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ARTICLE

Bank resolution and recovery in the EU: enhancing banking union?

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Abstract The article analyses some of the legal and economic policy issues concerning proposals to establish a European Banking Union. It discusses the role of the European Central Bank as a bank supervisor and the creation of the Single Supervisory Mechanism (SSM). The article then critically analyses the draft Directive on Bank Recovery and Resolution (RRD) and argues that it is inadequate to serve as one of the pillars of banking union. The article reviews the difficulties of Member States in implementing the RRD by analysing the United Kingdom's resolution framework as a case study. Finally, the article suggests that although strengthened powers for national resolution authorities are necessary to enhance the RRD, the logic of banking union demands further centralisation of sovereign authority in the Euro area in order to manage more effectively the resolution and recovery of financial institutions and to establish more institutional coherence with the ECB/SSM as bank supervisor. Further centralisation of banking supervision and resolution powers, however, could result in a deepening split in the EU internal market between member states not participating in banking union and participating states.

Keywords European Union law · Banking regulation and supervision · European economic law · European political economy · European institutions · Banking law

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1 Introduction

During the financial crisis of 2007–09, most EU states did not have effective bank resolution and recovery regimes to ensure an orderly restructuring or winding-up of a failing bank or financial institution. When a number of major European banks began to fail in 2008, including Fortis, Dexia and the Royal Bank of Scotland, the absence of an effective resolution and recovery framework led EU Member State authorities to engage in a chaotic scramble to freeze and seize assets located in their jurisdictions in order to pay creditors and depositors of distressed financial institutions in their countries. Moreover, national authorities resorted to *ad hoc* measures to provide state guarantees and inject capital into failing financial institutions.[1] The crisis demonstrated the EU's lack of a clear and predictable legal framework to govern how a distressed financial institution would be reorganized or liquidated in an orderly manner without undermining financial stability.

To address this, the European Commission published a Communication in 2009 on an 'EU Framework for Cross-Border Crisis Management in the Banking Sector', which analysed gaps and weaknesses in the EU legal framework governing bank resolution.[2] In December 2010, the Council of Ministers (ECOFIN) adopted conclusions calling for a more comprehensive Union framework to regulate financial markets, including crisis prevention, management and resolution. After further consultation, on 6 June 2012 the European Commission proposed a Directive on a Framework for Bank Recovery and Resolution (RRD).[3] The RRD provides new resolution tools and powers for Member State supervisory authorities to ensure that uninterrupted access to deposits and payment transactions is maintained during periods of market stress or when an individual bank or banking group becomes insolvent.[4] Member State authorities would be empowered to sell viable assets of the bank and to apportion losses in an equitable and organized manner by requiring, for example, that certain creditors incur losses on their claims against the distressed financial firm. The RRD is not intended to replace Member State bank insolvency laws and regulations, but rather to enhance and provide minimum powers across the EU for Member State authorities to require banks and financial groups to recapitalize or restructure creditor claims during periods of market stress in order to reduce the likelihood of a bank becom-

[1] According to the IMF estimates, crisis-related losses incurred by European banks between 2007 and 2010 were close to €1 trillion or 8 % of the EU GDP. In addition, between October 2008 and October 2011, the Commission approved €4.5 trillion (equivalent to 37 % of EU GDP) of state aid measures to financial institutions. See http://www.g20.org/images/stories/docs/eng/washington.pdf (last visited 9 August 2012).

[2] Commission Communication on an EU Framework for Cross-Border Crisis Management in the Banking Sector, COM(2009) 561 final.

[3] Commission Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms, COM(2012) 280/3.

[4] The European Commission proposal has incorporated some of the international standards on bank resolution adopted by the Financial Stability Board, 'Key Attributes of Effective Resolution Regimes for Financial Institutions', (July 2011) (BIS: Basel). See http://www.financialstabilityboard.org/publications/r_111104cc.pdf (last visited 8 August 2012).

ing insolvent and to mitigate the impact of a bank resolution or insolvency on the financial system.[5]

The article reviews recent proposals to establish a European Banking Union by considering the creation of the Single Supervisory Mechanism and the ECB as bank supervisor. It then critically analyses the draft Directive on Bank Recovery and Resolution (RRD) and argues that it is inadequate to serve as one of the pillars of banking union. The article reviews the difficulties of Member States in implementing the RRD and analyses the UK as a case study. The article finally suggests that although strengthened powers for national resolution authorities are necessary to enhance the RRD, the logic of banking union demands further centralisation of sovereign authority in managing resolution and recovery at the EU or Euro area level to provide a more coherent institutional relationship with the ECB/SSM in banking supervision. Yet, risks remain as further centralisation of banking union powers could result in a deepening split in the EU internal market between EU states not participating in banking union and EU states that are participating in banking union.

