

New steps in controlled approach to resolution of failing banks

In 2014 significant steps were taken towards developing a European regime for dealing with banks in difficulties, also known as resolution. The basis of this regime, consisting of a resolution authority and a legal framework, has now been established. The Single Resolution Board, the European resolution authority, was established and launched on 1 January 2015. On the same date, De Nederlandsche Bank (DNB) was designated as the national resolution authority for the Netherlands.

In anticipation of its new task, DNB in 2014 examined the complexity and resolvability of the significant Dutch banks, and translated the outcome into a resolution strategy and the first concrete operational resolution plans. The significant banks will be required to take action on the basis of these plans.

The resolution regime

During the financial crisis, European governments were forced to bail out a large number of banks. Banks proved too interconnected within the financial system and were believed to be too important for the real economy to fail ('too big to fail'). In order to prevent such problems in the future, firm measures have been taken. Capital requirements have for instance been raised and European banking supervision introduced on 4 November 2014. In addition, macro-prudential policies are being developed in order to address systemic risks while the size of the banking sector has been reduced.

If, despite these measures, banks run into difficulties orderly resolution should be possible. This means that they are stabilised in a controlled manner and restructured without material risks to both financial stability and taxpayers. Should banks fail in the future, losses will in principle be borne by their shareholders and unsecured creditors, and key activities will be continued. This, in short, is the task of the European Single Resolution Mechanism, which next to the ECB's Single Supervisory Mechanism forms the second pillar of the European Banking Union.

DNB resolution authority for the Netherlands

The European resolution mechanism consists of a European resolution authority, the Single Resolution Board, and the national resolution authorities for the euro area, including DNB. Both the European authority and DNB derive the legal powers to perform their task from the Bank Recovery and Resolution Directive and the Single Resolution Mechanism Regulation. After transposition into Dutch legislation later this year, the resolution directive will give DNB in its capacity as national resolution authority additional powers to prepare for the resolution of a bank (resolution planning), and to take action if a bank is failing. On the basis of the resolution directive, the resolution authority is empowered to force shareholders and subordinated creditors to absorb losses (better known as bail-in). The directive also provides additional protection to deposit holders, and requires individual countries to establish a resolution authority.

The resolution regulation governs central decision-making by the European resolution authority with respect to banks that are subject to ECB supervision. Decisions are made by the board, of which the Director resolution of DNB is also a member, and concern both resolution planning and execution. DNB will closely cooperate with the European authority where the Dutch significant banks are concerned, and will continue to be directly responsible for the resolution of smaller banks and a number of investment firms.

Towards orderly resolution of banks

Orderly resolution of a bank requires careful preparation, both by the institution itself and by the resolution authority. As part of resolution planning, the authorities will first determine how their resolution powers will be deployed if a bank fails (the resolution strategy). This strategy highly influences the choice of resolution instruments used during the resolution process. The resolution plan then further details the measures that the bank is required to take in order to improve resolvability to enable actual implementation of the strategy.

DNB in 2014 determined resolution strategies for the significant banks based on a thorough analysis of their financial, legal, and operational structures. An important choice for the resolution authority to make in determining the resolution strategy is the 'point of entry' for the resolution authority in the organisation. This decision is mainly driven by the structure of the bank and the degree to which business entities are integrated. For the Dutch significant banks, which are highly integrated, a central point of entry at group level is the more obvious choice. This is known as a 'Single Point of Entry' strategy. DNB envisages this strategy for three significant Dutch banks.

The decision to intervene at group level at a bank requires that possible losses can actually be allocated to shareholders and unsecured creditors at that level, and that the institution can be recapitalised. The resolution authority can use the bail-in instrument to do this. However, this is conditional on there being sufficient eligible liabilities available to perform the bail-in. A minimum global standard is currently being developed to address this issue.

Resolution plans for the large Dutch banks

In order to improve the resolvability of the three significant Dutch banks, DNB has compiled a first draft of the operational resolution plans and identified which measures the banks must take to enable implementation of the plan. One of the possible measures that the institutions will be required to take is to add resolution stay or other provisions to their contracts to ensure that critical functions are continued during resolution. They must also be able to provide the information necessary for resolution planning and execution to the resolution authority timely and promptly. In the months ahead, the banks will have to make a considerable effort to improve their resolvability.

All in all, good progress is being made with the development of the resolution regime and the operational set-up of resolution, but a great deal will still have to be done to resolve the too-big-to-fail problem. Achieving the main objective of orderly resolution will continue to require significant time and effort over the years ahead, from the sector as well as the legislator and the European resolution authorities.

Links:

- Standards for bail-in instruments
(<http://www.financialstabilityboard.org/2014/11/adequacy-of-loss-absorbing-capacity-of-global-systemically-important-banks-in-resolution/>)
- DNB letter on resolution planning as send to Parliament (translation by DNB)
[_http://www.dnb.nl/en/binaries/ENG%20translation%20of%20DNB%20letter%20to%20Parliament%20on%20resolution_tcm47-325109.pdf](http://www.dnb.nl/en/binaries/ENG%20translation%20of%20DNB%20letter%20to%20Parliament%20on%20resolution_tcm47-325109.pdf)