

At its 469th plenary session, held on 16 and 17 February 2011 (meeting of 16 February), the European Economic and Social Committee adopted the following opinion by 193 votes with four abstentions.

1. Conclusions and recommendations

1.1 **The EESC shares the Commission's main concern that taxpayers' money should not be used again to cover bank losses and supports in principle the establishment of a harmonised network of national ex-ante bank resolution funds (BRF) linked to a set of coordinated national crisis management arrangements. However, the EESC is concerned that in order to establish a workable bank resolution funds scheme, Member States should agree beforehand on the adoption of common methods and uniform rules in order to avoid distortions of competition.** The current signs seem to give the opposite impression. Quite a few Member States have already launched or are planning fiscal measures to replenish their meagre budgets or to strengthen their markets: an uneven playing field is already in place. Looking realistically at the current situation, and in view of past experiences, it is **difficult to be optimistic** about a solution being found rapidly. A more gradual approach might perhaps allow some of these differences to be reduced over time.

1.2 As regards **competition**, maintaining a level playing field at national, European and worldwide level should always be a primary objective. Now, the BRF scheme as it is currently conceived risks having disruptive effects at national level, by affecting only a part of the financial sector, at EU level, by imposing new charges on some national sectors that are already weak, and worldwide, because it is unlikely that a consensus can be reached at G-20 level.

1.3 **A major concern is the macroeconomic scenario**. All national and international authorities are putting pressure on the banking sector to ease the situation by granting more credit to the real economy. New prudential rules, new capital requirements and new taxes are estimated to be necessary and the authorities should seek to achieve a reasonable balance between the **contrasting need of capital in support of the national budget and the need of real economy**. At present, the BRF scheme is too vague to allow any precise calculations to be made in order to provide the necessary investments in production, growth and jobs. It is difficult to have benefits both ways without appropriate prioritisation and timing for implementing each stage of the proposed BRF scheme.

1.4 The EESC believes that before any steps are taken to introduce bank levies, the Commission should conduct a thorough assessment of the cumulative effects of levies and BRFs and take into consideration our concerns expressed above, especially those in point 1.3. Making a decision on introducing BRF requires an estimation of how much the entire scheme would cost, to what extent it would impact the lending potential of the banking sector, and how long it will take before the BRF is made strong enough or it reaches its target size. The EESC recommends tailoring these estimates to a worst case scenario in order to make sure that the scheme is realistic and workable in a crisis period when, on the one hand, banks will face difficulties making their contributions to the BRF, and on the other hand, this will be the time when the funds' resources will be needed.

2. Introduction

2.1 The European Commission welcomed the message that emerged from the G-20 meeting in Pittsburgh in September 2009, namely that taxpayers' money should not be used again to cover bank losses, and is working to achieve this aim in at least two complementary ways:

a) by reducing the probability of banking failure through stronger **macro and micro-economic supervision, better corporate governance and tighter regulatory standards**; and

b) by ensuring that if, in spite of these measures, failure does occur, **appropriate tools - including sufficient resources - are available for orderly and timely resolution**.

2.2 COM(2010) 254 final explains the Commission's thinking on how the financial sector could contribute to the cost of financing the resolution of failing banks within the overall set of tools for crisis prevention and management. The Commission believes that *ex ante* Bank Resolution Funds (BRFs) funded by levies on banks should be part of a financial stability framework and broader reforms to the financial system focusing on prevention. They are considered to be the appropriate instrument for intervening in, and resolving failing banks in a way that minimises the costs of bank failure to the public. The Communication explains the purpose, potential size, and the conditions under which BRFs might be established.

2.3 The objective of the European Commission is to introduce an EU approach to BRF and ultimately to set up a pan-EU Resolution Fund as a highly desirable solution. However, the Commission believes that it would be very difficult to begin with the creation of a pan-EU Resolution Fund **in the absence of an integrated EU supervision and crisis management framework. For that reason, an appropriate first step is considered to be the creation of a system based around a harmonised network of national *ex ante* resolution funds linked to a set of coordinated national crisis management arrangements**.

2.4 The EESC welcomes any proposals aimed at strengthening the financial sector and preventing future crises and in this context approves **in principle** the Commission's initiatives and recommendations for an EU approach to BRFs as expressed in COM(2010) 254 final, but at the same time it has some concerns. The EESC realises that at this stage some of the initiatives might not be applicable and acceptable for some Member States, while others require additional consideration, analysis and clarification.

