

Legal issues, practical concerns and cultural challenges in banking union

Contribution by

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Overview

- ❑ Safety of deposits by natural persons: the legal texts
- ❑ Review and judicial protection under banking union
- ❑ Transparency of supervisory practices in banking union
- ❑ Cultural challenges for banking union



Do I get my money back?



Safety of deposits: legal texts

- Eurogroup agreement on ESM direct bank recapitalisation instrument
- Bank Recovery & Resolution Directive
- SRM Regulation
- Banking Communication 2013

Is my money safe at European banks?

Reflections on the bail-in provisions in recent EU legal texts

René Smits

Capital Markets Law Journal, (2014) 9 (2), pp. 137-156

Deposit Guarantee Directive - 1

Directive 2014/49, OJ No. L 173/149, 12 June 2014

- Article 2:
 - (4) ~~eligible~~ deposits means deposits that are not excluded from protection pursuant to Article 5;
 - (5) ~~covered~~ deposits means the part of eligible deposits that does not exceed the coverage level laid down in Article 6;
- Article 5 contains the list of deposits excluded from guarantee: the ineligible deposits
- Article 6 contains the coverage level: ” 100,000 for each depositor

Deposit Guarantee Directive - 2

FAQs of the European Commission, 15 April 2014,
available at: http://europa.eu/rapid/press-release_MEMO-14-296_en.htm?locale=en

“ **What is the treatment of covered depositors under bail-in?**

“ Covered deposits are explicitly excluded from the bail-in regime. This means that covered depositors will never suffer any losses and their deposits will always be protected up to the coverage level of ” 100 000.

Deposit Guarantee Directive - 3

On a pan-European DGS, the FAQs say the following:

- “ **Should we have a pan-European Deposit Guarantee Scheme in the EU?**
- “ A pan-EU DGS is not currently under discussion. The text opens the way to a voluntary mechanism of mutual borrowing between the Deposit Guarantee Schemes from different EU [States]. This is the only form of mutualisation foreseen at this stage.
- “ The pan-European Deposit Guarantee Scheme could be a potential option in the future once the current banking reforms (e.g. BRRD Bank Resolution and Recovery Directive) have been implemented and the other elements of the banking union such as the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM) are in place.
- “ That said, the new Directive stipulates that 5 years after its entry into force, the Commission will submit a report, and, if appropriate, could put forward a new legislative proposal.

BRRD - 1

- Establishes a framework for the recovery and resolution of credit institutions and investment firms
- 28 Member States powers of resolution harmonised
- Groundwork for single resolution regime in Euro Area (Single Resolution Mechanism, 2nd element of banking union)
- Early intervention and resolution tools in the absence of harmonised insolvency regulation for financial firms
- In line with G20 / FSB calls for Living Wills and resolution regimes for significant financial institutions ([G]SIFIs)
- Continuity of critical functions of banks (societal function)

BRRD - 2

- Resolution objectives (Art.31 (2) BRRD):
 - (a) to ensure the continuity of critical functions;
 - (b) to avoid a significant adverse effect on the financial system, in particular by preventing contagion, including to market infrastructures, and by maintaining market discipline;
 - (c) to protect public funds by minimising reliance on extraordinary public financial support;
 - (d) **to protect depositors covered by Directive 2014/49/EU and investors covered by Directive 97/9/EC;**
 - (e) to protect client funds and client assets.
- Resolution tools include ~~the~~ bail-in tool

BRRD - 3

- General principles governing resolution (Art. 34 BRRD):
 - a) Shareholders bear first losses
 - b) Creditors bear losses in order of priority of their claims under normal insolvency proceedings
 - c) Management to be replaced (unless needed for resolution)
 - d) Management to assist in resolution
 - e) Those responsible for bank's failure made liable
 - f) Creditors of same class treated equitably
 - g) ~~No~~ creditor worse off [than under insolvency] principle
 - h) **Covered deposits are fully protected**
 - i) Resolution action taken in accordance with BRRD's safeguards

BRRD - 4

- **Bail-in tool** (Art. 2 (1) (57) BRRD):
bail-in tool means the mechanism for effecting the exercise by a resolution authority of the write-down and conversion powers in relation to liabilities of an institution under resolution in accordance with Article 43
- Clear intention of legislator to minimise taxpayers' contribution to bank rescue, and to reap benefits for them. Quotes from the preamble:
*A failing institution should be maintained through the use of resolution tools as a going concern with the use, to the extent possible, of **private funds**.+Resolution's aims include: %to protect public funds by **minimising reliance on extraordinary public financial support** to failing institutions.+%d) the resolution tools should be applied **before any public sector injection of capital** or equivalent extraordinary public financial support to an institution.+%Responsibility and assumption of risk should be accompanied by **reward**.+*

