Introduction

In order to increase the stability of the financial system, Europe is in the process of creating a Banking Union. The Banking Union consists of four pillars: one set of rules (the single rule book), one European supervisor (the single supervisory mechanism – SSM), one framework for recovery and resolution of banks (the single resolution mechanism – SRM) and one harmonised European Deposit Guarantee Scheme (DGS). The Single Resolution Mechanism (SRM) is a necessary next step for completing the Banking Union. A resolution mechanism at the European level supplementary to the single supervision by the ECB is a necessity to increase the stability of the European financial system.

Rabobank generally supports the creation of a Single Resolution Mechanism (SRM) with a Single Resolution Fund (SRF). To achieve a well-balanced SRM we would like to emphasize a few items. The position of Rabobank regarding the proposal by the European Commission (EC) for a Single Resolution Mechanism (“Proposal”) is summarized in the following paragraphs. A more elaborated view is set out in the annex.

1. Structuring and governance

According to Rabobank the European Resolution Authority should be a fully independent authority, free from political influence. Establishing an independent authority would require a Treaty change. Such process to arrange for a Treaty change should be commenced as soon as possible. For the time being Rabobank can accept the EC as the (temporarily) Resolution Authority. However, the position of the Single Resolution Board (SRB) should become more important and the power of the EC to act on its own initiative should be limited to exceptional circumstances only.

The governance of the SRM should be clarified, giving a clear structure of the respective tasks, roles and responsibilities of all parties involved in the SRM. The SRB should substantively make the decision with regard to a bank in difficulties, including on how and by what means resolution will be executed – which might include to go into insolvency and DGS coming into force.

A major task of the SRB and EC should be to safeguard a minimum burden on the SRF.

2. European vs. national rules

The effectiveness of the single European resolution mechanism is not supported by the applicable substantive regulation which is for a major part national law - especially the national implementation of the Banking Recovery & Resolution Directive (BRRD). This will in our opinion lead to both a lack of level playing field and difficulties in the determination for creditors of their real risk positions in advance which uncertainty will be taken into account in the pricing of funding for banks.
3. Legal protection
The SRM should be provided with an effective safeguarding of legal rights. At least there should be timely and proper legal protection with regard to ex ante measures, early intervention measures, the resolution decision and the compensation. To that effect we propose a special chamber within the European Court of Justice in due course.

4. Fund
An important part of the SRM is a clear mandate for the SRF addressing a limited use of the means of the Fund and for liquidity purposes only, under strict conditions and for limited time. No means could be used for loss absorption purposes. The mandate should also include a clear governance and investment framework. The independency of the management of the SRF – especially in its investment decisions - should be safeguarded.
Contributions to the SRF need to be adequately risk-weighted and capped.

5. Connection and transition between different pillars of the Banking Union
Only healthy, sound and resilient banks can participate in the SRF. All banks need to be subject to an asset quality review and a balance sheet review before they can make use of the SRF. This applies therefore also to banks not directly supervised by the ECB.
The Proposal only focusses on the situation that banks will pass the reviews (to be executed under the entrance to the SSM). We are concerned about those situations that banks will not pass the reviews. For these scenario’s the Proposal does not contain a solution supportive to the objectives of the European Banking Union.

To overcome complications with banks who have to be refinanced to make them pass the asset quality review and balance sheet reviews and to avoid a further undesirable feedback loop between banks and sovereigns creditworthiness the SRM and the BRRD - including the possibility to use the bail-in instrument - should go into force at the same time. Simultaneously structural national solutions need to be available which should include eventually a substantial ESM contribution.

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Annex

1. **Introduction – Proposal EC**
   In order to increase the stability of the financial system, Europe is in the process of creating a Banking Union. In addition to the Single Rule Book, setting the rules and consisting of the Capital Requirements Directive and Regulation (CRD/CRR), the Bank Recovery and Resolution Directive (BRRD), and the Single Supervisory Mechanism (SSM) - creating banking supervision on an European level - the European Commission has published a proposal for a Single Resolution Mechanism (SRM) (“Proposal”). The aim is that this will reduce the interdependencies between countries and banks. The Proposal entails one Resolution Authority, being the European Commission, and one European Resolution Fund. Rabobank endorses to the principle that in the Banking Union, bank supervision (SSM) and resolution (SRM) need to be exercised by the same level of authority at the European level.

2. **General assumptions**
   In our view in order to have an effective and well-balanced SRM in place the mechanism should meet the following conditions: (i) (possibility of) political interference and conflicting interests need to be avoided; (ii) there needs to be an effective procedure for appeal in place and strong safeguards for legal protection in general; (iii) the resolution authority should have a governance which will be in accordance with its tasks and responsibilities (including a clear description of the powers and under which circumstances acting will be admitted, such as accountability and control and checks), be accountable for its acts and decisions to the Council and the European Parliament and dispose of the relevant expertise on recovery and resolution of banks, and (iv) the SRM should be subject to periodical review.