2 The Banking Union proposals—*the RRD in context*

In June 2012, as Spanish and Italian bond interest rates were rapidly climbing, Spanish Finance Ministry officials reached an agreement in principle with the European Commission over the terms of a Eurozone bailout of the Spanish banking system. This led the European Union President, Herman van Rompuy, to issue a paper calling for a European Banking Union that would sever the vicious link between the banking crisis and sovereign debt crisis.[6] The Van Rompuy paper called for an integrated EU financial framework that should consist of three pillars: 'single European banking supervision and a common deposit insurance and resolution framework.'[7] The German Chancellor Angela Merkel welcomed the proposals as an important step in obtaining German support for allowing the Eurozone bailout fund—the European Stability Mechanism—to recapitalise ailing Eurozone banks. After the European Council of Ministers issued a Decision supporting the Van Rompuy proposal,[8] the European Commission proposed on 12 September 2012 a Regulation[9] that would provide the European Central Bank with banking supervision powers and another Regulation to enable the ECB to interact with the European Banking Authority in exercising its bank supervisory powers.[10] On 19 October 2012, President Van Rompuy endorsed

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[5]See RRD, Recital 1 provides 'adequate tools to prevent the insolvency of credit institutions or, when insolvency occurs, to minimise negative repercussions by preserving systemically important functions of the failing institution'.

[6]Council, Conclusions, 29 June 2012, EUCO 76/12., p. 3.

[7]European Council President, 'Towards A Genuine Economic and Monetary Union', 26 June 2012, EUCO 120/12, pp. 3–4.

[8]Council, Conclusions, 29 June 2012, EUCO 76/12, p. 3.

[9]Commission, Proposal for a Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, COM(2012) 511 final, Brussels, 12.9.2012.

[10]Commission, Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority).

the Commission's legislative proposals to create a Single Supervisory Mechanism (SSM) 'to prevent banking risks and cross-border contagion from emerging' and for the ECB 'to carry out supervision directly' by 'using national supervisors in regular supervisory tasks as much as possible.'[11] Member states continued further negotiations in November 2012 addressing specific issues, such as the separation of monetary policy and banking supervision within the ECB, the SSM's institutional structure and decision-making procedures, the scope of the ECB's competence to conduct banking supervision and its enforcement powers, and the ECB's interaction with the European Banking Authority in adopting draft regulatory standards and in voting modalities. Council reached agreement on these and other issues on 4 December 2012 by approving final language for the proposed Regulation.[12]

The ECB's supervisory powers would become fully operational by January 2014 with the creation of a Single Supervisory Mechanism (SSM) that would have an executive board—a Single Supervisory Board (SSB)—that would be responsible for supervising Eurozone banks that have accepted bailouts. The ECB/SSB's supervisory responsibilities would be extended to the biggest cross-border credit institutions and financial holding companies. National competent authorities will have primary responsibility to supervise an estimated 6000 smaller domestic credit institutions and financial groups in the Euro area and participating EU states with the ECB having the power to intervene in supervisory matters only in exceptional circumstances.[13] The ECB/SSB will be primarily responsible for licensing, monitoring and enforcing prudential regulations, such as capital adequacy requirements, liquidity buffers and leverage limits, against banks based in the Eurozone.[14] The ECB/SSB will also be empowered to approve bank recovery plans and asset transfers between affiliates within banking groups or mixed financial conglomerates.[15]

The Commission's proposals for the ECB to exercise competence to supervise credit institutions in the Euro area through the SSM represent a dramatic institutional restructuring of EU banking supervision which will have important implications for the practice of financial regulation in all EU states. Indeed, the proposed Banking Union in the Euro area is designed to sever the link between banking fragility and over-indebted sovereign debtors by authorising the European Stability Mechanism (the Eurozone's bailout fund) to recapitalise ailing Euro area banks on the condition that these banks are subject to ECB supervision and strict conditionality. The ECB/SSM proposals, however, are not intended to stand alone, as they were envisaged to be the first pillar of three pillars in a comprehensive banking union. The other

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[11] European Council President, 'Remarks by President Van Rompuy following the first session of the European Council', 19 October 2012, EUCO 193/12, pp. 1–2.

