The third condition for resolution and the application of the tests for resolution at the group level

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Overview

• The third condition: The public interest test
  – Background: A1P1 ECHR
  – Application in practice

• Group resolution
  – Application of the three conditions

• Cross-border cooperation and powers in relation to branches
The public interest test
ECHR: A1P1 (protection of property)

• Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.

• The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.
ECtHR case law

• The case law of the ECtHR confirms three key principles in applying A1P1: the State may only interfere with the owner’s property rights where:
  – it is justified in the public interest;
  – the State strikes a ‘fair balance’ between the general interest and that of the owner; and
  – an owner deprived of his property receives adequate compensation.

• *Grainger v UK*, Application no. 34940/10, 10 July 2012. Also see: *James v UK*, Application no. 8793/79 and *Lithgow v UK*, Application no. 9006/80 and 9262/81.
Reflections in the resolution framework

• Balancing of public and private interests inherent in resolution decision-making.

• FSB *Key Attributes of Effective Resolution Regimes*

The objective of an effective resolution regime is to make feasible the resolution of financial institutions without severe systemic disruption and without exposing taxpayers to loss, while protecting vital economic functions through mechanisms which make it possible for shareholders and unsecured and uninsured creditors to absorb losses in a manner that respects the hierarchy of claims in liquidation.
Reflections in the resolution framework (cont.)

- BRRD:
  - Article 32(1)(c): *a resolution action is necessary in the public interest pursuant to paragraph (5)*;
  - Article 32(5): *... a resolution shall be treated as in the public interest if it is necessary for the achievement of and is proportionate to one or more of the resolution objectives referred to in Article 31 and winding up of the institution under normal insolvency proceedings would not meet those resolution objectives to the same extent*;
  - Article 31(2): The resolution objectives e.g. to ensure the continuity of critical functions; to avoid a significant adverse effect on the financial system, in particular by preventing contagion, including to market infrastructures, and by maintaining market discipline; to protect public funds by minimising reliance on extraordinary public financial support; to protect depositors covered by Directive 2014/49/EU and investors covered by Directive 97/9/EC.
Reflections in the resolution framework (cont.)

• Banking Act 2009 (UK), section 7 (general conditions):

  (4) Condition 3 is that the exercise of the power is necessary having regard to the public interest in the advancement of one or more of the special resolution objectives.

  (5) Condition 4 is that one or more of the special resolution objectives would not be met to the same extent by the winding up of the bank.

  (5H) Before determining that Conditions 3 and 4 are met, the Bank must consult: (a) the Treasury, (b) the PRA, and (c) the FCA.
Reflections in the resolution framework (cont.)

• Banking Act 2009 (UK), section 4 (special resolution objectives):
  – to ensure the continuity of banking services in the UK and of critical functions;
  – to protect and enhance the stability of the financial system of the UK, including in particular by: preventing contagion, maintaining market discipline;
  – to protect and enhance public confidence in the stability of the financial system of the UK;
  – to protect public funds, including by minimising extraordinary reliance on extraordinary public financial support.

• The Treasury, the Bank, the PRA, and the FCA are required to have regard to the special resolution objectives in using and considering the use of the stabilisation powers, the bank insolvency procedure and the bank administration procedure.
Reflections in the resolution framework (cont.)

• The test of “necessity” is a high one.

• The assessment must seek to balance the short and long-term effects on financial stability, public confidence and depositor protection of different resolution objectives.
Balancing public and private interests in practice

• The weighting given to each consideration will vary according to:
  – the bank in question;
  – the conditions under which the bank fails (e.g. idiosyncratic failure or system-wide problems).

• The probable impact of failure will be assessed taking account of the position in a counterfactual insolvency scenario where the bank enters insolvency.
Group resolution
Group resolution

• In applying resolution powers to an institution, resolution authorities should consider the impact on the group—FSB, Key Attribute 3.9:

  In applying resolution powers to individual components of a financial group located in its jurisdiction, the resolution authority should take into account the impact on the group as a whole and on financial stability in other affected jurisdictions, and undertake best efforts to avoid taking actions that could reasonably be expected to trigger instability elsewhere in the group or in the financial system.

• In some cases resolution action in relation to more than one entity in a group may be appropriate.
Group resolution (cont.)

• BRRD, Article 33(1) to (3):
  – resolution authorities may take a resolution action in relation to an institution and relevant parent and holding companies, where the three resolution conditions are met with regard to both the institution and the parent company;
  – where the subsidiary institutions of a mixed activity holding company are held directly or indirectly by an intermediate financial holding company, resolution action should be taken at the level of the intermediate financial holding company.
Group resolution (cont.)

• BRRD, Article 33(4):
  – resolution authorities may take action at the level of the parent company when one or more of the subsidiaries comply with the conditions established in Article 32(1), (4) and (5) and their assets and liabilities are such that their failure threatens the institution or the group or the insolvency law of a Member State requires that groups be treated as a whole.

• Banking Act 2009 (UK), sections 81B to 83.
Cross-border cooperation and powers in relation to branches
Cross-border cooperation and powers in relation to branches (cont.)

- FSB, *Key Attribute 7* makes further provision with regard to the framework for cross-border cooperation:
  - cooperative solutions should be achieved wherever possible;
  - powers over local branches should be available for use to either support the home resolution authority or, in exceptional cases, to take measures at own initiative;
  - provision should be made for transparent and expedited processes to give effect to foreign resolution measures (e.g. by way of mutual recognition);
  - national laws and regulations should not discriminate against creditors on the basis of their nationality.
Cross-border cooperation and powers in relation to branches (cont.)

• In certain cases EU resolution authorities may exercise powers in relation to a Union branch of a third country institution (BRRD, Articles 95 and 96).

• The powers are available where the Union branch:
  – is not subject to third country resolution proceedings; or
  – is subject to third country resolution proceedings and one of the conditions specified in Article 95 applies, e.g. independent resolution action is necessary to achieve one or more of the resolution objectives or that creditors located or payable in a Member State would not receive the same level of treatment as third country creditors with similar legal rights under the third country home resolution proceedings.
Cross-border cooperation and powers in relation to branches (cont.)

• In order to exercise the powers in relation to the branch, the resolution authority must have determined that action is necessary in the public interest and one or more of the conditions specified in Article 96(2) BRRD is met (e.g. the Union branch no longer meets, or is likely not to meet, the conditions imposed by national law for its authorisation within the Member State and there is no prospect that any private sector, or other relevant action would restore the branch to compliance or prevent failure within a reasonable time frame).

• Where a resolution authority takes independent resolution action, again, the resolution authority must have regard to the resolution objectives (Article 96(3) BRRD).

• Banking Act 2009 (UK), sections 89H to 89J.
Questions for the panel

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