Study on the differences between bank insolvency laws and on their potential harmonisation

Executive summary

VVA, Grimaldi & Bruegel
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ABSTRACT

The resolution framework set out under Directive 2014/59/EU ('BRRD') provides EU Member States with comprehensive and harmonised arrangements to deal with failing banks at a national level, and is complemented in the euro area by the Single Resolution Mechanism Regulation (SRMR) that sets out a euro-area-wide resolution framework. But under EU law, unlike in the United States, resolution does not function as a stand-alone substitute for national insolvency proceedings. This study identifies the national insolvency procedures applicable to banks and analyses key differences between them, notably concerning the circumstances according to which the application of reorganisation or winding-up procedures is triggered, the ranking of liabilities, and the available tools to manage bank crises. By highlighting the differences that can be found in the legislative regimes applicable at national level and determining how these national insolvency regimes differ from the resolution regime as set out in the BRRD and SRMR, the study assesses the potential disadvantages that result from the lack of harmonisation of these bank insolvency regimes. Taking these disadvantages into account, policy options are outlined to address these divergences. The feasibility, benefits, obstacles and impact of these options are discussed. In terms of future revision of the current framework, more clarity and predictability of the applicable regime should be sought, particularly for medium-sized banks, with a holistic approach to reform that also takes into account related policies such as those on state aid control and deposit insurance.

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EXECUTIVE SUMMARY

The issue of the harmonisation of national insolvency laws as applicable to banks, including both winding-up and reorganisation of banks, has become increasingly relevant in the policy debate on the treatment of bank crises.

With the adoption of the Bank Recovery and Resolution Directive (BRRD)[1] and the Single Resolution Mechanism Regulation (SRMR)[2], European co-legislators introduced in 2014 harmonised rules for the crisis management of banks, setting out a framework to tackle non-viable credit institutions which are deemed to be of public interest[3].

These initiatives stem from the overall consideration that, due to the central role of banks in the economy as well as the general interconnectedness of the sector, bank failures may turn into systemic events which require consistent and coordinated regulatory action to allow early interventions and/or resolution and so avoid, when justified, normal insolvency proceedings. To this end, a harmonised resolution framework for the EU was adopted, as well as a single resolution mechanism for the euro area.[4] The resolution framework provides extensive and effective tools to ensure the continuity of the institution's critical functions. The new EU framework also contains measures to further improve the achievement of coherent action within the Banking Union by creating a European resolution authority (the Single Resolution Board) as well as a Single Resolution Fund.

When it is assessed that resolution of a bank is not in the public interest, the BRRD and the SRMR stipulate that national laws apply. Within the EU, these national insolvency regimes (specific or not to banks depending on member states) differ substantially from one another. **The study therefore aims to describe and compare the national bank insolvency frameworks of Member States, as well as to assess potential benefits of a more harmonised insolvency regime for banks. It assesses the feasibility of pursuing further harmonisation in this area, having in mind relevant interactions between insolvency law and resolution.**

The results of this study will feed into the Commission's analysis of potential further action to improve the available tools to address bank failures. This study has been conducted pursuant to a European Parliament Pilot Project on the Banking Union.

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[1] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council, OJ L 173, 12.6.2014, p. 190–348.

[2] Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010, OJ L 225, 30.7.2014, p. 1–90.

[3] This comes in addition to the previously adopted Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions, OJ L 125, 5.5.2001, p.15.

[4] For purposes of readability we occasionally refer to the euro area as the geographical scope of applicability of banking union policies, even though non-euro-area countries may also join voluntarily through the procedure of close cooperation.

Methodological approach to the study

The study was largely based on desk research, complemented with analysis of legal issues. A number of interviews were carried out with practitioners to complement the desk research. Certain aspects of the analysis were substantiated, to the extent possible, on the basis of available data, such as information on the number of issuances of certain categories of financial instruments.

In particular the study included the following objectives:

1. Mapping and analysis of the differences in the legislative regimes applicable at national level to normal bank insolvency proceedings.

The main methodological tool applied was desk research and the geographical scope included all the 28 Member States, as well as the United States (US) and Switzerland.

The main sources of information were national official journals, websites of the national banking supervisory and resolution authorities, law journals and academic publications, national case law databases, previous studies carried out for the European institutions (in particular the European Commission and the Parliament) and stakeholder consultations.

