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Cross-Border Resolution of Banking Groups: International Initiatives and U.S. Perspectives – Part II

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This is the second part of a three-part article analyzing the efforts of international bodies to create effective resolution regimes for systemically important cross-border banking institutions. This part discusses the ongoing efforts of the Financial Stability Board to promote such regimes and prominent national and regional efforts in the European Union aimed at bank resolution reform.

The promulgation by the Financial Stability Board (the "FSB") of the Key Attributes of Effective Resolution Regimes for Financial Institutions (the "Key Attributes") in November 2011 represented an important step in promoting more robust national regimes for the resolution of cross-border banking institutions.[1] However, as noted in Part I of this article, it was only a first step. The promulgation of the Key Attributes by the FSB as international financial standards had no self-executing effect. Although each member jurisdiction of the FSB has committed under the FSB Charter to implement the international financial standards established by the FSB,[2] implementation requires individual action at the national level, typically involving both legislative and regulatory components.

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Suasion, fortified by monitoring by such international bodies as the International Monetary Fund and World Bank, is the principal tool at the disposal of the FSB to prompt implementation by member jurisdictions. The issuance of additional guidance by the FSB on the expectations surrounding various Key Attributes may also facilitate the implementation process. Countries like the United Kingdom (the "U.K.") and Switzerland that face a large potential (and in the last crisis, actualized) exposure to their banking sectors and regions like the European Union (the "EU") that have experienced recent financial crises have their own incentives to move expeditiously to reform their resolution mechanisms. This part of the article discusses the FSB's ongoing promotion efforts as well as prominent national and regional efforts in the EU aimed at bank resolution reform.

FSB DEVELOPMENTS

FSB 2012 Progress Report

In November 2012, a year after the issuance of the Key Attributes, the FSB released a high-level progress report on the international adoption of resolution regimes reflecting the Key Attributes.[3] The focus of the progress report was on the implementation of the Key Attributes that were specifically directed at global systemically important financial institutions ("G-SIFIs"). These particular Key Attributes relate to requirements for cross-border crisis management groups, institution-specific cross-border cooperation agreements, recovery and resolution plans, and resolvability assessments. As to these requirements, the progress report found "[c]onsiderable but uneven" progress.[4] Significantly, the report noted that, in the course of this work, it had become clear to the FSB that many of the requirements in the Key Attributes were in fact interdependent. The lack of progress on one process or element could severely impede progress on other processes or elements. In the end, progress on most of these initiatives was also directly dependent on the reform of national resolution regimes. Without fundamental legislative reform, progress on other fronts, such as the formation of cross-border crisis management groups, institution-specific cross-border cooperation agreements, and recovery and resolution plans might create the appearance (or in the word of one commentator, the veneer) of greater convergence than actually exists.[5] The FSB itself acknowledged that "getting the right legislation" in place was essential to the effective implementation of resolution for G-SIFIs and the legal capacity for cross-border cooperation.[6]

On a more positive note, the FSB cited the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") as an important step toward implementation of the Key Attributes.[7] The alert observer will, of course, recall that the Dodd-Frank Act was enacted more than a year before the promulgation of the Key Attributes (and so it might more accurately be said that the Key Attributes of the FSB represent an important step in implementing the key attributes of the Dodd-Frank Act than the reverse). In any event, the FSB correctly noted that the adoption by the European Commission in June 2012 of a proposal for a bank recovery and resolution directive (the "RRD") would be critical to advancing reforms in the EU.[8] The FSB also highlighted, in abbreviated fashion, legislative changes that had been made in resolution regimes in certain FSB member jurisdictions, such as Germany, Spain, Switzerland, the Netherlands and the U.K., as a sign of some progress.[9]

FSB 2012 Consultative Documents

At the same time that it released its high-level progress report in November 2012, the FSB also released for comment three consultative documents on recovery and resolution planning.[10] The FSB had concluded that additional guidance on certain aspects of the Key Attribute requirements would be helpful in facilitating the national implementation processes. Indeed, many industry participants had urged upon the FSB the need for significantly more guidance on the implementation of certain Key Attributes, including specifically recovery and resolution planning. The consultative documents offered guidance covering three related areas: (i) recovery triggers and stress scenarios; (ii) resolution strategies and operational resolution plans; and (iii) identification of critical functions and critical shared services.

The FSB consultative document on resolution strategies observed that resolution planning in cross-border crisis management groups had generally coalesced around two "stylized" approaches: (i) a single-point-of-entry

("SPE") approach, involving the application of resolution powers at the top holding company level by a single resolution authority; and (ii) a multiple-point-of-entry ("MPE") approach, involving the application of resolution powers by two or more potential resolution authorities to multiple entities within a corporate group.[11] The Federal Deposit Insurance Corporation (the "FDIC") had previously outlined these two resolution approaches in January 2012 as part of its implementation efforts under Title II of the Dodd-Frank Act.[12] As early as that January 2012 presentation, it became clear that the staff of the FDIC regarded the SPE as the more promising approach, particularly from the perspective of minimizing the potential for adverse cross-border consequences of a resolution of a large complex U.S. financial institution.[13]

The SPE approach at its most "stylized" envisions that a legal resolution would occur only at the top holding or parent company, avoiding to the greatest extent possible the initiation of resolution proceedings at the level of the operating subsidiaries. This approach minimizes the complexities and conflicts that would invariably arise if multiple resolution proceedings (even within a home jurisdiction) had to be commenced at the level of the operating subsidiaries. This approach also holds the promise of minimizing the need for resolution proceedings in host jurisdictions. This approach envisions that losses that have been incurred at the level of the operating subsidiaries will be "pushed up" to the top holding or parent company, avoiding legal resolution at the operating subsidiary level. It permits the operation of critical home and host country functions on a going concern basis.[14]

The SPE approach is premised on the number of significant assumptions. The first is that there will be sufficient loss-absorbing capacity at the top company level. This loss-absorbing capacity at the top company level must be sufficient to bear the losses suffered not only at the top company level, but also those that would otherwise be incurred at the operating subsidiary level. This assumption in turn rests on several sub-assumptions. The first is that the parent company will have the sufficient "bail-in-able" debt on the parent-only balance sheet to permit the conversion of such bail-in-able debt into equity to recapitalize the group on a consolidated basis. The second assumption is that the parent company will have sufficient assets on the parent-only balance sheet to permit the intra-group recapitalization of the principal operating subsidiaries. This recapitalization could be accomplished through the contribution of assets by the parent company to the individual operating subsidiaries or through conversion into equity of debt owed by the operating subsidiaries to the parent company or through a combination of such techniques. The intra-group recapitalization of the operating subsidiaries must be sufficient to restore the capital of those subsidiaries to levels that the market-place finds adequate (after accounting for all the losses at the operating subsidiaries).

The third assumption is that the parent (or successor bridge company) will be in a position to provide liquidity support to its operating subsidiaries. The holders of "runnable" liabilities at operating subsidiaries (and the supervisory authorities of those subsidiaries) will require strong assurances that the parent company or successor bridge company will support the ongoing operations of the operating subsidiaries. The intra-group recapitalization envisioned above does not directly provide liquidity to the operating subsidiaries. Guarantees from the parent company or successor bridge company will likely be required by the market place and the relevant supervisory authorities. To be effective, such guarantees may also have to be backed by a pledge of assets or by a government or other public sector guarantee.

The SPE model rests on a set of robust assumptions. Like other models, the assumptions underlying the SPE will need to be carefully assessed. In several instances, the predicates for the assumptions will need to be established by regulatory or supervisory requirements. The FDIC and the Federal Reserve Board, for instance, have indicated that they intend to propose a long-term debt requirement for systemically significant bank holding companies as a first step in establishing one of the predicates (sufficient "bail-in-able" debt) for the possible use of an SPE approach.[15]

The FSB consultative document discussed the SPE and MPE approaches in a relatively clinical fashion, noting the requirements for making either strategy operational. It noted first that the selection of either the SPE or MPE strategy will depend on the circumstances of the case. The consultative document noted, for example, that the efficacy of the SPE strategy may be dependent upon a G-SIFI's corporate organization and funding structure.[16] It noted as well that a combination of the SPE and MPE approaches may be appropriate in certain circumstances. Thus, where a G-SIFI has a specific group of non-viable operating subsidiaries, it may be appropriate to use the

MPE to "carve out" the non-viable group from the larger group, leaving the larger group to be resolved under an SPE approach.[17]

The FSB consultative document also provided a preliminary discussion of the pre-conditions to the use of either of these resolution strategies and the development requirements for these resolution strategies. As the FSB consultative document noted, to make the SPE strategy effective it will be necessary to have sufficient loss-absorbing capacity at the holding company level to ensure that the surviving parts of the group are viable. It will also be necessary to create sufficient certainty on the part of host country authorities that the home country authorities will allow the resources generated by a recapitalization at the parent company level or otherwise made available from other sources to be down-streamed to host country subsidiaries.[18] The FSB consultative document noted that the SPE approach will also require clarity on the legal, regulatory, accounting and tax implications of arrangements for a parent company to assume losses of its operating subsidiaries and to down-stream resources generated through a bail-in at the parent company level to the subsidiaries.[19]

In this respect, it should be noted that the FDIC as well as industry groups in the U.S. have devoted substantial resources to building out the conceptual and legal underpinnings of the SPE model.[20] In addition, the operational requirements of the approach are being tested through public and private simulation exercises.[21] The FDIC has also invigorated its efforts to promote the SPE approach, including through coordination efforts with such foreign authorities as the Bank of England, the European Commission, the Japan Financial Services Authority, and the Swiss Financial Market Supervisory Authority.[22] As discussed below, this coordination effort resulted, in December 2012, in the issuance of a Joint Paper by the FDIC and the Bank of England on the feasibility of the use of the SPE approach by the U.S. and the U.K. authorities.[23]

At the same time, however, there have been some disquieting notes emerging from the United States on the question of the level of confidence in cross-border cooperation. In December 2012, the Federal Reserve Board released a proposal to implement provisions of the Dodd-Frank Act applicable to foreign banking organizations with a U.S. banking presence and with total global consolidated assets of $50 billion or more.[24] The proposal marks a significant departure from past U.S. practice, which has generally relied on consolidated supervision by home country authorities for oversight of capital and liquidity management of foreign banking organizations. The proposal includes various structural and regulatory elements that appear to rely instead on the ring-fencing in the United States of capital and liquidity for the U.S. operations of foreign banking organizations. In the preamble to the proposal, the Federal Reserve Board discussed how events during the financial crisis and subsequent changes in the approaches of other countries to the support of their banking organizations had called into question elements of the Board's past approach to supervising foreign banking organizations. The Federal Reserve Board noted that several other national authorities had adopted or were considering proposals to modify their regulation of internationally active banks within their geographic boundaries, including requirements to prioritize or segregate home country retail operations. In this regard, the Federal Reserve Board specifically cited certain developments and proposals in the U.K., which are discussed below.[25] The Federal Reserve Board proposal itself is discussed in detail in Part III of this article.