2.5 The objective of the new crisis management and prevention framework will be to make sure that, in the event of major banking failures, Member States will have common tools that can be applied in a coordinated manner to protect the broader financial system, avoid costs for the taxpayers and ensure a level playing field. These **common resolution tools** are expected to ensure that orderly failure is a **credible option for any bank**, ***irrespective of size or complexity***. The concept of **dimensions** is important. While in principle 'all' orderly failures should be guaranteed, what is important is **to define the concept of a 'major' or 'large scale' failure. Very large and complex financial institutions** (namely, international groups, not necessarily all-European or Europe-based) **may pose challenges**. Larger scale failures may require different treatment, possibly entailing maintaining the legal entity as a going concern through restructuring, debt write-downs and dilution/wipe-out of shareholders. Some additional funding from a fund might be needed as part of the package of measures.

2.6 On 20 October 2010, the Commission adopted a roadmap setting the timetable, measures, tools and plans for a complete EU framework for crisis management. In spring 2011, the relevant legislative proposals on crisis management and resolution funds are to be presented. At this stage we can have only some preliminary expectations and remarks. The **starting date** is to be established by a Directive, provided that it is approved. An educated guess, taking into account the circumstances and the Commission's promise to approve the relevant legislative proposals by spring 2011, might suggest a date of, at best, 2013-2014. Any fund will take time to reach its target size but, as it will incorporate *ex post* as well as *ex ante* funding, in theory it would be operational as soon as the legislation is in force in the Member State. However, we should bear in mind that some Member States have announced that they are not planning to introduce bank levies in the short term because their banking sectors have not been seriously affected by the crisis and still remain stable. The BRF is then to be considered as a **tool for coping with financial crisis in the medium to long term**.

3. Specific comments

3.1 *The approach to BRFs*

3.1.1 **The EESC approves the Commission approach proposing, as a first step, the setting-up of a harmonised network of national BRFs linked to a set of coordinated national crisis management arrangements**. However, at the same time it recommends that the network of funds be established **gradually and considering carefully the specific features of each Member State**. Germany and Sweden have started working on their own funds, which would collect the money raised from levies/contributions. **Each of them has its own method and rules for establishing the fund and at this stage the EESC cannot suggest which rules should be preferred**.

3.1.2 In view of the fact that some countries are already introducing country-specific bank levies, taxes, and systems, the EESC believes that, as a **very first step, some common basic principles and parameters for the levies should be discussed and agreed upon** in order to avoid distortions of competition within the EU financial sector. The EESC is in favour of a gradual approach that distinguishes between the short-term and the medium-term objectives [1]. In the short term, Member States should be expected to reach some agreement on the base of the levy, its rate and scope, while allowing for some degree of flexibility in view of the ongoing changes in the regulatory framework and developments towards a higher degree of harmonisation. After that, a gradual phasing-in approach for introducing a simple and appropriate levy could be considered, followed by the introduction of a more harmonised system of bank levies and BRFs.

3.1.3 The EESC considers the gradual approach more appropriate and realistic as it has the potential of reflecting both the different ways in which the financial crisis has affected different Member States and the specifics of their response to the crisis:

— The various Member States entered the crisis at different points in time, and have been affected in different ways and to a different extent. They are coming, or will come, out of the crisis at different times, and the moments when they will be capable of setting up their own BRFs will vary.

— The financial sectors of some Member States have not been seriously affected by the financial crisis, and they have not called for aid. Instead, their real economies have been hit by the global financial and economic crisis, with some time lags. Their banking sectors, though sound, are still struggling to avoid any crisis developments, while at the same time they are expected to support recovery. Such countries might be reluctant to establish national BRFs at a stage when most Member States would be ready to do so, also because some of them have deposit guarantee funds (DGF) that go beyond deposit guarantee schemes (DGS) and include some bank resolution functions.

3.1.4 The EESC welcomes the Commission's intention to explore the 'potential synergy between DGS and resolution funds', expressed in COM(2010) 579 final. The Committee believes that if the basis on which the DGF are currently funded is broadened, the deposit guarantee and bank resolution functions could be fulfilled by one fund, without jeopardizing the ability of the DGS and its funds to meet its depositors' protection objective. This exploration is highly appropriate for those Member States whose DGF already have some preventive and resolution functions, merging in one enlarged fund both scopes.