BRRD - 5

- Exclusion from the bail-in tool (Art. 44 (2) (a) BRRD):
 2. Resolution authorities shall not exercise the write down or conversion powers in relation to the following liabilities whether they are governed by the law of a Member State or of a third country:
 - (a) **covered deposits**;
(\tilde{o})
- Also, Art. 108 BBRD requires priority ranking in national insolvency proceedings for covered deposits
- ***108 defined terms, 132 provisions, 158 pages, and even then no single system of resolution of banks since national insolvency law (harmonised to limited extent) prevails***

Administrative review against ECB

- ECB-internal review process
- ~~an~~ optional review for persons to whom a decision of the ECB under Regulation 1024/2013 is addressed, or to whom such decision is of direct and individual concern, before bringing proceedings before the Court of Justice+ (paragraph 4, preamble, ECB Decision 2014/16)
- Direct recourse to CJEU possible (Art. 24 (11) SSM Regulation and Art. 19 ECB Decision 2014/16)
- NB prior ~~to~~ review of draft supervisory decisions (Art. 31(5) SSM Framework Regulation: right to be heard)

Administrative Board of Review

- An ECB-internal review board
- 5 (+ 2 alternates) independent and experienced members, appointed by Governing Council for 5 years
- ECB to assist Board with legal expertise, also on ECB powers under SSM Regulation
(Art. 6(3) Decision ECB/2014/16 establishing Board and setting out Operational Rules)

Administrative review proceedings - 1

- Applicant files notice of review within 1 month
- Applicant may request suspensive effect of review
- Suspension of decision *may* be granted by Governing Council upon Administrative Board of Review proposal if review request is admissible and not %obviously unfounded+and %immediate application of the contested decision may cause irreparable damage+
- Scope of review: %the relevant decisions\$ procedural and substantive conformity with Regulation 1024/2013+and limited to grounds submitted by applicant, so:
 - no application of wider principles or provisions
 - no ex officio widening of review grounds

Administrative review proceedings - 2

- Administrative review only once: new decision after review can be contested in judicial review only
(Art. 11(2) ECB Decision 2014/16 and Art. 24 (7) SSM Regulation)
- Closed oral hearing between applicant and ECB possible
- Evidence: written statements, witnesses, expert opinions
- Access to file except for confidential information
(correspondence between ECB and NCAs excluded)
(Art. 20(3), (4), (5) ECB Decision 2014/16)
- Review opinions to be adopted by 3 of 5 Board members
(Art. 24 (3) SSM Regulation and Art. 16(3) ECB Decision 2014/16)

Administrative review proceedings - 3

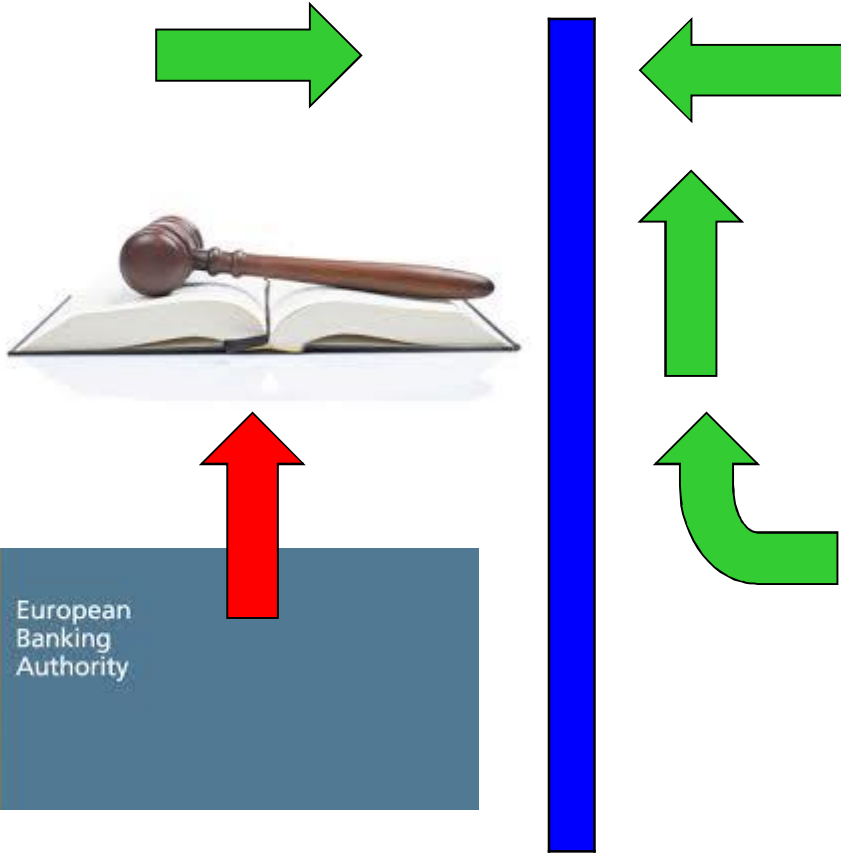
- Non-binding opinion within 2 months of application to Governing Council: abrogate, maintain, amend decision
- Supervisory Board receives opinion and prepares new decision for submission to Governing Council
- Review Board opinion, draft decision Supervisory Board, decision of the Governing Council notified to parties
- Costs in case of unsuccessful review applications!
(Art. 21 ECB Decision)