In January 2013 the press also reported that the Federal Reserve Board and the FDIC were advising large U.S. banks that they should not assume cooperation from foreign authorities when preparing the next iteration of their living wills.[26] The thrust of this story was confirmed in April 2013 when the Federal Reserve Board and the FDIC released written guidance for the 2013 submission of resolution plans, specifically directing the banking institutions to analyze the effects of non-cooperation from foreign authorities on their proposed resolution plans.[27] These developments have created a measure of dissonance about the level of confidence that the U.S. authorities actually have for the prospects of international cooperation in a future crisis. In light of the events of 2008, however, the U.S. authorities may perhaps be forgiven for believing that international cooperation should now be more fact-based than faith-based.

FSB 2013 Guidance

In July 2013 the FSB released final guidance documents on recovery and resolution planning after receiving comments on the November 2012 consultative documents.[28] The final guidance documents benefitted from industry comments, but perhaps not always in the ways that the industry had intended. For example, the final guidance document emphasizes the notion (mentioned only in passing in the consultative document) of sufficient loss-absorbing capacity ("LAC").[29] The guidance indicates that LAC needs to be available (i) in sufficient amounts, (ii) with minimum maturities, and (iii) at the right location in a corporate structure to facilitate the recapitalization or orderly wind-down of the firm or parts of the firm. The location of the LAC at the parent or at particular subsidiaries would be a significant factor in the choice of a preferred resolution strategy, *i.e.*, an SPE vs. MPE approach. The guidance suggests somewhat timidly that the authorities may need to consider the introduction of requirements for firms to hold a sufficient amount of LAC, "taking into account the potential impact of such requirements on the firms' financing cost and business operations."[30] The notion that at least the largest banking institutions should be required to maintain a specified LAC, consisting of equity, subordinated debt, and "bail-in-able" long-term debt has already been espoused by leading supervisory figures in the United States and in Europe.[31] Sufficient LAC has emerged as a key determinant of the feasibility of either an SPE or MPE strategy to provide for an orderly recapitalization and resolution of a large complex financial institution and its constituent parts. If sufficient LAC can be established for either an SPE approach or an MPE approach, it would substantially diminish the concerns with burden-sharing between home and host jurisdictions. The possible need for temporary government support of short-term liquidity in any resolution approach, however, might still require advance agreement among the relevant jurisdictions on liquidity issues. The coupling of a sufficient LAC approach with an SPE or MPE approach appears to be the most promising development in resolution planning.

In its final guidance document, the FSB also returned to a "critical consideration" that it first discussed in detail in connection with the Proposed Key Attributes in July 2011: depositor preference laws and their relation to the treatment of depositors in a bail-in exercise. The guidance document observes that

> [u]nless a jurisdiction provides for a depositor preference, a strict application of *pari passu* would require that uninsured deposits and, in respect of insured deposits, the deposit insurer assume losses along with senior unsecured debt if both are in the same class.[32]

As the guidance document notes, in an insolvency proceeding the deposit insurer generally assumes the rights and obligations of the insured depositors in respect of the insured part of their deposits. As a result, the position of the deposit insurer in the creditor hierarchy and the extent to which it will bear losses under a *pari passu* principle will depend on whether the insured deposits are preferred. A preference for the insured portion of deposits will limit the losses that the depositor insurer would otherwise suffer in a liquidation of the bank. For the holders of deposits that are not eligible for insurance and for those portions of eligible deposits that exceed the insurance amount limit, the extent of loss under *pari passu* principles will also depend upon whether they are covered by any depositor preference law. The FSB relegates to a footnote in the guidance document its discussion (or more accurately, its listing) of depositor preference approaches.[33] The first is a "general depositor" preference, giving preference to all deposits, irrespective of their deposit insurance eligibility, covered status, or location. The second is an "eligible depositor" preference, giving preference to all deposits meeting the eligibility requirements for deposit insurance coverage irrespective of insurance limits. The third is an "insured depositor" preference, giving preference only to insured depositors up to the coverage limits of the deposit insurance scheme.

The existence and scope of any depositor preference provision in national law will affect the application of the *pari passu* principle in Key Attribute 5.1 and the bail-in principle in Key Attribute 3.5. Key Attribute 5.1 provides that resolution powers should be exercised in a way that respects the hierarchy of claims, although it also provides that there should be flexibility to depart from the general principle of equal treatment of creditors in the same class if necessary to contain the potential systemic impact of a firm's failure or to maximize the value for the benefit of all creditors.[34] Key Attribute 3.5 provides that resolution authorities should exercise bail-in within resolution by writing down or converting into equity all or parts of unsecured and uninsured creditor claims in a manner that respects the hierarchy of claims in liquidations as envisioned by Key Attribute 5.1.[35] If a statutory depositor preference provision exists in a national insolvency law, it should be self-effecting for purposes of Key Attributes 3.5 and 5.1. Moreover, a synoptic reading of Key Attributes 3.5 and 5.1 suggests that even in the absence of a deposit preference law provision in national law, a national resolution authority could exclude certain uninsured deposits from a bail-in if it determines that it is necessary to contain the potential systemic impact of the firm's failure. The latter approach to Key Attributes 3.5 and 5.1 would, however, create the potential for different outcomes on the face of similar national laws that do not contain an express depositor preference provision.

In the end, the FSB guidance offers no guidance on the basic policy questions as to the use or scope of depositor preference laws. It simply observes that Key Attribute 7.4 provides that the treatment of creditors and the ranking of claims in insolvency should be transparent and properly disclosed to depositors and other creditors (and of course should not discriminate against depositors and creditors on the basis of nationality or the location of the claim). The FSB guidance urges home and relevant host jurisdictions to make clear the creditor hierarchy in their jurisdiction, including the ranking of deposits and the scope of depositor preference, if applicable.[36] The FSB guidance in effect leaves to national preference the issue of depositor preference.

There is in fact an active ongoing discussion in many quarters of the advantages and disadvantages of a depositor preference rule. Paul Tucker, the recently retired deputy governor of the Bank of England, expressed his views on the topic earlier this year:

> I can see a case for both insured and some uninsured depositors being preferred. That would help to provide some protection, beyond the [Deposit Guarantee Scheme], for users of the monetary services that banks provide via overnight and short-term deposits; it would provide a small degree of protection against runs; and there could be an element of social justice in insulating, say, small firms and charities from the first line of loss.[37]

Tucker was not inclined to extend depositor preference to large wholesale deposits with term maturities because they are not in the nature of transaction balances and because this treatment would likely cause other term financing simply to be recast into the legal mold of "deposits."[38]

Another advantage to a depositor preference rule covering uninsured deposits would be that it would facilitate the resolution of banks by avoiding the cumbersome task of splitting eligible deposits into covered and uncovered parts and would allow uninsured deposits to be transferred along with insured deposits to a bridge bank or other successor, thus increasing the franchise value of the bank in resolution.[39] In any event, most observers seem to be in agreement that the harmonization of depositor preference rules would provide important certainty and predictability to a bank resolution. As discussed below, the EU now seems committed to promoting such harmonization as it considers revisions to its proposed RRD.

Other critical issues are likewise discussed, if not resolved, in the FSB guidance document. The guidance document notes that in devising a resolution strategy there must be "sufficient" legal certainty that bail-in actions taken by a resolution authority will be effective, including with respect to debt issued under foreign law or out of a foreign jurisdiction by a branch or special purpose entity.[40] The options for achieving sufficient certainty with respect to such debt are less than promising. One option would be the required inclusion in foreign debt instruments of clauses that recognize resolution actions by the home resolution authority. Another option would be hoped-for complementary actions by home and host resolution authorities giving effect to a write-down or conversion of debt in a particular resolution case. A variant on the latter option would be a bilateral or multilateral mutual recognition agreement on foreign resolution actions. In the near term none of these options is likely to be sufficiently certain of accomplishment to provide the "sufficient" legal certainty that the FSB seeks.