(1) See Economic and Financial Committee Ad Hoc Working Group on Crisis Management, 17 September 2010.

3.1.5 The EESC understands the Commission's arguments in favour of a pan-EU Resolution Fund, as well as its concerns about the difficulties involved in setting one up, and considers its establishment premature and inapplicable at this stage. Bearing in mind past and recent experiences, the EESC has doubts about how efficiently a single EU Resolution Fund might work.

3.2 *Financing BRFs: the Levy*

3.2.1 **The Commission considers that BRFs should be financed by contributions or levies, paid by banks**. **An agreement was reached by the European Council on 17 June 2010 that bank levies should be part of a credible resolution framework** [2] **and this should be one of the principles to underpin their introduction**

3.2.1.1 While the Communication explains that the primary objective of the levy should be to make banks contribute to the costs of the crisis, mitigate systemic risk, limit distortions of competition and raise funds for a credible resolution framework, it fails to give a clear definition of it. A document [3] by the Economic and Financial Committee defines the term 'levy' as a 'charge (either a fee or tax) on financial institutions to make them contribute to the costs of financial crisis': a levy is considered to be a fee when aimed at a fund outside the budget and a tax when part of the government budget. The EESC expects the Commission to give a clear definition of the term 'levy'.

3.2.2 **The EESC considers the criteria for the levy base, as well as the levy rate, to be one of the main obstacles to reaching a general agreement and is convinced that as a first step several basic principles should be agreed upon**. The EESC shares the Commission's view that the levy base should comply with the principles enumerated in the Communication, p.8. It should be recognised that national financial sectors vary as regards **their size, governance systems, efficiency of supervision, and level of risk**. Based on these differences, initially Member States could be allowed the flexibility to consider different levy bases but afterwards the levy base should be harmonised.

3.2.3 **The Communication considers that contributions/levies could be based on three things: banks' assets, banks' liabilities and banks' profits and bonuses**. As the assets and liabilities of the balance sheet capture risk considerations better than other indicators, the EESC considers banks' profits and bonuses a less appropriate base for banks' contributions. Each of the first two bases for levies has its pros and cons, and perhaps a combination of both would have some merit.

(2) European Commission, Internal Market Services DG, Commission Services Non-Paper on Bank Levies for Discussion at the EFC Meeting on 31 August 2010, p. 4.

(3) Economic and Financial Committee, Ad Hoc Working Group on Crisis Management.

3.2.3.1 **Banks' assets are good indicators of their risks**. They reflect both the potential likelihood of a bank failure and the amount which might have to be spent in handling the bank's resolution. Risk-weighted assets, as suggested by the IMF ([4]) could also be considered an appropriate base for levies, as they have the merit of international comparability, given the broad acceptance of the Basel capital requirements. On the other hand, since banks' assets are subject to risk-weighted capital requirements, a levy based on them would duplicate the effects of the Basel Committee capital requirement.

3.2.3.2 **The EESC believes that banks' liabilities,** excluding guaranteed deposits and bank capital (e.g. tier one for banks) and including some off-balance sheet items, are probably the most preferable base for banks' contributions/levies ([5]). They are a good indicator of the costs that might have to be covered when facing the need to resolve a bank, they are simple, and, though some overlap cannot be excluded, they would not overlap as much as the asset-based approach ([6]). Other liabilities could also be excluded: subordinated debt, government guaranteed debt and intragroup debt transactions. However, bearing in mind that Member States have already introduced country specific systems of levies whose levy bases differ considerably, an initial harmonised approach, based on all the liabilities and their previous qualitative evaluation, might be more acceptable.

3.2.4 The EESC endorses the Commission's understanding, expressed in COM(2010) 579 final, that each BRF should receive contributions from institutions licensed in the same Member State, and the contribution should cover their branches in other Member States. Thus subsidiaries would be subject to host-state levies and branches would be subject to home-state ones. If all Member States raise levies on financial institutions following these principles, the risks of double charging and competitive distortions could be avoided.

3.2.5 **The EESC insists that the timing of the levy's introduction should be considered carefully in view of the challenges both banks and the economy are facing now**. After a period of severe financial crisis banks are usually risk averse and remain reluctant to lend for a couple of years despite the efforts of all national and international authorities to encourage them to assist economic recovery. At the same time banks have to bear the costs of new capital and liquidity requirements. Financial institutions could be granted an adequate transition period, consistent with the assessment recommended by the EESC in point 1.4 above, in order to strengthen their capital base, adjust to the new regulatory regime and finance the real economy. In the medium-term certain adjustments of the rate might be appropriate in order to take account of any future regulatory developments as well as the development of the EU resolution framework.