Challenging EBA and ECB

Different approach to challenges:

internal review (ECB) vs. Joint Board of Appeal (EBA, ESMA, EIOPA)

- Independence of review and appeal the same
 - Art. 24(4) SSM Regulation: %The members of the Administrative Board of Review shall act independently and in the public interest.+
 - Art. 58(6) EBA Regulation: %The members of the Board of Appeal shall undertake to act independently and in the public interest.+
- Assessment of use of powers: ECB to provide Review Board with input; Joint Board of Appeals to have its own expertise on board
 - Art. 58 (2) EBA Regulation: %The Board of Appeal shall have sufficient legal expertise to provide expert legal advice on the legality of the Authority's exercise of its powers.+
 - Art. 6(3) ECB Decision 2014/16: %The ECB shall provide the Administrative Board with appropriate support including legal expertise to assist in the assessment of the exercise of the powers of the ECB+
- Suspension of contested decision: Joint Board of Appeal ESAs decides versus Governing Council ECB decides
- Prior venue required before going to Luxembourg?
 - Prior appeal against before Joint Board is required (Art. 61(1) EBA Regulation)
 - Review against ECB is optional (preamble, Decision ECB/2014/16)



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19

SRM: EBA-similar appeals procedure

- Similar appeals procedure arrangements for SRM
(Art. 77b SRM Regulation)
- Six week appeals period . one month: appeals decision
- Then, recourse to the CJEU
- Review of legal acts: EBA, SRM versus ECB

Different approaches to review?

- Will different institutional set-up lead to different approaches to administrative review of EBA and ECB decisions?
- ECB's decisions are far more frequent and far-reaching
- Interplay between national and EU protection against SSM decisions
- Most interesting challenges when NCAs and ECB act
- See legal writing by, *inter alia*:
 - Raffaele D'Ambrosio
 - Stefaan Loosveld
 - Sven Schneider
 - Willem Bovenschen e.a.

Transparency and accountability - 1

- Far-reaching accountability mechanisms in MoU with Ecofin Council and Interinstitutional Agreement with EP
- Due respect for professional secrecy and business secrets
- Chair-to-Chair confidential oral discussions behind closed doors
- EP gets ~~an~~ comprehensive and meaningful record of the proceedings of the Supervisory Board that enables an understanding of the discussions, including an annotated list of decisions+and GC objections to SB draft decisions to be reported
- Cooperation with a Parliamentary inquiry regulated in advance



Accountability breeds
response-ability.

- Stephen R. Covey

Transparency and accountability - 2

- Impact of announced reflections on publishing an account of ECB Governing Council's policy deliberations (Mario Draghi, Amsterdam, 22 April 2014)
- Difference between policy areas: need for more openness derives from monetary policy (effective forward guidance and inflation expectation anchoring in turbulent times) but ECB has wider remit (payments, supervision)



Frankness in Frankfurt

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Friday 09 May 2014, 13:42

The new openness of Frankfurt on monetary policy will have an overflow effect on the ECB's other functions, notably banking supervision. Even though the different nature of this function will require the ECB to keep information secret (at least until well after an issue with an individual bank has been addressed), the Governing Council would be well-advised to ponder how to answer calls in other areas than monetary policy for more frankness from Frankfurt.

In Amsterdam, Mario Draghi did not elaborate on providing more reasoning behind choices in respect of other policy areas than monetary policy. **Only a balanced openness across the board will do justice to today's generally felt need for more central bank transparency.**

Cultural challenges

- Combining national supervisory perspectives: joint teams
- Language issues: do we understand one another?
- Have national rules all been translated into English?
- Culture of banking industry to change: ethics and culture
- Concomitant supervisory culture change
- Harmonised supervisory culture in SSM (Vítor Constâncio)



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25

“It always seems
impossible, until
it’s done” –
Nelson Mandela