A similar issue is presented by the limited jurisdictional reach of even those Key Attribute-compliant home country resolution regimes that provide for temporary stays on the close-out, termination, and cross-default provisions in financial contracts.[41] The FSB guidance document can only suggest that the authorities review their regulatory policies and incentives for firms to adopt contractual provisions that would temporarily stay the counterparties' rights in certain resolution events.[42] The abbreviated discussion in the guidance document of this issue, like the extraterritorial issues for bail-in within resolution, is nonetheless enough to suggest the significant issues that supervisors and firms will confront in ensuring that any preferred resolution strategy can be made operational.[43]

The guidance document identifies other operational and structural issues that may affect the viability of a particular resolution strategy. As to LAC, not only must it be sufficient and in the right location in a group structure, but it must also be held "in the right hands," avoiding concentration in other financial firms, insurers or pension funds that could have an impact on financial stability.[44] Within a financial group, the funding and liability structure would need to be set up in a way that allows losses to be pushed up to the top-tier parent or holding company. This may require the provision of debt funding by the parent company to the most important subsidiaries that can be written down or converted into equity in amounts sufficient to recapitalize those subsidiaries. But in some regulatory regimes, large exposure limits on intra-group funding could impose constraints on this funding of subsidiaries.[45] The guidance document also suggests that if the intra-group funding is senior or even *pari passu* with external debt issued by the subsidiary, it may not be possible for losses incurred by the subsidiary to be absorbed by the parent before external creditors suffer losses.[46] At the most basic level, valuation methodologies and the speed at which valuation can be done may also affect the feasibility of a bail-in approach.

The guidance document envisions that the pre-conditions for successfully executing an SPE strategy would differ from those for successfully executing an MPE strategy and recommends that the authorities identify in advance the "preferred" strategies for a firm or parts of a firm.[47] At the same time, the guidance document notes that there is no binary choice between the two approaches and that in practice a combination of the two approaches might be necessary to accommodate the structure of the firm and the local regimes where it operates and that at least in some cases a group might need to be restructured to make it more amenable to one strategy or another.[48] The guidance document also recommends that fall-back strategies should be considered, as for example in the case where a preferred resolution strategy cannot be implemented because losses of specific operational subsidiaries exceed the LAC of the top-tier or holding company.[49] The guidance document thus leaves open the possibility that a firm and its supervisors may have to plan for multiple approaches, including SPE, MPE and combinations or variations of the two, as well as fall-back strategies. The guidance document may be correct in stating that there is no binary choice between the two theories *in theory*, but *in practice* a choice must at some point be made at least for preparation purposes.

Finally, the guidance document offers advice on the important question of what public disclosure of resolution strategies should be made by the supervisory authorities. As the FSB indicated in its overview of the comments received on the 2012 consultative document, a number of respondents commented on the desirability of disclosure of a "presumptive" path or approach to the resolution of individual firms while recognizing the need for the authorities to retain flexibility for handling the specific circumstances of a failure.[50] Other respondents expressed concern about the risk of negative market reactions to disclosure of plans for specific institutions.[51] The guidance document itself marks out a middle course. The guidance document refers only to the possibility of a "preferred" approach, not a "presumptive" approach, to avoid the appearance of committing the resolution authorities to a particular approach. It nonetheless indicates that the authorities may want to make some information about institution-specific resolution strategies available to the public.[52] When the authorities choose not to disclose publicly the resolution strategies for individual firms, the guidance indicates that they should at least communicate their possible approaches at a generic level (without reference to specific individual firms) to help inform market expectations.[53] But it is likely that a generic type of disclosure will be made sufficiently anodyne as to not sufficiently inform market expectations.

In one respect, however, the guidance document does offer the prospect of greater disclosure. It suggests that the authorities consider disclosing, or requiring firms to disclose, the amount, location and nature of the LAC (including its position in the creditor hierarchy) on an individual entity basis.[54] This type of disclosure might better inform the marketplace of the potential risk of loss for creditors in the hierarchy (subject always to the assumption that bail-in can otherwise be made operational with respect to the firm).[55] The guidance document does acknowledge, as many industry respondents had urged, that disclosure of specific aspects of both resolvability assessments and resolution strategies may need to be made to the financial firms in order to develop effective resolution plans.

FSB April 2013 Thematic Review

While the FSB was in the midst of developing additional guidance on the Key Attributes, it was also in the process of surveying progress on the implementation of the Key Attributes. In April 2013 the FSB issued a detailed progress report on the implementation of the Key Attributes in the form of a Thematic Review on Resolution Regimes.[56] This Thematic Review, conducted as a peer review exercise by a team led by the FDIC, analyzed existing resolution regimes in all the FSB member jurisdictions against the Key Attributes as a benchmark. The Thematic Review is the most detailed analysis to date of the resolution regimes of the FSB member jurisdictions.

The high-level conclusions of the Thematic Review were mixed at best. Indeed, one press source headlined its report on the FSB report as "G20 countries falling well behind on resolution plans."[57] In summary, the FSB concluded that

- in many member countries, resolution authorities currently lack important powers needed to resolve systemic institutions, such as the power to achieve rapid transfer of assets and liabilities and to write down or convert liabilities into equity;
- most jurisdictions lack power to take control of the parent company or affiliates of a failed financial institution;
- few jurisdictions currently have expedited procedures for giving effect to foreign resolution actions and clear statutory provisions for domestic authorities to share information and cooperate with foreign authorities;
- resolution authorities in most jurisdictions lack the power to impose a temporary stay on acceleration or early termination rights in financial contracts;
- most jurisdictions rely on privately sourced funds for resolution but it is unclear whether such arrangements are adequate in scale or scope; and
- many jurisdictions lack a statutory resolution planning requirement or the power to require firms to make changes to their structure to improve their resolvability.[58]

More specifically, the FSB reported that only two jurisdictions (Switzerland and the United States) had provisions authorizing their resolution authorities to write down equity and unsecured debt and convert debt claims into equity.[59] Only four jurisdictions (Canada, Spain, Switzerland, and the United States) currently provide for the imposition of a temporary stay on the exercise of contractual acceleration or early termination rights.[60] Only three jurisdictions (Japan, Singapore, and Switzerland) currently have statutory provisions through which actions by a foreign resolution authority for a banking institution could be given prompt legal effect (subject to a qualification for the required mutual recognition by one EU Member State of a winding-up proceeding in another EU Member State).[61]

The FSB also noted that progress in establishing firm-specific cross-border cooperation agreements had been relatively slow both because they present complex issues and because in many jurisdictions the powers necessary to implement a preferred resolution strategy had not yet been provided.[62] The FSB re-iterated that resolution strategies, resolution plans, and cooperation agreements cannot be made operational without national legislation providing both the resolution tools and the legal basis for close cooperation and exchange of information. This somewhat negative overall assessment was leavened in the mind of the FSB by the "substantial headway" made in the U.S. with the adoption of the Dodd-Frank Act and by the "refinements" made to resolution regimes in other FSB jurisdictions, such as Australia, Germany, France, Netherlands, Spain, Switzerland and the U.K.[63]

The FSB also looked forward to the prospect of future progress, particularly in the form of the adoption and implementation of the EU's proposed RRD, which would incorporate most of the principles reflected in the Key Attributes.[64] The FSB appeared to pin much of its hope for further progress on the adoption of the proposed RRD, in no small part because the EU is home to 14 of the 28 global systemically important banks that have been designated by the FSB.[65] Events in Europe since the time the FSB began its reform initiatives in 2009 have independently emphasized the need for, and the challenges attending, reform efforts directed at facilitating bank resolution.

EUROPEAN INITIATIVES

The epicenter of the financial crisis in the 2007-2009 period appeared to be in the United States although the effects of the crisis were widely felt in European banking systems.[66] By 2010 as part of a seismic shift, the epicenter of the financial crisis had moved to Europe, or perhaps more precisely (and more incongruously for an epicenter) to the periphery of Europe. Events in such countries as Greece and Cyprus have highlighted the risks to the stability of banking systems when the sovereign itself experiences significant financial difficulties. The linkage between sovereign debt and the banking systems in the EU has now come to be described by economists as a "doom loop" and by governmental authorities as a "vicious circle."[67]

The road to the Eurozone crisis was paved many years ago and the issues underlying the crisis extend well beyond the operation of bank insolvency laws in individual European states. This article aspires to do no more than to identify some of the issues in the national insolvency regimes in the EU that may continue to present vulnerabilities in a cross-border banking crisis. In this respect it is worth noting that even before the onset of the Eurozone crisis, public-sector observers had observed that "[t]he [2007-2009] crisis has brought the long-building tension between increasingly transnational financial institutions and national financial stability arrangements [in the EU] to a breaking point."[68] Similarly, private-sector observers prior to the 2007-2009 crisis had observed that the difficulty in obtaining commitments from EU Member States with respect to crisis prevention and crisis management exposed "the political difficulty at the heart of the financial integration project, both in Europe and more broadly."[69] These tensions and difficulties are now on full display in the Eurozone.

EU Winding-Up Directive

The EU provided an early model for cross-border cooperation between Member States in its 2001 Directive on the Reorganization and Winding Up of Credit Institutions (the "Winding-Up Directive"). The Winding-Up Directive provides the home Member State with the exclusive competence to take reorganization measures and to initiate liquidation proceedings to resolve a credit institution (including its branches in other Member States) in a single insolvency proceeding.[70] Host Member States are required to recognize the home Member State actions as provided in the Winding-Up Directive. The procedural and substantive law of the home Member State applies to the insolvency proceeding, with certain specific exceptions such as those relating to host state rules on employment contracts, contracts for immovable property, and contracts for transactions carried out in a regulated market.[71] The Winding-Up Directive provides for mutual recognition of Member State insolvency proceedings for credit institutions. The Winding-Up Directive is based on the principles of home country control, mutual recognition, and minimal harmonization of law, the same principles that underlay the Second Banking Directive's approach to a "single passport" for branching across the EU. The approach does not assume any significant harmonization of Member State insolvency laws. In fact, substantial differences in the insolvency laws among individual Member States can and do exist. But perhaps more importantly, substantial deficiencies in the insolvency regimes of individual Member States can exist. Events during the 2007-2009 period and more recently during the Eurozone crisis have demonstrated the deficiencies in individual insolvency regimes.