[12] Council Conclusions, 4 December 2012, ECOFIN 1011.

[13] Commission Proposal for a Council Regulation conferring specific tasks on the European Central Bank concerning the policies relating to the prudential supervision of credit institutions, Art 27 (1) & (2), 2012/0242 (CNS), ECOFIN 1011, Brussels, 3.12.2012.

[14] Commission, Proposal for a Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, Art 4 (1)–(4), COM(2012) 511 final, Brussels, 12.9.2012. The Regulation was subjected to final amendments approved by EU Heads of State on 11 December 2012.

[15] Art 4 (1)(k).

two pillars that are expected to follow in due course are, namely, a common resolution mechanism and a common deposit insurance scheme possibly under the control of a common resolution authority. Even as the proposal for a SSM emerged, however, some countries led by Germany resisted the prospect that the other two pillars would be implemented quickly. This led to President Van Rompuy conceding that whilst the common resolution mechanism and common deposit insurance scheme remain essentials pillars for banking union, there is no consensus on their introduction.

The October 2012 EU Summit further reinforced this disagreement on when banking union would be fully adopted by simply noting that the Commission's intention to propose a single resolution mechanism for EU states participating in the SSM will only occur once the existing drafting Recovery and Resolution Directive and proposed Deposit Guarantee Schemes Directive had been adopted.[16] It is now time to examine the main provisions of the proposed RRD.

3 The draft Recovery and Resolution Directive (RRD)

The legal basis for RRD is Article 114 of the Lisbon Treaty (TFEU) which provides for the establishment of EU bodies and institutions that are vested with responsibilities for contributing to the harmonization of laws and facilitating their uniform implementation by Member States.[17] The RRD attempts to improve the conditions for the establishment and functioning of the internal market by proposing minimum harmonizing legislation that delegates authority to the European Banking Authority (EBA) to draft and propose technical implementing standards for Member States to adopt for their recovery and resolution regimes. These tasks conferred on the EBA are closely linked to the subject matter of the RRD, which is to promote more harmonized Member State recovery and resolution practices that will reduce barriers to the internal market.

The RRD's scope of application extends widely to include all credit institutions, investment firms subject to capital requirements of at least €730,000, any financial institution engaged in a wide range of financial services which is a subsidiary of a credit institution and which is subject to consolidated supervision at the level of the parent company.[18] Throughout the Directive, the term 'institution' is used generally to signify an entity subject to the RRD requirements. The Directive defines 'institution' to be a credit institution or investment firm defined as a €730,000 firm. The RRD's coverage runs parallel with the Capital Requirements Directive,[19] which harmonizes capital, liquidity, and governance arrangements for financial institutions and

[16] Council, Conclusions, October 2012, EUCO.

[17] See Case C-66/04 *United Kingdom v. European Parliament (Smoke Flavourings)* [2005] ECR I-10553, Case C–217/04 *United Kingdom v. European Parliament (ENISA)* [2006] ECR I-3771.

[18] RRD, Article 1. A €730k firm is defined as such under Article 9 of Directive 2006/49/EC (the Recast Capital Adequacy Directive).

[19] Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions, [2010] OJ C 293/1; and Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions, [2009] OJ L 94/97.

banking groups established in an EU Member State. The CRD is a maximum harmonization directive, the requirements of which Member States may not depart from except in specified circumstances, whereas the RRD is a minimum harmonization directive based mainly on general principles and powers to be adopted by Member States into their domestic legal frameworks with considerable discretion for which legal instruments they use to comply with the Directive. Member State authorities will be required to implement most requirements of the RRD by 1 January 2015, whilst the Directive's more controversial bail-in requirements discussed below must be implemented by 1 January 2018.

Each Member State is required to designate a resolution authority at the level of the member state to exercise powers under the RRD.[20] States are free to decide whether or not the resolution authority will be a separate authority or combined with some other institutional authority, such as the bank regulator. However, where supervisory and resolution authorities are located within the same institutional structure, functional separation and independence between the authorities must be demonstrated and there must be safeguards against conflicts of interests.

