

Banking Union Resolution 'Dossier' for FMIs¹

1 March 2021

1.1 INTRODUCTION AND PURPOSE

This document provides a brief overview of the resolution tools available in the Banking Union² and their impact on a bank's³ ability to maintain continuity of access to financial market infrastructures (FMIs) services in resolution. To the extent necessary, it also covers the resolution framework (institutional setup, objectives and decision processes) and the relevant legal provisions supporting continued access to FMI services in resolution.

1.2 RESOLUTION FRAMEWORK

The Single Resolution Mechanism (SRM) was established to ensure the uniform application of the bank resolution regime within the Banking Union⁴ and comprises the Single Resolution Board (SRB) and National Resolution Authorities of Banking Union countries (NRAs).⁵

The Single Resolution Mechanism Regulation (SRMR⁶) and Bank Recovery and Resolution Directive (BRRD⁷) grant the SRB and the NRAs with specific powers and resolution tools to ensure that the entities under their remit are resolvable. When applying these powers and tools, resolution authorities follow five resolution objectives⁸, as defined under the SRMR and BRRD. Among them are ensuring the continuity of critical functions and avoiding significant adverse effects on financial stability, in particular by preventing contagion, including to market infrastructures.

Conditions for resolution are the following:

¹ This publication is not intended to create any legally binding effect and does not in any way substitute the legal requirements laid down in the relevant applicable European Union and national laws. It may not be relied upon for any legal purposes, does not establish any binding interpretation of EU or national laws and does not serve as, or substitute for, legal advice. This document may be subject to further revisions, including due to changes in the applicable EU legislation. The SRB reserves the right to amend this publication without notice whenever it deems appropriate, and it shall not be considered as predetermining the position that the SRB may take in specific cases, where the circumstances of each case will also be considered.

² The Banking Union comprises the countries within the European Union (EU) that use the Euro as their currency and those that have transferred supervision to the ECB and resolution powers to the SRB, such as Bulgaria and Croatia.

³ The SRB is the resolution authority for banks that are considered significant or in relation to which the European Central Bank (ECB) has decided to exercise directly all relevant supervisory powers, as well as for other cross-border groups where both the parent and at least one subsidiary bank are established in two different participating Member States of the Banking Union and fall within the scope of Regulation (EU) No 806/2014 ("banks").

⁴ Including participating Member States.

⁵ Please see the SRB's website (<https://srb.europa.eu/en/content/what-bank-resolution>) for more information about bank resolution in the Banking Union.

⁶ (EU) No 806/2014.

⁷ (EU) No 879/2019.

⁸ <https://srb.europa.eu/en/content/resolution-objectives>.

- ▶ An entity is determined to be failing or likely to fail (FOLTF) by relevant authorities,⁹
- ▶ There are no supervisory actions or alternative private sector measures that would prevent its failure within a reasonable timeframe, and
- ▶ Resolution action is necessary in the public interest, i.e. the resolution objectives would not be met to the same extent if the bank were wound up under normal (national) insolvency proceedings. (If, on the other hand, resolution is not considered necessary in the public interest, a bank will be wound up by national authorities under normal insolvency proceedings.)¹⁰

In this context, resolution authorities rely on several valuations, for example for determining whether the conditions for resolution are met or for informing the decisions about the implementation of resolution tools. Resolution authorities shall thereby ask central counterparties (CCPs) to support the valuation of the derivatives contracts entered into by the bank in resolution in accordance with Commission Delegated Regulation 2016/1401 of 23 May 2016.¹¹ This is without prejudice to any other support that the resolution authorities may request the CCPs to provide.

1.3 WHY IS IT IMPORTANT TO PRESERVE ACCESS TO FMI SERVICES FOR A BANK IN RESOLUTION?

One of the resolution objectives is to ensure the continuity of a bank's critical functions¹². These are economic functions (such as deposit taking or lending) whose discontinuation would have a detrimental impact on the real economy and/or financial stability in one or more Member States. This may require continued direct or indirect access to clearing, payment, settlement, custody and other services provided by FMIs or by FMI intermediaries¹³, which are necessary for the performance of one or several critical functions.

Within the Banking Union, the SRB and the NRAs seek to ensure this as part of their resolution planning activities. Banks are requested to provide information for each FMI they are directly or indirectly members of and to draw up contingency plans to ensure that banks have:

- ▶ A detailed understanding of their FMI dependencies, including their importance for the continuity of critical functions and of core business lines that will need to be preserved throughout resolution (together "key FMI services");
- ▶ A detailed understanding of the rules governing each key FMI service provider relationship;

⁹ This entails that at least one of the following circumstances occur, or there is objective evidence that one of the first three will occur in the near future: (i) it infringes requirements for continuing authorisation in a way that would justify withdrawal of the license, (ii) its assets are less than its liabilities, (iii) it is unable to pay its debts as they fall due, (iv) it requires extraordinary public financial support (in a way that does not fall under regulatory exceptions).