The full range of vulnerabilities that the EU would face if a major cross-border banking crisis were to occur had been identified well in advance of the 2007-2009 financial crisis by both public and private-sector observers. These vulnerabilities included the lack of specialized bank resolution laws in most Member States, the weakness of a non-binding MOU approach to crisis management, and most fundamentally the absence of burden-sharing arrangements among Member States for pan-European banks.[72] Some observers have concluded that legal and political considerations militated against the collective action necessary in the EU to address these vulnerabilities before a crisis actually occurred.[73] Another seasoned observer offered a dual explanation for the lack of action by the EU: first, the solutions were perceived to be difficult to implement and would take an extended period of international effort, and second, the EU policymakers thought that crisis events were sufficiently unlikely that action was not needed.[74] Many observers also concluded that the official sector was concerned that the announcement of advance arrangements for crisis management and financial support would create greater moral hazard in the system. These observers suggested that the official sector was prepared to live with a degree of "constructive ambiguity" as to the official response to a large bank failure.[75] In any event, a number of observers predicted with uncanny accuracy the range of suboptimal responses that national authorities would take in the face of a major cross-border banking crisis.[76]

U.K. Reforms

The bailout of banks by various EU Member States and the conflicts between Member States in handling the bailout of cross-border banks have prompted reforms in several individual Member States as well as calls for reform in relevant EU regimes.[77] The U.K. was one of the first EU Member States to reform its insolvency regime in response to the financial crisis, acting initially in the wake of the U.K. government take-over of Northern Rock. The U.K. entered the financial crisis with only a general corporate insolvency law on its books. It had no specialized insolvency law for banking institutions.[78] The U.K. Banking Act 2009 was designed to provide the U.K. authorities with specialized tools to facilitate the orderly resolution of failing banks. The Banking Act 2009 establishes a special resolution regime ("SRR") and provides the Treasury, the Bank of England, and the Financial Conduct Authority with a variety of new powers to deal with failing banks.[79]

The SRR consists of three pre-insolvency "stabilisation options" and two new insolvency procedures.[80] The "stabilisation options" are: (i) the transfer of a bank to temporary public ownership (*i.e.,* to a company owned by, or by a nominee of, the Treasury); (ii) the transfer of all or part of a bank to a private sector purchaser; and (iii) the transfer of all or part of a bank to a bridge bank owned by the Bank of England. The insolvency procedures consist of: (i) a bank insolvency procedure designed to ensure a faster pay-out to depositors than can be achieved via ordinary insolvency procedures; and (ii) a bank administration procedure designed to ensure that where either option (ii) or option (iii) of the stabilisation options mentioned above is used, the insolvent "rump" bank continues to provide services and facilities to the business which has been transferred.[81]

As part of a broad reform program, the U.K. government has also committed to implementing the ring-fencing proposal set out in the report by the Independent Commission on Banking (the "ICB") chaired by Sir John Vickers, which was published in September 2011.[82] The Financial Services (Banking Reform) Bill 2013 (the "Bill"), which incorporates the recommendations of the ICB report, was introduced in the House of Commons in February 2013 and is expected to become law in 2014.[83] Among the most important provisions in the Bill are those relating to:

- ring-fencing requirements for vital banking services; the ring-fencing is designed to ensure that the retail banking activities of a retail and investment banking group are provided by a legally and operationally separate subsidiary;

- primary loss absorbing capacity requirements; the Bill gives the Treasury the power to make regulations governing the way in which the Prudential Regulation Authority may use its powers to impose debt requirements on banks; and
- depositor preference requirements, including amendments to the Insolvency Act 1986 to provide that, with effect from January 1, 2019, insured deposits, *i.e.*, deposits that are eligible for protection under the U.K. Financial Services Compensation Scheme (currently capped at £85,000), are to be preferential debts.[84]

The ring-fencing proposal in the ICB report as now reflected in the Bill has drawn prominent attention in international circles, and with good reason. Other wise men (and women) have suggested variations on a ring-fencing theme, as for example in the Liikanen Report to the European Commission in October 2012, and France and Germany have recently adopted legislation providing for limited ring-fencing of certain trading activities. The U.K., however, appears to be pursuing the most robust form of ring-fencing for retail banking operations in the Bill. When the Bill was introduced in the House of Commons in February 2013, George Osborne, chancellor of the exchequer in the U.K., emphasized the purpose and importance of the ring-fencing proposal. He made it clear that the primary purpose of the ring-fencing approach in the Bill would be to allow the U.K. government in a future crisis "[t]o keep the bank branches going, the cash machines operating, while letting the investment arm fail."[85] These legislative developments and policy statements have been read by some U.S. regulators as suggesting that foreign authorities may now be even more inclined to ring-fence capital and liquidity in support of domestic retail banking operations at the expense of domestic and foreign investment banking operations than before.

Chancellor Osborne's comments may also have caused some observers to revisit some of the preliminary conclusions that they had reached on the basis of the December 2012 Joint Paper issued by the FDIC and the Bank of England. The stated purpose of the Joint Paper was to discuss how an SPE or top-down approach could be used for a U.S. or a U.K. financial group in a cross-border context to facilitate an orderly resolution. Certain U.S. authorities have noted, however, that the section of the Joint Paper describing how the U.K. authorities would use an SPE or top-down strategy expressly states that an SPE or top-down strategy "would not necessarily be appropriate for all U.K. G-SIFIs in all circumstances."[86] The Joint Paper notes that there might be cases where resolution at the level of one or more operating subsidiaries might be more appropriate. In this case, the Joint Paper notes that application of the resolution tools to the operating subsidiaries would be easier "if the subsidiaries providing critical services were operationally and financially ring-fenced from the rest of the group."[87] This observation appears to have been added in anticipation of the kind of ring-fencing approach that Chancellor Osborne endorsed in his February 2013 comments and that is now incorporated in the Bill.

In the main, however, the Joint Paper does speak approvingly of the notion of an SPE or top-down resolution strategy. As the Joint Paper notes, the top-down strategy in the U.K. would involve the bail-in (through write-down or conversion) of creditors at the top of the group to restore the whole group to solvency. This approach would ensure that "activities of the firm in foreign jurisdictions in which it operates are unaffected, thereby minimizing risks to cross-border implementation."[88] But as the Joint Paper also indicates, additional powers (beyond those established by the Banking Act 2009) are needed in the U.K. to implement the top-down strategy. These powers would be sourced from the expected implementation of the proposed RRD (discussed in detail below) and the implementation of the recommendations in the ICB report (which have now been incorporated into the Bill).[89] As noted in the Joint Paper, the statutory authority for certain critical resolution measures, such as the power to bail-in creditors within resolution, the power to impose a temporary stay on the exercise of termination rights, and the power to require changes in the legal or operational structures of U.K. financial firms, will be dependent upon the adoption by the EU of the proposed RRD.[90] Similarly, the statutory authority to require a minimum level of loss-absorbing (*i.e.*, "bail-in-able") debt and to provide for ring-fencing of retail bank operations will be dependent upon enactment of the Bill. Thus, the discussion in the Joint Paper of a U.K. SPE or a top-down strategy is, in important respects, still contingent on further legislative actions.

Even more important than these legislative contingencies are the operational contingencies that will also have to be addressed to implement the SPE or top-down strategy outlined in the Joint Paper. The Joint Paper observes that the use of an SPE or top-down approach is dependent "upon the satisfaction of a large number of pre-conditions in terms of structure and operations" of the particular group.[91] The Joint Paper provides a list of the most important pre-conditions and operational requirements. One pre-condition is the existence of sufficient loss-absorption capacity available at the top of the group to absorb the losses at the operating subsidiaries. This pre-condition may present special issues in the U.K. because as the Joint Paper points out, financial holding companies at the top of groups in the U.K. often do not account for a significant proportion of the group's unsecured debt raised externally.[92] This means that either the groups may have to restructure their financing arrangements or the U.K. authorities may have to rely on bail-in at the level of the top operating subsidiaries. The Joint Paper observes that a bail-in at an operating subsidiary would require careful planning and consideration in light of possible legal constraints, such as the fact that senior unsecured bonds would typically rank *pari passu* with other unsecured liabilities that are unlikely to be bailed in.[93] The form of creditor hierarchy in the bail-in provisions of the final RRD may affect the legal scope for action on bail-in at operating subsidiaries. The Joint Paper also recognizes the difficult issues for a cross-border resolution presented by financial contracts and debt instruments governed by foreign laws that may not recognize a home country temporary stay on termination or a home country bail-in action.[94] The Joint Paper identifies still other areas, such as those relating to valuation methodologies and listing requirements, that will also require significant work in order to establish the operational feasibility of an SPE strategy.[95] Overall, the Joint Paper provides a general and high-level statement in favor of an SPE approach, but it is at the same time specific in identifying the substantial work that still lies ahead in making any such strategy operational.

