EBERHARD KARLS
UNIVERSITÄT
TÜBINGEN

Proportionality at the resolution stage: Calibration of resolution measures and the public interest test

Conference on Proportionality
in European Banking Regulation

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Prof. Dr. Jens-Hinrich Binder, LL.M.

Outline

I. Where and how? The role of proportionality under the BRRD

II. Why? The functions of the public interest test (Art. 32(5) BRRD, Art. 18(5) SRM Reg)

III. The application of the principle within the institutional setting of the SRM

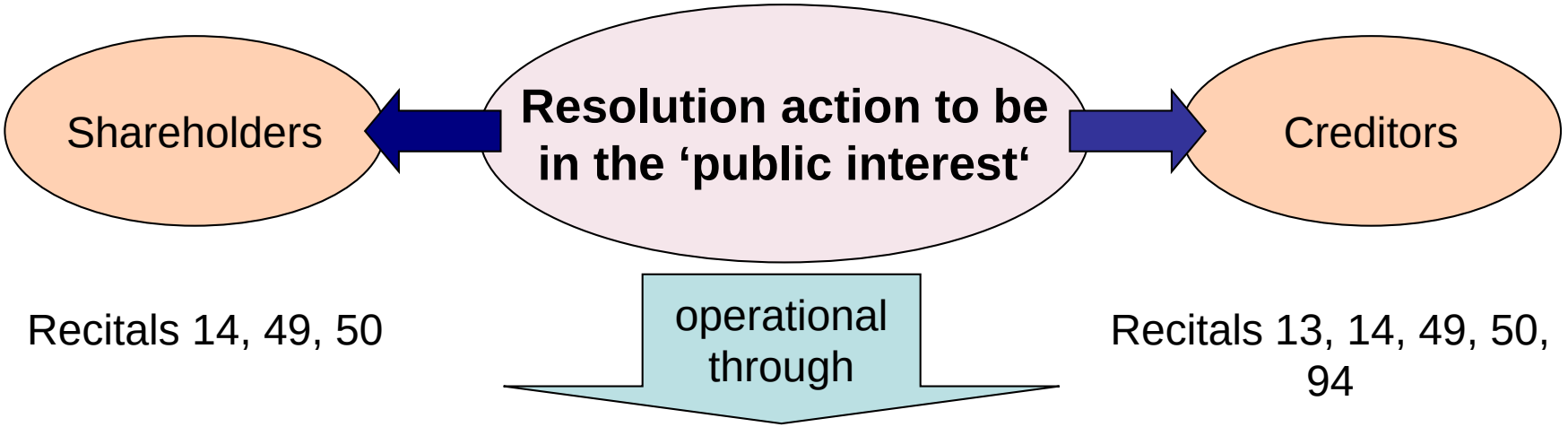
IV. Conclusions

Conditions for "Resolution"

- **Art. 32 (1) BRRD (cf. Art. 18(1) SRM Reg):** resolution action to be taken only if the following conditions met:
  - institution is determined by Competent Authority, or Resolution Authority after consultation with Competent Authority, to be **failing or likely to fail**
    - note further specification in Art. 32(4) BRRD (Art. 18(4) SRM Reg)
    - additional specification in EBA Guidelines of 6 August 2015
  - **proportionality:**
    - no other option, including early intervention or write down or conversion of capital instruments, likely to prevent failure
    - application necessary in the **public interest** (Art. 32(5) BRRD: if proportionate to objective and if traditional winding up (liquidation) of bank would not meet objectives to same extent)

Where and how?

- **Two dimensions:**



Where and how?

Shareholders

Creditors

'Resolution objectives'
(Art. 31(2) BRRD /
Art. 14(2) SRM Reg),
in particular:

- preserving critical functions
- preventing contagion
- protecting public funds

?

The winding-up counterfactual:

Ordinary winding-up

(general insolvency law or special bank insolvency law)

The insolvency counterfactual: what for?

- **So why resolution (only) as ultima ratio?**
- **cf. COM Draft**, 6 June 2012, COM(2012) 280 final, p. 5

  "(…) the experience from different banking crises indicates that insolvency laws are not always apt to deal efficiently with the failure of financial institutions insofar as they do not appropriately consider the **need to avoid disruptions to financial stability, maintain essential services or protect depositors**. In addition, insolvency proceedings are lengthy and in the case of reorganization, they require complex negotiations and agreements with creditors, with some potential detriment for the debtors and the creditors in terms of delay, costs and outcome."

- **In line with pre-crisis view:** "banks are special" – also with regard to procedural design of bank insolvency laws?!

The insolvency counterfactual: what for?

- **The implications of resolution and winding-up compared**
  - **Shareholders:** dilution in both resolution and winding-up scenarios
  - **Creditors:**
    - ‘no creditor worse off‘ (Art. 34(1)(g) BRRD / Art. 15(1)(g) SRM Reg)
    - but (cf Binder, The Position of Creditors Under the BRRD, 2016):
      - valuation problems
      - no participation in decision making process during resolution
      - restricted access to legal redress (cf Arts. 85 and 86 BRRD)
  - **Public interest?**
    - witness US experience: the costs of alternative means of resolution

Some preliminary conclusions

- **Assessing proportionality:** the complex task of balancing shareholder, creditor and (public) stakeholder interests
  - cf. ‘normal bankruptcy‘: shareholders vs. creditors
- **It’s the creditors‘ rights that matter most:** the public interest test as a means to calibrate the application of the toolbox in order to avoid
  - unjustifiable infringements on creditor rights
  - inefficient allocation of resolution efforts / costs

Some preliminary conclusions

- **Problems?**
  - the vagueness of the standard
  - residual differences on policy in Member States, e.g.
    - Monte dei Paschi
    - Hypo Alpe Adria / HETA
- **And remedies?**
  - further specification of proportionality criteria through EBA guidelines, RTS…?
  - or rather further centralisation of decision-making powers?

Any differences in the SRM?

- **In terms of substantive law:** no!
- **But note the procedural nature of proportionality requirements:**
  - Proportionality does NOT mean (just) one possible solution!
  - The relevance of the process:
    - Who decides?
    - What are the facts?
    - And, above all, how are they evaluated, given the decision-maker‘s preferences (and biases)?

➔ The SRM as basis for more ‘pure‘ proportionality assessments!?

Key observations

- The function of proportionality in the area of bank resolution is more complex than in other areas of bank regulation, given the need to reconcile creditor rights with the public interest in preserving financial stability and preventing contagion.
- Against this backdrop, the ‘public interest test’ should be interpreted as a key instrument to restrict the application of the resolution toolbox to cases where public interest concerns do justify the inevitable infringement of individual creditors’ rights.
- The application of the principle can be fraught by national biases, resulting in economically inefficient results and/or in infringement on stakeholder rights that are not justified by objective systemic stability concerns.
- The centralisation of decision-making powers within the SSM (ideally at least) can help to reduce the influence of such biases and improve efficiency and legal certainty (“reliable proportionality“) especially in cross-border cases within the Monetary Union.