Each financial institution, covered investment firm and parent entity subject to consolidated supervision will be required to prepare a recovery plan as a condition for authorization.[21] Article 4 prescribes certain information to be provided in the recovery plan. The Directive also requires that the EBA propose and the Commission adopt technical implementation standards on the minimum content to be provided by institutions in their recovery plans.[22] Article 5 requires institutions to submit their recovery plans for approval to the resolution authority. In reviewing the proposed recovery plan, the resolution authority must consider whether the plan can restore the firm's viability and financial soundness in difficult market circumstances without having adverse impact on the financial system. Recovery plans will contain information addressing business strategy, organizational structure of the firm, expected funding sources, and risk management. Authorities have the power to require firms to adopt any measure which the authority believes is necessary to overcome potential impediments or deficiencies in the implementation of the firm's plan.

The requirement to prepare and maintain a recovery plan also applies to parent companies and subsidiaries subject to consolidated supervision. This means each institution within or which is part of the financial group is required to prepare a recovery plan consisting of the elements and arrangements set forth in Article 5. These plans must also provide the details of any arrangements for intra-group financial support for entities within the group that are experiencing financial difficulties.[23] The group recovery plan must be submitted for review by the lead supervisor of the consolidated group and by any competent authorities where the group has significant operations.

[20] Article 3 RRD.

[21] Article 5 RRD. The EU Council has proposed to amend article 7 RRD to require that group recovery plans be required only for the group as a whole and individually for significant entities in the group.

[22] European Banking Authority, *EBA Discussion Paper on a template for recovery plans*, 15 May 2012 (EBA/DP/2012/2) (containing draft template with information to be provided in recovery plan).

[23] Article 16 RRD.

The recovery plan must be approved and endorsed by the board of directors of the institution (or equivalent managerial body).[24] In the case of a financial group, the board of the parent company or group subject to consolidated supervision, and the board of each institution within the group, must approve the group recovery plan before it is approved by the resolution authority.

The resolution authority will be required to develop resolution plans for each financial institution that is not part of a group and for each group subject to consolidated supervision.[25] Unlike the recovery plans, which are prepared by the regulated entity and the group holding company, the resolution plans are prepared by the resolution authority in consultation with the regulated entity and group. Resolution plans are required to show how crucial payment functions and business lines can be separated economically and legally so as to ensure continuity of the bank's services to depositors and other customers. The plan must also provide an assessment of the institution's resolvability and a list of measures to address or remove impediments to resolvability. A feasibility assessment of alternative resolution strategies and how they could be financed without the assumption of extraordinary public support must be included, along with an analysis of the impact of the plan on other institutions within the group. [26]

The resolution plan of the financial group shall consist of resolution plans for the parent company or institution subject to consolidated supervision and for each institution or firm within the group.[27] The resolution authority responsible for consolidated supervision of the group is responsible for preparing the resolution plan jointly with the resolution authorities of the subsidiaries and to coordinate within resolution colleges that will operate under the aegis of the EBA. The financial institutions will be required to provide the authorities with the information necessary to write the resolution plan. The authorities will be required to update the resolution plan annually or after any event which could have a material effect on the plan. The EBA will propose guidelines and technical standards seeking to promote supervisory convergence in the development of resolution plans and in proposing scenarios to be used for testing the robustness of resolution plans. The RRD envisages that the resolution plans should be able to respond to a range of market developments including idiosyncratic risks and market-wide stress scenarios.

The RRD contains a number of other important provisions that will be briefly mentioned. Articles 31–64 authorize Member State authorities to apply resolution tools against financial institutions and groups when they do not satisfy prudential standards, or when certain early intervention trigger points are met. For example, the authority can compel the institution to sell a business, or an institution can have all or part of its assets transferred to a 'bridge institution', usually state-owned. The authority can also engage in asset separation by transferring viable assets to third party purchasers, thus allowing non-viable assets to be wound down in the rump institution or in a bridge bank. Authorities will also be encouraged to use bail-in

[24] See Annex XI to Draft Directive for the content requirements of a recovery plan.

[25] Articles 9-12 RRD.

[26] Article 10 RRD.