Swiss Reforms

Along with the U.K., Switzerland has been the other European country to adopt the most comprehensive reform of its regulatory and resolution regimes in response to the financial crisis. The situation of Switzerland is unique. As of the end of 2012, the aggregate on and off-balance sheet assets of the two largest

Swiss banks were still four times the size of Switzerland's gross domestic product, notwithstanding the significant reduction in size of the two banks from where they stood at the end of 2007.[96] Following a report from a Commission of Experts for limiting the economic risks posed by large companies issued in 2010, the Swiss parliament in 2011 and 2012 adopted significant changes to the Swiss Banking Act.[97] These changes provided *inter alia* for capital requirements for the largest Swiss banks that substantially exceed the Basel III capital requirements and for new restructuring and resolution authority for the Swiss Financial Market Supervisory Authority ("FINMA"). The new authority for FINMA includes early intervention rights, accelerated resolution procedures, power to bail-in or write-down debt, power to create bridge banks, and power to transfer assets and liabilities to bridge banks or other entities. In the words of FINMA, with these legislative enactments and implementing ordinances from FINMA, "Switzerland leads the way" in addressing too big to fail.[98] Indeed, the findings in the FSB April 2013 Thematic Review indicate that Switzerland is one of the few countries that has already revised its statutory framework to incorporate virtually the full range of the FSB Key Attributes. Again, in the words of FINMA, it has been the policy of Switzerland to implement globally agreed regulations with a "Swiss finish" and "to put its initiatives into effect as soon as possible, ahead of those of several peer countries."[99]

In August 2013 FINMA published a position paper on the resolution of global systemically important banks ("G-SIBs").[100] The paper explains FINMA's resolution strategy for the two current Swiss G-SIBs, Credit Suisse and UBS, and how the strategy could be implemented in cooperation with foreign supervisory and resolution authorities. The paper confirms that the preferred resolution strategy for Swiss G-SIBs is an SPE bail-in. Under this strategy the unsecured creditors of the parent bank or top-level holding company would bear the losses (after creditors holding contingent convertible bonds bear losses), allowing the entire financial group in Switzerland and abroad to be recapitalized.[101] If an SPE bail-in is not possible, then the "less desirable" fallback scenario would call for protection of critical functions under Swiss and other local jurisdiction emergency plans and the liquidation of non-systemically important parts of the group.[102]

FINMA explains that this strategy, which has been developed in cooperation with the U.S. and the U.K., as members of the crisis management group for the two Swiss G-SIBs, is in line with the preferred strategy outlined in the Joint Paper from the FDIC and the Bank of England. The strategy is particularly well suited to the centralized funding structure of the two Swiss G-SIBs, which, according to FINMA, currently have subordinated and senior unsecured debt at the parent level equal to between 30 percent and 40 percent of their risk-weighted assets. This bail-in-able debt will be on top of the equity and contingent convertible bonds amounting to 19 percent of risk-weighted assets that the two banks will be required to maintain under the new "Swiss finish" capital regime when it is fully phased in.[103] An MPE bail-in strategy would not be viable for these banks because their centralized funding structure means that their foreign subsidiaries would not have sufficient or appropriate types of external liabilities for use in a bail-in at the subsidiary level.

The FINMA position paper emphasizes that it represents the preliminary results of ongoing work by FINMA and the other regulatory authorities that are currently developing resolution strategies for the Swiss G-SIBs. Like the Joint Paper, the FINMA position paper identifies several critical conditions or paths to the use of an SPE resolution strategy. One critical path is the valuation process to determine the full scope of losses and hence the necessary breadth and depth of the bail-in process. In a single sentence, the position paper marks out a possible approach: a "deliberately cautious recapitalization" or "over bail-in", with provision for compensation to the affected creditors after the fact as soon as the actual extent of the losses is known.[104] Another critical determinant will be the quantity of liabilities available for bail-in. Here the FINMA position paper notes that a significant amount of the bail-in-able liabilities of each of the two Swiss G-SIBs is issued out of the foreign branches of the Swiss parent in the U.K., Channel Islands, and the U.S., and is governed by non-Swiss law, thus increasing the execution risk of an SPE bail-in.[105] Execution of an SPE bail-in may have to rely on "complementary orders" from the host authorities with jurisdiction over those branches.[106] The alternative would be to require such debt (presumably in the future) to include provisions explicitly recognizing FINMA's bail-in authority.

The FINMA position paper provides an important affirmation of the desirability of pursuing an SPE strategy, particularly for those G-SIBs that have highly integrated operations and centralized funding, booking, and risk management structures. From the perspective of cross-border resolution, an effective SPE bail-in strategy means that the losses will be borne by shareholders and the holders of bail-in debt at the parent level, substantially reducing the issues of fiscal burden-sharing among the home and host jurisdictions. As noted above, however, there may still be a need for temporary burden-sharing among jurisdictions to provide short-term liquidity support to the restructured entity and its subsidiaries. As a "stylized" model, the SPE provides the most elegant solution to the problems of the complexity of the resolution of a financial group and its cross-border effects. Nonetheless, as the FSB 2013 guidance suggests, for some institutions, particularly those following a more decentralized funding and operational model, an MPE strategy, despite its greater complexity and its greater disruptive effect in some jurisdictions, may be the more appropriate model, if only by default.

EU INITIATIVES

Recovery and Resolution Directive

Other EU Member States, such as Germany, Spain, and the Netherlands, have also adopted their own specialized insolvency regimes for their banks in response to the crisis.[107] While significant from a national perspective, these reforms did not necessarily result in greater harmonization of individual Member State regimes and did not directly address the issues of cross-border cooperation or mutual recognition of other jurisdictions' resolution regimes, particularly for banking groups.[108] In a working paper written in March 2010, the IMF staff noted the shortcomings in the EU cross-border arrangements for crisis management and crisis resolution and observed that "[t]he EU thus faces a need for reform at three levels: national, EU, and global."[109]

In response to these challenges, the EU has initiated a wide-ranging set of reforms to its financial sector and supervisory regimes. The European Commission began the process for reform with its release of an EU Framework for Crisis Management in the Financial Sector in October 2010.[110] The EU Framework document envisioned a three-step process. The first step would be the development of a legislative proposal for a harmonized EU regime for crisis prevention and bank recovery and resolution. The second step would be an examination for the need of further harmonization of Member State bank insolvency regimes, with the aim of resolving banks under the same procedural and substantive insolvency rules. The third step would include the creation of an integrated resolution regime, possibly based on a single European Resolution Authority. As a concomitant to a single resolution regime, the European Commission expressed a belief that a single EU resolution funding mechanism would better serve the purpose of an efficient EU resolution regime than reliance on a network of national resolution funds, although in the first stage of the reform process reliance was in fact to be placed on national resolution funds.[111] The initial approaches outlined in the Framework were to be stress-tested in real time as the crisis in the Eurozone metastasized in the course of 2011 and 2012.

After an extensive consultation process, the European Commission released a proposal for the RRD in June 2012 as a final step in implementing the EU Framework for Crisis Management.[112] It quickly became clear that the European Commission also saw the proposed RRD as an important first step in a much broader project, *i.e.*, establishing a European banking union. As originally envisioned by the European Commission, the proposed RRD was intended to equip national authorities "with common and effective tools and powers to tackle bank crises at the earliest possible moment, and minimize costs for taxpayers."[113] The common tools consisted of three basic types: (i) preparatory and preventative measures, such as a requirement for financial institutions and resolution authorities to prepare recovery and resolution plans; (ii) powers to take early action to remedy problems, such as powers for supervisors to require the replacement of management or to require an institution to implement a recovery plan or divest assets or business lines; and (iii) resolution tools, such as the power to effect the takeover of a failing institution by a sound institution or to transfer all or part of its business to a temporary bridge firm.[114] The proposed RRD also established stronger mechanisms for cooperation between national authorities. The proposed RRD was developed with an eye to both the CBRG recommendations and the FSB Key Attributes, as well as the special issues presented by EU law, such as the effects of the proposed measures on "fundamental rights" of shareholders and creditors under the EU Charter of Fundamental Rights.[115]

One of the objectives of the process was to "aim for international consistency as far as possible," including specifically the Key Attributes.[116] The proposed RRD in fact covered all the necessary elements from the Key Attributes, and with significantly more detail in many instances than the Key Attributes themselves. The proposed RRD was particularly expansive in its provisions relating to a bail-in regime. It provided for the possibility of bail-in on a "going concern" basis as well as bail-in on a "gone concern" basis, *i.e.*, after the firm is put into a resolution process. It also provided that a broad set of liabilities would be subject to bail-in with only a few categories excluded, such as deposits guaranteed under a deposit guarantee scheme and unsecured liabilities with an original maturity of less than one month.[117] The bail-in provisions attracted much attention from the banking industry, but as with the Key Attributes relating to bail-in, the comments from the banking industry were characterized by significant differences of opinion. Industry trade associations reported that there were significant differences of views within their membership, with some members strongly opposed, for example, to the use of a bail-in mechanism on a going concern basis and others in favor of this flexibility.[118] Similarly, there was a diversity of industry views on the question of the appropriate scope of the liabilities to be made subject to bail-in. One major industry group acknowledged a range of views among its members on the question of whether there should be an exclusion from bail-in for short-term unsecured liabilities, with some members suggesting that there be no exclusion for such liabilities and others suggesting that the exclusion should be expanded to cover liabilities with a longer maturity such as up to six or even 12 months.[119] On the other hand, there appeared to be more widespread support from the banking industry for excluding derivatives from the scope of bail-in.