3. **Relation SRM to the applicable regulation**
   In essence, the SRM gives the formal procedural rules which, due to the fact that the SRM is a Regulation, are harmonized within the Eurozone. The substantive regulation which is to be applied within this procedures is basically included in the BRRD. This is a Directive and therefore needs to be implemented in national law. It follows that the effectiveness of the single European resolution mechanism is not supported by the applicable substantive regulation which is for a major part national law. As a consequence this will lead to a lack of level playing field. A general application of deviating rules will result in different outcomes. That will prevent transparency for investors. Such uncertainty will be taken into account in the pricing of funding for banks.

4. **Decision making for resolution**
   According to the Proposal, the European Commission - as an EU institution - has the power to initiate the resolution of a bank, based on a recommendation by the Single Resolution Board (SRB) or on its own initiative. The SRB would monitor the execution by the national resolution authorities of its decisions according to national law and, should a national resolution authority not comply with its decision, it could directly address decisions to banks.
Rabobank is in favour of the Resolution Authority being a fully independent institution. Assuming that this would require a Treaty change we recognize that at the moment the only available institution within the EU legal framework for deciding about resolution related matters is the European Commission. We can accept the proposal made in the draft Regulation on the SRM for the EC as Resolution Authority but only as a temporarily structure. As from the start there should also be a preparation for a permanent structure, including the Authority being an independent institution, supported by a strong commitment by means of an ECOFIN statement to such future Treaty change.

Furthermore, it is better to have an independent power of the Commission to act on its own initiative only to a limited extent. The role of the SRB needs to be more important. The substantive decision to draw up (recovery and resolution) plans and to prepare for and/or enter into resolution should be made by the SRB. The regular procedure should be that, based on its own information and/or information of the ECB or national resolution authorities, the SRB prepares a recommendation, being the substantive decision, to be followed by the formal decision of the Commission. Only in exceptional circumstances the Commission should exercise its authority to decide about resolution on its own initiative, for example when the SRB is unable to reach a decision within a reasonable time limit.

5. **Structuring and governance of the mechanism:**

Rabobank considers the following elements essential for the structuring and governance of the SRM:

a. **Resolution decision**
As stated earlier, in our view the SRB should make the substantive preparation of the resolution decision, in close cooperation with the (single) supervisory authorities. Only the formal decision should be made by the EC. Therefore, the SRB should need to have all resolution powers provided by the BRRD. The SRB needs to be responsible for the resolution planning as well for the determination of the MREL level for the banks under direct supervision by the ECB whereby the national authorities will make this determination for all other banks under strict final responsibility of the SRB. For banking groups decisions should be taken on a consolidated level to the maximum extent.

b. **Scope of the resolution decision**
It will be in line with the objectives of the SRM when the SRB will be able to make use of all available resolution measures, including making the decision that a bank will go into bankruptcy and be liquidated (whereby the costs will be borne by the shareholders and the creditors, and the DGS taking effect).

c. **Tasks and objective**
Any decision taken by the SRB and the EC should primarily focus on minimizing the use of the Resolution Fund. This can be done primarily by fully utilizing the bail-in instrument.
d. Clear and uniform procedures and governance
As the national authorities will be part of the SRB, the SRB should guard the uniformity of the procedures and the national frameworks on Recovery and Resolution.

There should be clarity on the roles and responsibilities of the different parties involved. Questions regarding the start, end, scope and accountability of responsibilities need to be answered before the SRM can start. The respective relations between the participants in the SRM need to be clarified in order to have a fully transparent and balanced process. Banks should have only one contact person as representative of the SRM. If it is necessary to share information about a certain bank, the SRB should share the relevant information with the other relevant member(s) of the SRB.

e. Relation national authorities – (single) resolution authority
The abovementioned required clarity with regard to the roles and responsibilities of all parties involved should include the national authorities. Also in resolution (daily) supervision will be ongoing. The competences and powers of the national authorities and the (single) resolution authority and the cooperation and coordination between them should be clear from the start of the SRM.

f. Confidentiality
Sharing of information needs to go hand-in-hand with a strict safeguarding of confidentiality in every stage and with regard to all parties involved. Only the executive session of the SRB on each bank/banking group should be able to have access to highly confidential information – such as the recovery plans and (information for) the resolution plans, but limited to situations where such access is necessary.

6. Single Bank Resolution Fund
To support the resolution process and enhance its effectiveness, the Proposal establishes a Single Bank Resolution Fund (Fund). If banks are under European supervision and decisions on the recovery and resolution of banks are taken on a European level such supervision and decisions need to be backed by a European funding. However, the costs of a bank resolution need to be carried primarily by the shareholders and creditors through bail-in. To our opinion, only for cases where specific funding is required support from the European Fund can be given.

Rabobank endorses a restricted European Fund under the following conditions:

a. Eligibility for the Resolution Fund – transition within banking union
In the Banking Union proposals the Asset Quality Review (AQR) and Balance Sheet Assessment (BSA) will cover the approximately 130 banking groups under direct supervision of the ECB as part of the SSM (starting fourth quarter 2014).

The Proposal does not state what the situation will be for the remaining 6,000 smaller European banks. According to Rabobank it is necessary that all banks will be subject to a
proper test before they can become part of the SRM. Only healthy, sound and resilient banks should be able to participate in the Fund.