[27] Article 9 RRD.

measures that allow institutions to recapitalize themselves whilst in distress by imposing losses on priority creditors and other unsecured creditors according to their ranking only after shareholders' interests have been extinguished. Depositor claims will be treated *pari passu* along with priority unsecured creditors.[28] Articles 16–19 create the legal concept of 'group interest', that each member of the corporate group has an indirect interest in the prosperity of the rest of the group, and that intra-group financial support from one subsidiary to another would be permitted and in some circumstances could be required by the bank supervisor or resolution authority if they considered such support to be necessary to maintain or stabilise the group. Any company law provisions that prioritise the interests of the subsidiary over that of the group, thereby posing an obstacle to intra-group transfers, would be superseded. In short, intra-group support provided pursuant to a recovery or resolution plan could not result in a breach of national law restrictions on intra-group support. The RRD requires Member States to allow groups to enter into agreements for intra-group financial assistance in the form of loans, guarantees, and collateral provision to support third party transactions so long as certain conditions are met, including, *inter alia,* that the financial support has the objective of preserving or restoring the financial stability of the group as a whole. The resolution authority must approve such agreements and determine that they will not result in the parties breaching their capital and liquidity requirements or becoming insolvent.

4 Member state implementation—the UK approach to resolution

The UK Banking Act 2009 provides a state of the art regime for resolution of deposit-taking banks and building societies. As mentioned above, the RRD draws considerably on the principles and practices set forth in the UK's special resolution regime. The Banking Act's special resolution regime creates a special resolution authority (SRA) within the Bank of England that can decide how to resolve a bank or building society which has not complied with applicable prudential regulatory requirements. The SRA can exercise stabilization powers to transfer property and shares from a failing bank to a state-owned bridge bank or private bank, or place the bank into temporary public ownership with the consent of the Treasury. Although the exercise of these resolution powers can substantially interfere with shareholder rights and other property rights, these powers have the objective of striking a balance between the legitimate rights of bank shareholders, creditors and depositors while preventing a failing bank from causing a systemic crisis and threatening depositor rights.

The UK SRR has been criticised on the grounds that it does not provide an adequate resolution framework for large or too-big-to-fail banks.[29] Indeed, the opera-

[28]This conflicts with the UK Independent Commission on Banking (Vickers' Commission) proposals which would give retail deposit creditors a priority over the bank's unsecured bondholders. The UK Treasury has incorporated the depositor preference rule as a provision in the UK Banking Bill 2013.

[29]In a recent report, the International Monetary Fund concluded that certain features of the UK SRR—particularly property transfer arrangements to the private sector—could be used to resolve other types of financial firms.

tional complexity, jurisdictional issues, and political sensitivity of resolving a large cross-border bank requires a more robust transnational approach. The UK Financial Services Bill (Banking) 2013 attempts to address some of these weaknesses by adopting the proposals of the Independent Commission on Banking (ICB), namely, to ring-fence by subsidiarisation UK banks' retail deposit-taking from the rest of the banking group (including separation from investment banking); to impose higher loss-absorbing capital requirements on UK retail bank subsidiaries; and to grant creditor preference to insured deposits with the retail subsidiary.

Another gap in the UK resolution regime is that it does not cover investment banks, insurance firms, financial groups and conglomerates. Although the Financial Services Act 2010 provides powers to support recovery and resolution planning, it does not require UK retail deposit-taking institutions or other UK financial firms to have recovery plans, nor does it subject insurance and investment firms and financial conglomerates (excluding a bank subsidiary) to the resolution regime. The RRD would address this by requiring member states to extend their special resolution regimes to certain investment banks, insurance firms and financial conglomerates and groups. The UK Treasury conducted a consultation in 2012 that addressed whether or not the UK SRR should go beyond the minimum harmonisation requirements of the RRD by extending the recovery and resolution framework to potentially systemic financial infrastructure, such clearing houses, payment systems, and securities settlement institutions.[30] The UK Treasury concluded that any extension of the UK recovery and resolution regime beyond that already established under the Banking Act 2009 for deposit-taking institutions should cover diversified financial groups, including the entities or infrastructure which they own or control in the European Union. To avoid regulatory arbitrage, the UK recommends that recovery and resolution planning be mandatory for stand-alone exchanges, clearing houses and settlement institutions. Indeed, the new regulatory requirements for centralised clearing of standardised derivative contracts will result in central counterparties becoming systemic actors in the financial system because of the breadth and complexity of their operations and cross-border interconnectedness with other CCPs and settlement institutions. Similarly, recovery and resolution plans for international central securities depositories (e.g., Euroclear and Clearstream) and national central securities depositories are necessary because they perform systemic functions in both the global and European financial systems. ICSDs, such as Euroclear, perform vital settlement operations in the securities markets and are linked to the ECB's Target2 Securities system which provides certainty in delivery versus payment of electronic securities transactions. The RRD should clarify that Member State supervisors or resolution authorities should have the competence to require entities that provide financial infrastructure to adopt and comply with recovery and resolution plans.