The provisions in the proposed RRD providing the specifications and funding requirements for individual national resolution funds also attracted substantial attention. These provisions would require each Member State to establish arrangements in the form of *ex ante* assessments on its banks to prefund a national resolution fund in a targeted amount equal to one percent of guaranteed deposits within 10 years.[120] Resolution funds would be available to provide temporary support to institutions under resolution via loans, guarantees, asset purchases, or capital for bridge banks but only after losses are borne first by shareholders and creditors. The resolution funds could also be drawn on to compensate creditors if and to the extent that their losses under bail-in exceed the losses they would have suffered under normal insolvency proceedings, in line with the "no creditor worse off" principle. The proposed RRD would also require that the resolution fund of one Member State be permitted to borrow from another Member State's resolution fund.[121] This latter provision appeared to suggest an element of pan-European support for an individual Member State resolution problem. The Impact Assessment for the proposed RRD prepared by the staff of the European Commission noted that, while setting up a single European Resolution Fund would have certain advantages, "at this current juncture" setting up a European Resolution Authority or a European Resolution Fund is "neither desirable nor feasible."[122] Nonetheless, in proposing the RRD the European Commission itself suggested that a more integrated banking union would be the "logical next step." This more integrated banking union would rest on four pillars:

- a single EU deposit guarantee scheme;
- a common resolution authority and a common resolution fund at least for systemically important and cross-border banks;
- a single EU supervisor for systemically important and cross-border banks; and
- a single rule book for the prudential supervision of all banks.[123]

Banking Union

Events in Europe accelerated the need for consideration of a more integrated banking union. In September 2012 the European Commission published A Roadmap towards a Banking Union (the "Roadmap").[124] The Roadmap consisted in the first instance of a proposal for a single supervisory mechanism ("SSM") for all banks in the Eurozone.[125] The SSM, as originally proposed, would transfer to the European Central Bank (the "ECB") principal supervisory responsibility for banks established in Eurozone Member States, with national supervisors retaining responsibility for supervision in more limited areas such as consumer protection, anti-money laundering measures, and the licensing and oversight of branches of banks from non-EU countries.[126] The proposal envisioned that the European Banking Authority would at the same time continue to develop a single supervisory handbook to preserve the integrity of the single market and to ensure coherence in banking supervision for all EU countries.[127] The European Commission concluded that, given the pooled responsibilities in the Eurozone, there were risks to cross-border spillover effects in the event of bank crises and that relying on coordination of national banking supervision was no longer an option.[128] Instead, a move to an integrated system was necessary. The European Commission also noted importantly that the establishment of a single EU-level supervisory mechanism had been made a pre-condition for the possible direct recapitalization of banks through the newly formed European Stability Mechanism that was being established to assist Member States encountering sovereign debt problems.[129] The Roadmap also envisioned that the European Commission would make a proposal for a Single Resolution Mechanism ("SRM") in the Eurozone once agreement was reached on the Commission's proposal for deposit guarantee reform and on the proposal for the RRD.[130]

The adoption of a directive like the proposed RRD is a fraught and intensely political process. It requires negotiation and agreement with the Council of the European Union (the "Council") and the European Parliament, resulting in a "trilogue" process among these bodies. Even in normal times trilogue can be a complex process. In the midst of debt crises in several Member States, consideration of the proposed RRD understandably became even more politically charged. Nonetheless, on June 27, 2013 the European Commission and the Council were able to announce that a broad agreement had been reached based on various compromises and changes to be made to the RRD.[131] Some of the most important of these compromises related to exclusions from the scope of liabilities subject to bail-in and to the funding requirements for national resolution funds. The Council's proposal would exclude from the scope of bail-in inter-bank liabilities with an original maturity of fewer than seven days and liabilities arising from participation in payment systems with a remaining maturity of fewer than seven days (in substitution for the exclusion of liabilities with a maturity of less than one month in the RRD as originally proposed by the European Commission).[132] The Council's proposal would also allow a national resolution authority "in exceptional circumstances" to exclude other liabilities from the scope of bail-in if the resolution authority determined that exclusion is necessary to achieve continuity of critical functions and business lines, to avoid widespread contagion in the financial markets, or to avoid destruction of value to other creditors, or if it is not possible to bail-in the particular liabilities within a reasonable time.[133] This general discretionary exclusionary authority (described by the Council as an exercise in "framed flexibility") has prompted concern from some industry groups that it will permit variation in resolution approaches among Member States and will distort the ability of investors and creditors to estimate *ex ante* what the impact of bail-in will be.[134] Among other changes also made by the Council was the provision for a depositor preference or priority scheme in Member State insolvency law. Deposits up to the amount covered by a deposit guarantee scheme in accordance with the EU Directive on Deposit Guarantee Schemes (and the resulting subrogation position of the deposit guarantee scheme) would have a priority over other general unsecured creditor claims, followed by deposits from natural persons and micro, small and medium-sized enterprises in excess of the guarantee amount under the deposit guarantee scheme.[135]

The Council also made several significant changes to the resolution funding regime. One change was to provide that any lending between national resolution regimes would be on a voluntary basis.[136] Another significant change related to a proposal to allow national resolution funds to be used to absorb the cost of the exclusion or partial exclusion of certain liabilities from a bail-in regime, subject to a set of restrictions.[137] These restrictions would require that a minimum level of loss equal to eight percent of total liabilities including "own funds" (*i.e.*, funds representing regulatory capital) be imposed on the institution's shareholders and creditors before funds from a national resolution fund could be tapped. The overall contribution of the resolution fund would also be capped at five percent of the institution's total liabilities. The Council also revised the provisions of the RRD to provide that the national resolution authorities should set minimum loss absorbing requirements in the form of "own funds" and eligible liabilities (*i.e.*, liabilities eligible for bail-in) as a percentage of the institution's total liabilities, based on the individual institution's size, risk and business model. Based on a subsequent recommendation from the European Banking Authority, it is expected that a harmonized requirement applicable to all banks would be introduced. This revision was made to reflect the concern expressed by some Member States that it was not possible without further quantitative analyses, reflecting in particular the different activities and business models among banks, to set a harmonized level for minimum loss absorbing capacity for all banks.

The final resolution of these issues now rests on the trilogue process among the European Commission, the Council and the European Parliament. Once final action on the RRD is taken by both the Council and the European Parliament, Member States will be required to amend their laws to implement the RRD. The European Commission originally proposed that Member States be given until December 31, 2014 to "transpose" the requirements of the RRD into national law (with the effective date for the bail-in provisions to be January 1, 2018).

With the announcement of a broad agreement on the RRD with the Council, the European Commission said that the path was clear to move forward with stage two of the integrated banking union through the establishment of an SRM.[138] In pursuit of that objective, on July 10, 2013 the European Commission released a detailed proposal for an SRM and a Single Resolution Fund.[139] The European Commission was encouraged in taking this action not only by the general agreement reached with the Council on the proposed RRD, but also by the rapid progress made on the SSM proposal, which had been proposed by the European Commission in September 2012 as the first step toward a banking union. In quick order the Council announced its agreement with the SSM proposal in December 2012 and the European Parliament announced its preliminary agreement in March 2013.[140] For a proposal of this significance, the speed of action was remarkable, compelled undoubtedly by developments in countries like Spain, Greece and Cyprus. The establishment of the SSM is a particularly ambitious undertaking, with the details of many legal, policy and operational issues still to be addressed.[141]

The SSM and the SRM are seen not only as natural corollaries but also as necessary complements to each other.[142] In the words of the European Commission, in a banking union "bank supervision and resolution need to be exercised by the same level of authority and backed by adequate funding arrangements."[143] The European Commission sees significant benefits to this approach. Aligning supervision and resolution at a central level would not only allow bank crises to be more effectively managed in the banking union, but would also "contribute to breaking the link between sovereign crises and failing banks."[144]

The SRM would build on the foundation to be laid by the RRD. The proposed SRM would thus apply the substantive rules of bank recovery and resolution envisioned in the proposed RRD.[145] The ECB as the new supervisor under the proposed SSM would initially propose when a bank was in severe financial difficulty and needed to be resolved. A Single Resolution Board, consisting of representatives from the ECB, the European Commission, and the relevant national authorities would prepare the resolution approach for the bank.[146] However, for legal reasons, the European Commission would make the final determination whether and when to place a bank into resolution and which resolution tool to use.[147] The national resolution authorities would be responsible for the execution of the resolution plan under the supervision of the Single Resolution Board. In addition, a Single Resolution Fund would be set up under the control of the Single Resolution Board. The Single Resolution Fund would be built up over time (from 10 to possibly 14 years) by contributions from the banking sector, replacing the national resolution funds envisioned in the proposed RRD for the Member States participating in the banking union.[148] The target size of the fund would equal one percent of the guaranteed amount of the deposits of the banks in the Member States in the Eurozone.[149]

As noted above, the SRM is intended as a complement to the SSM. On September 12, 2013, the European Commission and the European Parliament announced that following intensive trilogue negotiations the Parliament had given final approval to the SSM.[150] The European Commission has said that it now hopes for a quick agreement by year-end 2013 on the proposed RRD and the proposed SRM. At the European Council on June 27–28, 2013, the EU leaders set for themselves the target of reaching agreement on the SRM by the end of 2013 so that it can be adopted before the end of the current European Parliament term in 2014. This would enable the SRM to apply from January 2015, together with the RRD, which would constitute its basic rulebook.

The dialogue and trilogue over the SRM may well overshadow the other work that needs to be done to finalize the RRD. Although the SRM would apply the rules contained in any final RRD, the proposed SRM represents a significant departure from the proposed RRD in moving the crucial decision-making power as to whether, when and how to intervene in a bank from the national authorities to a centralized EU authority. European bank observers have raised the question whether Eurozone Member States are really prepared to accept the substantial transfer of sovereignty from Member States to the European Commission implied in the SRM (although it might be observed that these Member States have already accepted a significant transfer of sovereignty in agreeing to the SSM.)[151] The German government, for example, has indicated its opposition to the SRM proposal on legal and policy grounds.[152] Other Member States are also opposed to the pooling of national resolution funds into a Single Resolution Fund with the resulting "mutualization" of losses among Eurozone Member States.[153] Finally, doubts are already being expressed about the sufficiency of the proposed Single Resolution Fund for the broad purposes it is supposed to serve.[154] One should anticipate substantial *sturm* and considerable *drang* from certain quarters in the EU as the SRM proposal and Single Resolution Fund proposal are debated. Predicting the ultimate form that the SRM and Single Resolution Fund may take would require sibylline-like skills.