The analysis covered the main aspects of the national insolvency procedures applicable to banks, including:

- The administrative and judicial nature of the insolvency procedures;
- The circumstances under the applicable national insolvency laws which trigger the application of reorganisation or winding-up procedures;
- Specific description of the hierarchy/ranking of claims under the insolvency regime applicable to the bank, in particular with respect to the ranking of depositors;
- Procedural aspects, including standing to initiate the proceedings and appointment of the administrator/liquidator;
- The main objective(s) of national bank insolvency proceedings and the tools available.

2. Assessment of potential available options in terms of the harmonisation of bank insolvency regimes.

Available options in terms of harmonisation of bank insolvency regimes were identified through consultation with relevant industry associations working at the EU level and competent national bodies. These included financial market (Austria) / stability (Finland) / supervisory (Germany) / surveillance (Luxembourg) / services (Malta) authorities, national central banks (Belgium, Bulgaria, Croatia, Cyprus, Czechia, France, Greece, Hungary, Ireland, Italy, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, UK), resolution authorities (Denmark, Estonia) and the Swedish National Debt Office.

With industry associations, the research was based on interviews, while national respondents were given the opportunity to answer a written questionnaire featuring open as well as closed questions. As a result, 12 national respondents replied to the written questionnaire and two industry associations were interviewed. In addition, a meeting was held with the European Banking Federation (EBF) which was attended both by a representative from the EBF and around twenty-five of its members.

3. Policy considerations on the current EU regime for FOLF banks.

We also reflected on the overall policy regime applicable to banks that are failing or likely to fail (FOLF). This reflection allowed us to identify some perceived shortcomings and to understand whether additional useful elements for a reflection on potential avenues for further harmonisation of the insolvency laws for banks can be derived from this analysis.

Outcome of the analysis and points for further reflection

The analysis carried out shows that insolvency regimes for banks at national level are extremely varied, both in terms of general structure (administrative or judicial) and specific aspects, such as the hierarchy of claims or the triggers to initiate the proceedings.

The analysis focused on three main aspects of the proceedings: the triggers to initiate insolvency proceedings, the ranking of liabilities and the available tools to manage bank crises.

With respect to triggers, we found that they are generally linked with balance sheet insolvency (liabilities exceeding assets) and/or with cash-flow insolvency (illiquidity). National specificities arise, however, whether they refer to the possibility to take into account forward-looking elements (i.e. that the bank is likely to become balance sheet or cash flow insolvent) or to the prerequisite of withdrawal of the banking licence by the supervisor (which, in some cases, is the only possible ground for initiating insolvency proceedings). In some Member States, insolvency can be triggered on the basis of a specific public interest assessment.

Our analysis also indicates that the triggers to initiate national insolvency regimes are in most countries not aligned with the triggers to initiate resolution, particularly the conditions that justify a bank being considered as failing or likely to fail, as per Article 32(1) BRRD. On this basis, the study provides some considerations with respect to the desirability of a harmonised set of triggers aligned with those currently foreseen for FOLF under the BRRD.

Another element of the national insolvency frameworks which was analysed in the study is the diversity with respect to the ranking of liabilities. It should be highlighted in this respect that EU legislation has been increasingly pursuing further harmonisation of banks' liabilities ranking in the context of insolvency, first through the original text of the BRRD, and then as a result of additional legislative interventions, particularly the 2017 Bank Creditor Hierarchy Directive (BCHD, (EU) 2917/2399) and the so-called "Banking Package" including the "BRRD2" directive amending the BRRD[5].

However, the analysis carried indicates that there are some areas where the ranking of liabilities diverges among different national insolvency laws. A reflection on whether there is room for further harmonisation of the ranking of liabilities, with particular focus on deposits, is then provided.

Finally, some considerations on the issue of the tools available in insolvency are given. In this respect, it is noted that a few national insolvency laws of Member States provide for tools which are comparable, in terms of scope and effectiveness, to those available in resolution.

[5] https://www.europarl.europa.eu/legislative-train/theme-deeper-and-fairer-internal-market-with-a-strengthened-industrial-base-financial-services/package-banking-reform-package

On the basis of the descriptive analysis, the study provides some points for reflection on possible reform. These may be motivated by a range of policy objectives, including that of moving closer to a true single market for banking, and the aim to break the vicious circle between banks and sovereigns which has been consistently invoked as the motivation for the creation of the banking union.

The study explores whether the addition of a set of tools (comparable to those available in resolution) in a harmonised way in the insolvency laws of all Member States is a desirable and feasible improvement to the current framework. We also looked into some the possible features of a more consistent and predictable regime, taking inspiration partly from the experience in the United States and the procedures managed there by the Federal Deposit Insurance Corporation (FDIC). On this basis, we sketched out some of the core elements which, in our view, should be put forward for further discussion.