[30] The Treasury's consultation concluded that the UK special resolution regime should extend to insurance and investment services firms, and financial conglomerates and groups. UK Treasury Consultation, Financial sector resolution: broadening the regime, Cm 8419 (HM Treasury: August 2012).

5 Enhancing the RRD in the Banking Union

Although the RRD's detailed requirements for recovery and resolution plans are important steps for improving Member State resolution regimes, these measures are incremental at best and do not go far enough in providing the clear legal authority for Member States to exercise the necessary intervention tools to require bank management to undertake certain actions, such as recapitalizing the bank or restricting dividends, when it is in breach of prudential standards or when it poses a risk to financial stability. The RRD proposes harmonized principles and enumerates a set of resolution tools that encourage Member State authorities to intervene in the institution's risk management and strategy, but Member States are free to adopt divergent approaches in deciding both whether and when to use these tools. Although the EBA will publish guidelines on how and when Member State authorities should use resolution tools, Member States will have ultimate discretion to decide whether or not to adopt these tools in their legal and regulatory frameworks. This may create incentives for states to adopt light touch approaches to resolution practice and potentially lead to regulatory arbitrage within the Union and undermine the internal market. The Commission recognizes this by stating expressly that the draft Directive provides a minimum harmonization framework that is meant to allow Member States to experiment with different resolution approaches and to use their discretion in exercising resolution powers.

Nevertheless, more legal certainty should be provided that establishes clearly that the resolution tools supersede existing domestic law and related EU law. It is not enough to provide a harmonized set of principles and a proposed resolution framework to be applied in a discretionary manner by Member States. An effective EU resolution regime must consist of precise legal powers for Member State authorities to impose specific corrective measures on weak and failing financial institutions and groups at the early intervention stage before insolvency.

Another weakness with the current proposal is that it has been overtaken by events with Council's approval in December 2012 of the Regulation conferring supervisory powers on the ECB. The Regulation envisions future legislation that would introduce a common resolution mechanism for banks and financial institutions established in participating EU states in the SSM. It further envisions that the ECB would eventually either act as a resolution authority, or it would oversee and direct an entity controlled by it that would serve as a resolution authority, that would operate the common resolution mechanism. The common resolution mechanism would eventually become a common resolution fund for EU states participating in the SSM. As discussed above, the RRD requires member states to establish national resolution funds, which will require *ex ante* levies on banks and investment firms. The RRD's minimum harmonisation approach essentially rejects the notion of an EU-wide resolution fund as impracticable. Yet, the Commission's September 2012 paper, *A Roadmap towards Banking Union*, argued that a single resolution mechanism

> "would be more efficient than a network of national resolution authorities, in particular in the case of cross-border failures, given the need for speed and credibility in addressing banking crises. It would be a natural complement to

the establishment of a single supervisory mechanism. It would also entail significant economies of scale, and avoid the negative externalities that may derive from purely national decisions." [31]

The RRD therefore is not fully consistent with the logic of the SSM's aim to create a common resolution mechanism. Indeed, the Regulation creating the SSM is an important shift away from the harmonisation model of EU regulation which Member States have opted for in recent years in much of their financial regulation legislation. The RRD encapsulates the harmonisation (albeit from a minimum harmonisation perspective) of the legal framework governing recovery and resolution. However, the SSM/banking union proposals represent an alternative model that enshrines the concept of centralisation of sovereign authority that provides the ECB with competence to supervise all banks established in participating states in the SSM. The Commission's *Roadmap towards Banking Union* envisions an expansion of the ECB/SSM's competence for banking supervision to include a common resolution mechanism and common deposit guarantee scheme.[32] Tensions exist, however, between Member States regarding which model is more appropriate, as the RRD harmonisation model would apply to EU states not participating in the SSM whereas a common resolution mechanism would presumably apply only to Members States who decided to participate in the SSM and banking union.