CONCLUSION

It is both appropriate and ironic to conclude this survey of international coordination efforts on bank resolution with a discussion of the EU experience. Appropriate because the EU would appear to enjoy a comparative advantage in bank harmonization efforts based on its highly evolved (if sometimes baroque) mechanisms designed to achieve harmonization across its Member States. Ironic because any such comparative advantage in achieving harmonization of bank resolution regimes was not in evidence before the 2007-2009 financial crisis and has been sorely tested in the wake of the Eurozone crisis. National interests and interests of national constituents still play a dominant role in the deliberations over bank resolution regimes, particularly with respect to burden-sharing among governments.

Nonetheless, significant progress in the EU appears to be in the offing. The approval of the SSM paves the way for greater EU control over bank supervisory processes in Eurozone Member States (and other Member States that choose to join the banking union). The next step in a banking union

— the SRM — may be more difficult to achieve, but if achieved will ensure greater conformity and coordination over the resolution process for banks headquartered in Member States in the banking union. Finally, the adoption of the RRD will provide greater harmonization among national resolution regimes covering both banks from Member States in the banking union and banks from other Member States like the U.K. that are not in the Eurozone and unlikely to join the banking union. The RRD will be important in establishing a harmonized baseline (subject to elements of discretion at the national level) for bank resolution for all Member States in the EU.

The RRD establishes several fundamental principles to govern future bank resolutions in the EU. The first principle is recognition of write-down and bail-in as necessary tools to facilitate the prompt recapitalization of a failing bank or a successor bridge institution. The second and related principle is that shareholders and unsecured creditors (potentially including uninsured depositors) of a failing firm would be required to bear losses before public funds are put into the resolution process. This principle is established through a framework in the RRD in which shareholders and unsecured creditors (potentially including uninsured depositors) would, through write-down or bail-in, bear losses in an amount up to eight percent of the institution's total liabilities, followed, if necessary, by contributions from the national resolution fund (which is to be funded by assessments on the banking industry in the individual Member State) in an amount up to an additional five percent of the total liabilities of the institution. Only after these two private-sector sources of recapitalization are used would there be possible recourse to the funds of a Member State or for banks headquartered in a Eurozone Member State to the ESM.[155]

There are nonetheless concerns with the RRD. One concern is that it lacks assurance of uniform application. While the RRD provides a broader set of powers to the national authorities, it does not provide assurance as to when and how these powers will be used by the individual national authorities.[156] Proponents of the SRM argue that one of its benefits is that it would assure uniformity of application of the RRD. The SRM, however, would apply only to Member States in the Eurozone and other Member States that elect to join the banking union. Another concern arises from the fact that the bail-in provisions in the RRD as proposed would only come into effect on

January 1, 2018. If a large bank were to require resolution before that date, bail-in might not be available as a tool, forcing recourse to other measures. A related problem is that the national resolution funds required by the RRD will only be funded over a 10-year period beginning in 2015. The Single Resolution Fund proposed by the SRM would also be funded over a similar 10-year period. There are doubts about whether the ultimate size of either a national resolution fund or the Single Resolution Fund would be adequate. There must be even greater doubts about the size of a fund during the interim funding period (although the ESM may be available as a supplement).[157]

Timing has become critical. The ECB is scheduled to conduct an asset quality review of the largest banks in the Eurozone in 2014 for the express purpose of identifying the banks that need to be recapitalized. This independent review by the ECB is regarded by many observers as essential to restoring faith in the Eurozone banking system.[158] The ECB, however, has said that backstops for banks that will require recapitalization must be in place before the assessment begins. Pressure is thus mounting for prompt action on the SRM and the Single Resolution Fund.[159]

Meanwhile the FSB has forged ahead on its project to end "too-big-to-fail" and to promote the adoption of the Key Attributes. On August 28, 2013 the FSB issued an extensive consultative paper proposing a methodology for assessing member jurisdictions' compliance with the new international standards reflected in the Key Attributes.[160] The paper provides greater specificity as to how the Key Attributes should be implemented. Besides facilitating the international assessment process, the paper will also assist jurisdictions in their individual legislative and regulatory reforms to implement the Key Attributes.

On September 2, 2013, the FSB also issued a report to the G20 on progress in addressing the "too-big-to-fail" problem, including the status of implementation of the Key Attributes.[161] The report urged the G20 leaders to make a renewed commitment to adopt the legislative reforms necessary to implement the Key Attributes, particularly in the areas of bail-in, cross-border cooperation, and recognition of foreign resolution actions. For its own part, the FSB committed to study and produce recommendations on such matters as (i) strengthening information sharing between home and host jurisdictions, (ii) the nature, amount, location within a group structure, and disclosure of "gone concern" LAC, and (iii) contractual or statutory approaches to prevent large-scale early termination of financial contracts. These studies are to be completed by year-end 2014.

In its progress report the FSB noted an additional consideration that has recently come to the fore: domestic structural reform measures designed to address too-big-to-fail concerns, including requirements for the separation of activities into different legal entities and for increased local capital and liquidity. As examples of these domestic structural reform measures, the FSB cited the Volcker Rule in the U.S., the ICB Report in the U.K., the Liikanen Report in the EU, and recent legislative developments in France and Germany.[162] These structural measures are intended to put constraints on risk-taking and to improve the resolvability of SIFIs at the individual jurisdictional level. As the FSB notes, however, diverging structural measures imposed by different jurisdictions may have an impact on integration across national and regional markets. These measures may also create incentives for regulatory arbitrage. In response to a request from the G20 Finance Ministers and the Central Bank Governors, the FSB has agreed to produce an assessment of the cross-border consistency and global financial stability implications of these structural measures, taking into account country-specific circumstances. As the request for the assessment suggests, the tensions between national reform efforts and international coordination and consistency remain very much alive.

NOTES

1 FSB, *Key Attributes of Effective Resolution Regimes for Financial Institutions* (Oct. 2011), *available at* www.financialstabilityboard.org/publications/r_111104cc.pdf [hereinafter *Key Attributes*]. The *Key Attributes* are intended to apply to the resolution not only of banking institutions, but also to the resolution of other non-bank financial institutions, such as insurers. The focus of this article is on the *Key Attributes* as they relate to banking institutions. The FSB has recently issued a Consultative Document on the application of the *Key Attributes* to certain non-bank financial institutions. *See* Press Release, FSB, FSB consults on implementation guidance for the Key Attributes of Effective Resolution Regimes (Aug. 12, 2013), *available at* http://www.financialstabilityboard.org/press/pr_130812.pdf.

2 FSB, Charter, Art. 6(1)(c) (June 2012).

3 FSB, *Resolution of Systemically Important Financial Institutions: Progress Report*

(Nov. 2012), *available at* http://www.financialstabilityboard.org/publications/r_121031aa.pdf [hereinafter *2012 Progress Report*].

[4] *Id.* at 1.

[5] *See* Letter from the British Bankers' Assn. to the FSB 6 (Sept. 2, 2011), *available at* http://www.financialstabilityboard.org/press/c_11909k.pdf.

[6] Press Release, FSB, FSB releases reports on progress in implementing the SIFI framework (Nov. 1, 2012), *available at* http://www.financialstabilityboard.org/press/pr_121031a.pdf.

[7] *2012 Progress Report*, *supra* note 3, at 5.

[8] *Id.* *See* European 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* (2012), COM (2012) 280 final, *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52012PC0280:EN:NOT [hereinafter *Proposed RRD*].

[9] *2012 Progress Report*, *supra* note 3, at 6.

[10] Press Release, FSB, FSB consults on guidance for recovery and resolution planning (Nov. 2, 2012), *available at* http://www.financialstabilityboard.org/press/pr_121102.pdf.

[11] FSB, *Consultative Document*, *Recovery and Resolution Planning: Making the Key Attributes Requirements Operational* 14-15 (Nov. 2012), *available at* http://www.financialstabilityboard.org/publications/r_121102.pdf [hereinafter *FSB 2012 Consultative Document*].

[12] *See* FDIC, Office of Complex Financial Institutions, *Dodd-Frank Act Title II: Resolution Strategy Overview* (Jan. 25, 2012), *available at* http://www.fdic.gov/about/srac/2012/2012-01-25_resolution-strategy.pdf.

[13] Chairman Gruenberg of the FDIC confirmed the FDIC's predisposition for the use of an SPE approach in comments delivered in May 2012. *See* Martin J. Gruenberg, Acting Chairman, FDIC, Remarks to the Federal Reserve Bank of Chicago Bank Structure Conference (May 10, 2012), *available at* http://www.fdic.gov/news/news/speeches/chairman/spmay1012.html. He specifically observed that the SPE approach offers "the promise of overcoming many of the cross-border issues that have been identified in both theory and practice."

[14] For a succinct discussion of the benefits of the SPE approach, see Shaun Kern, Bipartisan Policy Center, *Creditor Treatment and Single Point of Entry* (June 26, 2013), *available at* http://bipartisanpolicy.org/blog/2013/06/26/creditor-treatment-and-single-point-entry. For a more detailed discussion of the benefits and challenges of the SPE approach, see Thomas C. Baxter, Jr., Executive Vice

President and General Counsel of the Federal Reserve Bank of New York, Resolving the Unresolvable: The Alternative Pathways to Ending Too Big to Fail, Remarks at the International Insolvency Institute 13th Annual Conference, Columbia University Law School (June 17, 2013), *available at* http://www.newyorkfed.org/newsevents/speeches/2013/bax130618.html [hereinafter Baxter Remarks].

[15] *See, e.g.*, Daniel K. Tarullo, Member, Bd. of Governors of the Fed. Reserve Sys., Speech at the Peterson Institute of International Economics: Evaluating Progress in Regulatory Reforms to Promote Financial Stability 10 (May 3, 2013), *available at* http://www.federalreserve.gov/newsevents/speech/tarullo20130503a.htm [hereinafter Tarullo Speech].