¹⁰ Please refer to the paper on the [Public Interest Assessment : SRB approach](#).

¹¹ As part of the valuation to inform decisions about resolution action, the resolution authority will request each relevant CCP to provide its valuation of the early termination amount for all the derivative contracts in the relevant netting set, in accordance with the CCP default procedure. This will need to be provided within the set deadline agreed with the CCP and the CCP's competent authority; the CCP default procedure documents and the default management steps undertaken to conclude a valuation as set out above, if any.

¹² Please refer to the paper on [Critical functions: SRB approach](#).

¹³ FMI intermediaries are other institutions offering payment, clearing and settlement services, including by way of facilitating indirect access to an FMI.

- ▶ A strategy to maximise the likelihood of continuity of access in resolution to key FMI service providers; and
- ▶ The capabilities, in terms of governance, data and monitoring, operations, etc. to support continuity of access.

1.4 HOW DOES THE LEGAL FRAMEWORK SUPPORT CONTINUED ACCESS TO FMIS?

The legal framework in the EU supports continued access to FMIs for a bank in resolution. It does so, provided that certain requirements are met, by preventing the termination of contracts upon resolution, by supporting the transfer of access to a bridge institution or another transferee and by granting resolution authorities with powers to ensure the continuity of contracts:

- Article 68 BRRD prevents service providers and counterparties incorporated in the EU, including FMIs, from terminating contracts solely because an entity to whom services are provided is addressed with a crisis prevention or crisis management measure - as long as the 'substantive obligations' including payment and delivery obligations are met.
- Articles 38(12) and 40(10) BRRD support the access to FMIs, respectively, by a buyer or a bridge institution, by granting to the transferee, under conditions, the possibility to exercise any right that was exercised by the institution under resolution, including - *inter alia* - in respect of participation in/membership of FMIs and stock exchanges.¹⁴
- Article 64(1)(d)/(f) and (3)(a) BRRD grants resolution authorities the power to (i) ensure that the transferee is "treated as if it were the institution under resolution"; and to (ii) cancel or modify the terms of contracts, to ensure that the business transferred may be operated by the recipient.

1.5 HOW DOES THE LEGAL FRAMEWORK PROTECT THE OPERATIONS OF FMIS IN CASE OF RESOLUTION OF A BANK?

Whilst facilitating continuity of access, the legal framework also ensures that FMIs are exempted from the application of the resolution authorities' powers that may affect their operations. This contributes to achieving the second resolution objective, namely to avoid a

¹⁴ Articles 38(12) and 40(10) BRRD state that "MSs shall ensure that

- the purchaser/BI [...] may continue to exercise the rights of membership and access to payment, clearing and settlement systems, stock exchanges, investor compensation schemes and DGSs of the institution under resolution, provided that it meets the membership and participation criteria [...]
- access is not denied on the ground that the purchaser/BI does not possess a rating from a credit rating agency, or that rating is not commensurate to the rating levels required to be granted access to the system [...]
- where the purchaser/BI does not meet the [...] criteria [...] the rights [of membership] are exercised for such a period of time as may be specified by the RAs, not exceeding 24 months, renewable on application by the purchaser/BI to the RA."

significant adverse effect on the financial system, in particular by preventing contagion to market infrastructures. These legal protections for FMIs concern:

- An **exclusion from bail-in**: Resolution authorities should not exercise write-down or conversion powers in respect of liabilities with a remaining maturity of less than 7 days, owed to (operators of) designated systems or their participants, and arising from the participation in such a system, or to CCPs (including non-EU CCPs recognised by ESMA), in accordance with Art.44(2)(f) BRRD.
- An **exclusion from resolution stays**: Resolution authorities cannot suspend payment and delivery obligations towards CCPs (including non-EU CCPs recognised by the European Securities and Markets Authority, ESMA), as well as payment and settlement systems designated under Directive 98/26/EC ("designated systems") in accordance with Article 69(4)(b) BRRD.
- An **exclusion from the restriction of enforcement of security interests**: Resolution authorities cannot restrict (operators of) designated systems, CCPs (including non-EU CCPs recognised by ESMA) or central banks from enforcing security interests in relation to assets pledged or provided by way of margin or collateral in accordance with Article 70(2) BRRD.
- An **exclusion from the power to temporarily suspend termination rights**: Resolution authorities cannot suspend the termination rights of (operators of) designated systems, CCPs (including non-EU CCPs recognised by ESMA) or central banks in accordance with Article 71(3) BRRD.
- **Protection of trading clearing and settlement systems in case of partial transfer**: Operation and rules of designated systems should not be affected by resolution authorities' tools and powers to (a) partially transfer rights or liabilities; or (b) cancel or amend terms of contract or substitute a recipient in accordance with Article 80 BRRD. In particular, such a partial transfer shall not revoke a transfer order, modify or negate the enforceability of transfer orders and netting, the use of funds, securities or credit facilities or protection of collateral security.