Some EU regulatory officials are calling for 'stronger steps in the euro area towards a common resolution mechanism—maybe also a common resolution authority.'[33] This view is premised on the notion that stability in the Eurozone requires supervision, resolution and deposit insurance and monetary policy to be conducted institutionally at the euro area level. Indeed, there is a concern that certain inconsistencies would arise if supervision is conducted by a EU or euro area authority but resolution is conducted at the national level; this could lead to inconsistent policies; for instance, where there is a supervisory failure by a EU authority, a national resolution authority might decide not to spend its taxpayers' money to rectify the EU authority's supervisory mistakes. On the other hand, there is the view that a single resolution mechanism is not 'inevitable' nor 'absolutely necessary', whilst there are other views that consider a common resolution mechanism to be necessary only for large cross-border systemically important banks and financial institutions.

The legal, political and institutional complexity of establishing a common resolution mechanism should be recognised; however, if the goal of EU policymakers is to break the destructive link between banks and sovereign states then it may be necessary to revise the RRD substantially so that resolution and bank supervision in the SSM can be exercised in a more institutionally coherent and coordinated manner. Although the RRD is an important—albeit incremental—step towards strengthening EU banking supervision and regulation, the harmonisation model it sets forth—namely minimum harmonisation—is no longer adequate to ensure effective macro-prudential

[31] Commission Communication, COM(2012) 510 final.

[32] Ibid., p. 15.

[33] See Oral evidence of Andrea Enria, Chairman of the Supervisory Board, European Banking Authority, before *House of Lords Subcommittee on Europe* (Economic and Finance): European Banking Union: Key Issues and Challenges, 7th Report of Session 2012–13.

supervision and regulation of EU financial markets. The potential move, however, towards further banking union with a common resolution mechanism and a common deposit scheme runs the grave risk of deepening the growing split and division within the EU single market for financial services.

Any consideration of the RRD should be undertaken within the broader context of the ongoing Eurozone sovereign debt and banking crisis and the decision by EU Heads of State in December 2012 to establish the first pillar of banking union: the SSM. Moreover, it is envisaged that the ECB could be involved in providing liquidity support to banks and financial groups subject to a resolution procedure and future legislation could authorise the ECB to administer a euro area resolution fund. It is clear therefore that the proposed RRD Directive will be part of a broader policy and legislative package that will undoubtedly include major changes to EU banking regulation, supervision and resolution. This will undoubtedly result in substantial revisions to the RRD.

6 Conclusion

The European Commission's proposed Directive on a Bank Recovery and Resolution Framework is an important step toward building a more effective cross-border EU regulatory regime. It contains important principles that provide the basis to build a stronger EU resolution regime. However, clearer and more specific powers are needed for national resolution authorities to intervene in the operations of financial institutions so that they do not pose a serious risk to taxpayer funds. Effective prudential regulation and supervision requires a seamless process between the use of crisis prevention measures and crisis management powers, including recovery and resolution measures, for financial institutions in distress. The RRD proposal recognises the important link between crisis prevention and crisis management and therefore supports other important regulatory reforms designed to stabilize the European financial system. Nevertheless, this article suggests that although the RRD represents an important step in reforming the EU bank resolution regime, Member State supervisors should be given stronger powers to impose prompt corrective measures on failing banks and financial groups.

In addition, the ECB is expected to have authority to ensure compliance with European banking rules, such as capital adequacy. The Commission's proposal however does not address how the ECB's vast new supervisory powers will interact with member state resolution powers, nor does it address the legal question of whether it can do so under the Treaty.[34] However, assuming SSM is constitutional, EU policymakers

[34] Article 127 (6) of the EU Treaty provides that: "The Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the European Central Bank, confer specific tasks upon the European Central bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings." Under EU law, European institutions have legal competence to exercise powers that are specifically conferred. Under article 127 (6), the ECB does not have the conferred power to exercise supervision over credit institutions unless it is provided by unanimous consent of EU states. The Regulation granting bank supervisory powers to the ECB relies on Article 127 (6). According to Article

are confronted with the dilemma of whether they can centralise sovereign authority for the supervision of banks and other financial institutions with the ECB, yet maintaining a Member State driven resolution regime based on minimum harmonisation principles. Also, the need for burden-sharing amongst countries affected by possible fiscal costs of recapitalization must also be considered, as well as the imperative to minimize bailout costs for taxpayers. These outstanding issues suggest that continued work on a European Banking Union is urgently needed in order to design a more effective institutional framework that can achieve regulatory objectives while overcoming outstanding legal issues.

127 (6), however, the ECB can only have supervisory powers conferred on it 'concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.' This means it can only have bank supervisory powers conferred on it under this provision, not resolution powers, as suggested by President van Rompuy and the Commission.