The Proposal also does not elaborate on the situations that banks will not pass the reviews and tests. If banks will not pass the tests there will be no access to the SSM. It is expected that the problems should be solved by the bank itself (including limited use of bail-in) or (with support of) the member state in which the bank has its statutory seat. If necessary the bank could be supported by the ESM. In any case, the Fund cannot be involved. However, the absence of clear rules on such scenario’s might impose risks on the objectives of the Banking Union. A ‘clean’ starting point is required to start with the Banking Union.

b. Clear rules and accountability on the possible use of the Fund

The Fund should only be used in very limited and clearly described situations – and after full use of the bail-in instrument. Moral hazard needs to be avoided in any case. The Fund cannot be used to absorb losses. There could be a facility to provide liquidity and recapitalization but only under the conditions that means of the Fund can only be used in the context of a resolution measure and the support by the Fund can only be temporarily.

c. Strict governance of the Fund and independence of the board

The structuring and governance of the Fund needs to be clear. The governance should be in line with the principles that the Fund can only be used for a very limited set of situations in the context of resolution tools and powers and that (possible) improper use of the Fund should be avoided.

As part of the governance the management of the Fund should be substantively independent. Decisions on the investments of the Fund should be the responsibility of the management, free from any political involvement. The management of the Fund must be able to act freely within the mandate which needs to include a low risk profile, spreading of the investments and focus on high liquidity. At the same time, the management of the Fund should be transparent and accountable to all stakeholders, including the banks.

In addition, although the decision for use of the Fund is taken by the SRB and EC, the management of the Fund should have its own independent check on the proper fulfillment of the requirements to which any contribution by the Fund will be subject, before any contribution can be made.

d. Involvement banks

The banking sector, as the financier of the Fund, should be involved with the governance of the Fund – in a supportive, advisory role.

e. Target level and timeframe for reaching target level

When the system of bail-in will be in place and will be applied correctly and fully, there will be no need for a large fund. Having large amounts of funds available which are not being used for the real economy hampers economic growth and might increase the risks for moral hazard. Rabobank considers a target level of 0.5% of the covered deposits per member state.
appropriate, taking into account also the DGS Fund.

That also brings that the Fund needs to be build up in a responsible period in which banks are not faced with several levies causing a heavy burden. A period of 15 years will meet that requirement.

f. Contributions
Rabobank is in favour of an adequate and substantial risk weighted premium for the Fund, both for the ex-ante and ex post contributions. Contributions by banks need to reflect properly the risks connected to each individual institution due to its business model, governance, size, activities, etc. We are however in doubt whether the mentioned list (in Article 66, para. 1: BRRD Article 94 (7)) with extensive quantitative and qualitative criteria will, in a varied banking landscape, finally result in a just and accurate risk weighting all over the EU.

Also a relevant aspect of the risk-weighting should be the extent to which each institution has unsecured assets and/or a large amount of bail-in-able liabilities available. The expected claim for these banks on the Fund will be limited.

Due to the fact that the SRB can decide that, following from relevant considerations regarding its relevance for the financial system, interconnectedness, size, etc. an institution will go into normal insolvency proceedings, contributions should also - to a limited extent - be related to the chance that an institution will need to make use of the Fund.

Contributions to the Fund should also be capped, both for the ex-ante and the ex post contributions. Despite the responsibilities which could be taken by the banking sector to contribute to the SRF, it is not in accordance with the requirements for banks to have their capital strengthened and to be transparent to the markets when they are confronted with possible unlimited and unforeseeable contributions to the Fund.

Finally, existing European or national taxes and/or levies which have the same purpose as the Fund should be abolished or transferred to the European Fund.

7. Legal protection
The SRM does not include any provisions concerning legal protection of both an institution and/or its investors and other stakeholders. This raises concerns for us.

For example, under the current SRM proposal investors can only get compensation based on an earlier valuation. It is not clear what happens if the investors do not agree with the outcome of this valuation. Is it possible for them to appeal against this valuation at the European Court of Justice? Maybe more important for them is an independent test on the legitimacy of a resolution decision.

In addition, it is not clear whether the institution itself has any right to appeal against decisions of either the SRB or the Commission made on the basis of the SRM, for example
decisions concerning ex ante restructuring or early intervention of a banking group.

It is necessary that the SRM proposal will contain timely and effective legal protection possibilities with regard to at least the ex-ante measures, early intervention measures, the resolution decision and the compensation. We would like to see that the legal protection for both the institution and the investors is arranged for in the SRM itself. We would prefer that a special chamber is set up within the European Court of Justice for cases regarding decisions made under the SRM and BRRD. In this way it is possible to have a speedy trial in which the legitimacy of such decisions can be tested.

It is necessary that such decision can be obtained in a very short time after decisions have been made in order to establish clarity which will contribute to the stability of the financial system and the financial markets.

Not only is a proper legal protection a prerequisite for a good functioning of the mechanism in order to give the parties involved the necessary trust and confidence in the mechanism. A solid system of legal protection which will be able to give certainty on concrete issues and questions in a very short term will also contribute to the stability of the financial system as a whole.