1.6 RESOLUTION TOOLS AND POWERS: WHAT DO THEY MEAN FOR FMIs?

Resolution authorities in the Banking Union have four resolution tools at their disposal:

- ▶ The sale of business tool, allowing for the total or partial sale of the entity and its business, in accordance with Article 38 BRRD;
- ▶ The bridge institution tool, whereby part or all of the entity is transferred to a temporary ("bridge") entity, which is partially or fully owned by public authorities, in accordance with Article 40 BRRD;
- ▶ The asset separation tool, whereby assets, rights or liabilities can be transferred to an asset management vehicle, which is partially or fully owned by public authorities, in accordance with Article 42 BRRD; and
- ▶ The bail-in tool, which allows the cancellation, reduction and/or conversion of capital and debt owed by a bank to shareholders and creditors, in accordance with Article 43 BRRD.

During resolution planning, resolution authorities identify for each bank a preferred resolution strategy as well as, where necessary, one or more variant strategies. The resolution strategy comprises the resolution approach (multiple points of entry or single point of entry), as well as a preliminary view on the set of tools that resolution authorities expect to use in case of resolution. Resolution authorities may select different tools at the time of resolution depending on the circumstances.

The boxes below describe the potential impact of resolution tools on FMIs:

Tool:	Bail-in¹⁵
Description:	The bail-in tool allows resolution authorities to cancel, reduce and/or convert capital and eligible liabilities, with a view to absorbing losses and recapitalising the institution. The bail-in tool can be used on a stand-alone basis in an open bank bail-in. In this case, the aim is to restore its CET1 capital ratio and sustain sufficient market confidence, enabling the institution to continue operating and to meet, for at least one year, the conditions for authorisation. An open bank bail-in rests upon the condition that the institution will be restored to financial soundness and long-term viability. The bail-in tool may also be used in combination with other resolution tools, in which case it supports the implementation of these other tools.
Possible impact on FMI:	As outlined above, FMIs are generally excluded from bail-in. In the case of an open bank bail-in, the legal entity does not change. The aim of the bail-in is that the entity is sufficiently well capitalised to restore market confidence and to meet its regulatory requirements. The latter should facilitate access to liquidity for the entity in resolution. The entity remains a participant/member of the FMI and continues to fulfil its payment and delivery obligations. <u>In case the FMI provides credit/liquidity against collateral and accepts securities issued by banks as collateral:</u> An indirect effect on FMIs, unrelated to the membership/participation of the bank in resolution, may result from the write-down or conversion of securities issued by the bank that other counterparties post as collateral to the FMI. These counterparties could be expected to receive an additional margin call or collateral request to top-up their collateral balance. Similar effects can be expected in case of bilateral exposures between banks secured by securities issued by the bank in resolution and bailed-in. This may impact the activity of any triparty or securities financing transactions offered by FMIs. <u>Involvement of FMIs in reflecting the execution of bail-in:</u> Both the write down and conversion of capital instruments and bail-in entails action by

¹⁵ The potential impacts on FMIs are similar for the write-down and conversion of capital instruments and eligible liabilities pursuant to Article 21 of Regulation (EU) No 806/2014 (SRMR) ("write-down and conversion powers") and the execution of the bail-in tool in resolution.

	the bank's issuer CSD(s). This includes the mark down of CET1 items and the issuance of additional equity (following the conversion of bonds or other liabilities of the bank).
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Tool:	Sale of Business
Description:	The Sale of Business tool allows resolution authorities to sell all or parts of a failing entity to one or more purchasers without the consent of the failing entity's shareholders or any third party - other than the purchaser(s). There are two types of transactions: (i) 'Share deal': a transfer of shares or other instruments of ownership of the failing entity to the purchaser(s); and (ii) 'Asset deal': a transfer of assets, rights, or liabilities of the failing entity to the purchaser(s). The sale of business tool can be used on a stand-alone basis or in combination with other resolution tools. While this tool provides a market solution in response to a crisis, it relies on the availability of a purchaser(s).
Possible impact on FMI:	The Sale of Business tool foresees a change in legal entity and/or ownership structure, as the purchaser takes on either part or all of the rights and obligations of the bank in resolution, depending on the scope of the disposal. This is similar to an M&A process, whereby the legal transfer would take place upon resolution, whilst the operational transfer may take longer to materialise. In case of a share deal, the legal entity with which the FMI transacts and their bilateral contracts continue to exist. The new owner exercises the rights and obligations of the purchased entity, including those towards the FMI. In case of an asset deal, the purchaser usually takes over some activities of the bank (for example, deposit taking), which include rights and obligations towards FMIs, with the aim to integrate these activities into its own business. For this, continued access to FMIs is necessary. The purchaser, however, may already have established such access itself. It can be expected that all accesses of the (purchased part of the) bank in resolution are maintained (including BIC codes and operational infrastructures) until a successful integration into the new owner's infrastructure can be ensured. The purchaser is also responsible for meeting payments and delivery obligations. In the scenario where the purchaser would buy assets only, and not take over any of the activities of the bank, the remainder of the bank including the contractual relationships with the FMI may be subject to another resolution tool or wound down under normal insolvency proceedings. The fact that the FMI's member has been purchased and belongs to a new group is likely to have consequences on the external rating provided by