3.3 *Scope and size of BRF*

3.3.1 **The scope and size of BRF depend on how the Commission determines the task of funds to finance the orderly resolution of distressed financial entities, including banks**. The EESC supports the Commission's view that resolution funds should be available for the resolution of banks, but their use to bail out institutions should be clearly excluded. However, the EESC considers it unacceptable that the crisis resolution framework developed by the Commission **focuses mainly on the banking sector**, as all financial institutions may be dangerous for investors when they take high risks. The EESC recommends that **all** banks and **all supervised financial institutions** (with the exception of insurance entities, for which a separate scheme is currently being prepared) should be part of the resolution framework ([7]). This is to ensure that there is a level playing field and also to avoid sending a misleading signal to public opinion that only one segment of the financial community is to blame for the crisis.

3.3.2 The Communication has not yet indicated what size funds should be – but has indicated that the financial sector should bear all the resolution costs – if necessary through *ex post* financing arrangements. The problem will be how to **calculate the appropriate target size**, country by country. Here we see two problems: one is that **the weakest systems will call, proportionally, for the highest contributions**, thus raising concerns about whether the playing field is level. The other is the timeframe used for calculations: the **target limit is calculated on the basis of current and prospective situations**. Before the target limit is attained, the situation may have changed substantially, thus making it necessary to adjust both the target and the contributions. Rules should take account of **possible changes of the initial conditions and calculations**. In addition, as risks vary over the cycle, the levy rate would have to be adjusted so as to help make the financial system less pro-cyclical.

([4]) IMF, A Fair and Substantial Contribution by the Financial Sector, Final Report for the G-20, June 2010, p. 17.

([5]) The IMF expresses preference for a broad set of liabilities, including some off-balance sheet items but excluding capital and insured liabilities. The Commission also supports the market liabilities-based approach in its non-paper of 20 August. Four Member States have already adopted an approach, based on differentiated-liabilities.

([6]) The Basel Committee proposals oversee liquidity and transformation risks undertaken by banks.

([7]) In COM(2010) 579 final the Commission promises to apply the EU framework for crisis management in the financial sector to all credit institutions and some investment firms without giving a clear definition of investment firms. The EESC believes that the resolution framework should be applied to all. supervised financial institutions.

3.4 *Independence and Governance of BRFs*

3.4.1 **The EESC approves the Commission view that BRFs should remain separated from the national budget. The EESC agrees that their functional independence from government would ensure that they only cover resolution measures, and nothing else**. However, Member States are currently pursuing two different approaches for allocating the funds raised from the financial sector. Countries such as Germany, Belgium and Sweden rely on the principle that a clear link should be established between the pay-in and pay-out side of the resolution mechanism. Other countries allow funds raised from the levy to be absorbed by the general budget as no explicit link to the resolution framework for the financial sector is intended. Arrangements which create expectations that financial institutions might receive support from the government could jeopardise the objective of the proposed framework, which is to introduce an orderly resolution of distressed financial institutions, excluding the use of taxpayers' money. The EESC shares the Commission's view that establishing dedicated resolution funds may result in diminishing the dependence of the financial sector on public funds and reduce the moral hazard problem associated with 'too big to fail' institutions. The EESC takes the view that, as with deposit guarantee funds, the money raised from the levy should be under the control and governance of authorities other than those responsible for fiscal matters, i.e. those in charge of ensuring the governance of the Financial Stability Framework.

3.4.2 Before a final decision is taken about the governance of the BRF, clear answers have to be given to the following questions:

— Is the fund part of the prudential regulation? or

— Is it conceived as a fiscal measure, aimed at asking the financial sector to contribute to the recovery of public money spent? or

— Is it a mere fiscal move, aiming at a more transparent market by fighting financial speculation?

If the Commission views the BRF as a para-fiscal measure and part of a financial stability framework, it should make sure that this is well understood, because a correct governance of the BRF cannot be established unless there is a clear idea about its nature.

Brussels, 16 February 2011.

The President
of the European Economic and Social Committee
Staffan NILSSON