	rating agencies and/or the internal rating established by the FMI for the entity. This is not expected to have an impact on participation or membership. As noted under the general principles, the legal framework establishes the obligation for FMIs incorporated in the European Union, as well as stock exchanges, to continue accepting the transferee – after the sale of business – as a member or participant, provided it meets the relevant membership criteria, with a possible temporary exemption for the rating criterion, if applicable. <u>In case the FMI takes credit or liquidity risks on its participants or members</u> a rating change may impact the level of exposures that the FMI would be willing to bear, or the collateral that they may accept. FMIs will determine this in line with their rules.
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Tool:	Bridge institution
Description:	The Bridge Institution tool allows resolution authorities to transfer instruments of ownership (e.g. shares) or assets, rights, or liabilities of a failing entity to a bridge institution without the consent of the failing entity's shareholders or any other third party. This is similar to an M&A process, whereby the legal transfer to the bridge bank would take place upon resolution, whilst the operational transfer may take longer to materialise. The items for transfer are selected with the aim of maintaining the bank's critical functions, while the remainder may be wound down under normal insolvency proceedings. The bridge institution tool is a temporary measure to ensure the fulfilment of resolution objectives before finding a private sector solution. The bridge institution tool can be used on a stand-alone basis or in combination with other resolution tools. In principle, its lifespan is not expected to exceed two years, although under certain circumstances resolution authorities may extend this period by one or more years.
Possible impact on FMI:	The Bridge Institution tool entails a change in the legal entity that the FMI transacts with in case the transfer concerns an operating entity. In that case, it is not limited to ownership instruments but extends to the corresponding rights and obligations of the bank in resolution. The fact that the FMI member has been transferred to a bridge bank may have consequences on the external rating provided by rating agencies and/or the internal rating established by the FMI for the entity. Immediately after the resolution weekend, insufficient information may be available to carry out an assessment and to assign a rating to the bridge bank or its affiliates.

	This is not expected to have an impact on participation in or membership of the FMI. As noted under the general principles, the legal framework establishes the obligation for FMIs and stock exchanges incorporated in the European Union to accept the bridge institution as a member or participant, providing it meets the relevant membership criteria, with a possible temporary exemption for the rating criterion (if applicable). <u>In case FMIs take credit or liquidity risks on their participants or members:</u> a rating change may have an impact on the level of exposures that the FMIs would be willing to bear, or on the collateral that they may accept. FMIs will determine this in line with their rules. From an operational perspective, the bridge institution and/or its relevant affiliates would maintain all the accesses of the bank in resolution (including BIC codes and operational infrastructures) until a successful migration (including change of name and, where necessary BIC codes) can be ensured. Some FMIs may have established or envisage establishing fast-track admission procedures to speed up the (contractual aspects of the) migration process. The bridge institution is also responsible for meeting payments and delivery obligations. <u>For the remainder of the bank in resolution, which may be wound down under normal insolvency proceedings,</u> there is the possibility that certain FMI participations or memberships would be suspended or terminated following the liquidation of part of the bank's activities. As a result, the member's positions may need to be liquidated or re-allocated and client positions may need to be ported to another member of the same FMI, in accordance with the FMI's rules and procedures. This is particularly relevant for CCPs.
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Tool:	Asset separation
Description:	The Asset Separation Tool allows resolution authorities to transfer assets, rights, or liabilities from a failing entity or a bridge institution to an asset management vehicle (AMV) without the consent of the failing entity's shareholders or any other counterparty. Typically, this tool would be used to isolate NPLs of the failing entity by moving them into a vehicle where they can be managed as efficiently as possible. The AMV will manage the transferred assets with the aim to maximise their value through an eventual sale or orderly wind down.
Possible impact on FMI:	<i>A priori</i> , the AMV is not designed to hold a banking licence and is not expected to need access to an FMI (though it may need indirect access through a Clearing Member to manage its outstanding positions).