[16] *FSB 2012 Consultative Document*, *supra* note 11, at 15.

[17] *Id.*

[18] *Id.*

[19] *Id.* at 16.

[20] *See, e.g.*, The Clearing House, *Ending "Too-Big-to-Fail": Title II of the Dodd-Frank Act and the Approach of "Single Point of Entry" Private Sector Recapitalization of a Failed Financial Company* (Jan. 2013), *available at* http://www.cov.com/files/Publication/714f0b24-8047-4d79-825f-55f5d1e80bdc/Presentation/PublicationAttachment/f7462820-7d03-4ed2-8b75-96b917418d8f/White_Paper_Ending_Too-Big-to-Fail.pdf; Bipartisan Policy Center, *Too Big to Fail: The Path to a Solution* (May 2013), *available at* http://bipartisanpolicy.org/sites/default/files/TooBigToFail.pdf; Institute of International Finance, *Making Resolution Robust — Completing the Legal and Institutional Frameworks for Effective Cross-Border Resolution of Financial Institutions* (June 2012), *available at* http://www.iif.com/download.php?id=vVrz1cqvQzI=.

[21] *See, e.g.*, The Clearing House, *Report on the Orderly Liquidation Authority Resolution Symposium and Simulation* (Jan. 2013), *available at* http://www.theclearinghouse.org/index.html?f=074709.

[22] *See Improving Cross Border Resolution to Better Protect Taxpayer and the Economy: Hearing Before S. Comm. on Banking, Housing & Urban Affairs Subcomm. on National Security and International Trade and Finance* (statement of James R. Wigand, Director, FDIC Office of Complex Financial Institutions) (May 15, 2013), *available at* http://www.fdic.gov/news/news/speeches/spmay1513_2.html?source=govdelivery.

[23] FDIC & the Bank of England, *Resolving Globally Active, Systemically Important, Financial Institutions* (Dec. 10, 2012), *available at* http://www.

fdic.gov/about/srac/2012/gsifi.pdf [hereinafter *Joint Paper*]. *See also* Martin Gruenberg & Paul Tucker, *Global Banks Need Global Solutions When They Fail*, Fin. Times, Dec. 10, 2012, *available at* http://www.fdic.gov/news/letters/srac.html.

[24] *See* Press Release, Federal Reserve Board, Federal Reserve Board releases proposed rules to strengthen the oversight of U.S. operations of foreign banks (Dec. 14, 2012), *available at* http://www.federalreserve.gov/newsevents/press/bcreg/20121214a.htm; & Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies, 77 Fed. Reg. 76628 (Dec. 28, 2012).

[25] 77 Fed. Reg. at 76629-31 & n.31.

[26] Tom Braithwaite *et al.*, *US regulators warn banks on living wills*, Fin. Times, Jan. 27, 2013, *available at* http://www.ft.com/cms/s/0/a17d0e9a-688c-11e2-9a3f-00144feab49a.html#axzz2ePETGBNX.

[27] *See* Joint Press Release, Federal Reserve Board and FDIC, Agencies Provide Additional Instructions for Submission of Some Resolution Plans (Apr. 15, 2013), *available at* http://www.federalreserve.gov/newsevents/press/bcreg/20130415c.htm.

[28] Press Release, FSB, FSB releases guidance papers on recovery and resolution planning (July 16, 2013), *available at* http://www.financialstabilityboard.org/press/pr_130716.pdf.

[29] FSB, *Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Developing Effective Resolution Strategies* 7 (July 16, 2013), *available at* http://www.financialstabilityboard.org/publications/r_130716b.pdf [hereinafter *FSB 2013 Guidance*].

[30] *Id*.

[31] *See* Tarullo Speech, *supra* note 15. *See also Improving Cross Border Resolution to Better Protect Taxpayers and the Economy: Hearing before the S. Comm. on Banking, Housing & Urban Affairs Subcomm. on National Security and International Trade & Finance* (statement of Michael S. Gibson, Director, Div. of Supervision & Regulation, Bd. of Gov. of Fed. Res. Sys.) (May 15, 2013), *available at* http://www.federalreserve.gov/newsevents/testimony/gibson20130515a.htm (suggesting that it might be useful to work toward an international agreement on minimum total loss absorbency for globally systemic firms).

[32] *FSB 2013 Guidance*, *supra* note 29, at 8.

[33] *Id*. n.4.

[34] *Id.* at 8.

[35] *Id.* at 7.
[36] *Id.* at 8. For a discussion of the range of issues presented by deposit guarantee schemes in bank resolution, *see* CLIFFORD CHANCE, Deposits, Deposit Guarantee Schemes and Bank Resolution (Apr. 2013), *available at* http://www.cliffordchance.com/publicationviews/publications/2013/05/deposits_depositguaranteeschemesandban.html.
[37] Paul Tucker, Deputy Governor for Financial Stability, Bank of England, Resolution and Future of Finance, Speech at INSOL International World Congress (May 20, 2013), *available at* http://www.bis.org/review/r130606a.pdf [hereinafter Tucker Speech]. This speech provides a particularly insightful and unusually literate discussion of the challenges in bank resolution reform.
[38] *Id.*
[39] *See, e.g.*, Benoit Coeuré, Member of the Executive Committee of the European Central Bank, The Single Resolution Mechanism: Why it is needed, Speech at the International Capital Market Assn. Annual General Meeting and Conference (May 23, 2013), *available at* http://www.ecb.europa.eu/press/key/date/2013/html/sp130523.en.html.
[40] *FSB 2013 Guidance*, *supra* note 29, at 9.
[41] *Id.* at 10.
[42] *Id.*
[43] *See, e.g.*, Baxter Remarks, *supra* note 14, at 4 (discussing the significant challenges to a Title II orderly resolution presented by cross-default and close-out provisions in derivative contracts governed by foreign law and suggesting changes to the International Swaps and Derivatives Association documentation to address these challenges).
[44] *FSB 2013 Guidance*, *supra* note 29, at 14.
[45] *Id.* at 15.
[46] *Id.*
[47] *Id.* at 13.
[48] *Id.*
[49] *Id.* at 14.
[50] FSB, *Recovery and resolution planning guidance: Overview of responses to the public consultation* 2-3 (July 16, 2013), *available at* http://www.financialstabilityboard.org/publications/r_130716d.pdf.
[51] *Id.* at 3.
[52] *FSB 2013 Guidance*, *supra* note 29, at 20.
[53] *Id.*

54 *Id*.

55 In a pure SPE strategy, the creditors of the top-tier parent or holding company will have the most direct interest in this information because it is assumed that third-party creditors at the operating subsidiary level will not be required to bear losses. However, because there can be no assurance that a pure SPE strategy can be made operational, creditors at the subsidiary level will also have an interest in information relating to LAC at the subsidiary level in light of the possibility that a modified SPE strategy involving the liquidation of at least certain subsidiaries or a MPE strategy involving bail-in at subsidiary levels might be used. This disclosure process will also presumably force the hand of the national authorities as to a discussion of the possible or expected treatment of uninsured depositors in the absence of an express depositor preference provision in national insolvency law.

56 Press Release, FSB, FSB publishes peer review on resolution regimes (Apr. 11, 2013), *available at* www.financialstabilityboard.org/press/pr_130411.pdf; FSB, *Thematic Review on Resolution Regime: Peer Review Report* (Apr. 11, 2013), *available at* https://www.financialstabilityboard.org/publications/r_130411a.pdf [hereinafter *FSB 2013 Thematic Review*].

57 David Keefe, *G20 countries falling well behind on resolution plans*, GLOBAL RISK REGULATOR, Apr. 2013, *available at* http://www.globalriskregulator.com/article.php?pgkey=3058.

58 FSB, *Implementing the FSB Key Attributes of Effective Resolution Regimes — how far have we come?* 5-6 (Apr. 15, 2013), *available at* http://www.financialstabilityboard.org/publications/r_130419b.htm [hereinafter *Implementing the FSB Key Attributes*].

59 *FSB 2013 Thematic Review*, *supra* note 56, at 24 n.29 & n.30. The FSB reported that Spain provided such power to its resolution authority only for subordinated debt and only through June 2013. *Id*. at 24 n.29.

60 *Id*. at 27 n.32.

61 *Id*. at 30.

62 *Implementing the FSB Key Attributes*, *supra* note 58, at 3.

63 *Id*. It is curious that the FSB referred to "refinements" in resolution regimes with respect to the statutory changes made in Germany, the Netherlands, Switzerland and the U.K. On their face the statutory changes made in these jurisdictions appear to be substantial even if they do not always reflect the full set of Key Attributes. Whether they are sufficient of course cannot be told until policymakers have occasion to use the enhanced measures in a major crisis. It is also important to recognize that providing new resolution powers to

policymakers offers no assurance that the policymakers will use the new powers if other considerations intrude upon the decision-making process.

[64] *Id*. *See* Proposed RRD, *supra* note 8.

[65] Other policymakers have also attached a similar importance to the adoption and implementation of the Proposed RRD. *See* Tucker Speech, *supra* note 37, at 3 ("[I]t is not an exaggeration to say that the EU's Directive is the keystone to breaking the back of the TBTF problem.").

[66] Carmen Reinhart & Kenneth Rogoff, *This Time Is Different: Eight Centuries of Financial Folly* 200 (2009).

[67] *See* Andy Mullineux, The Eurozone Crisis: Escaping the 'Doom Loop,' Working Paper (Nov. 12, 2012), *available at* http://ssrn.com/abstract=2176670; European Council Conclusions, at 3, (EUCO) 205/12 (Dec. 14, 2012).

[68] Wim Fonteyne *et al.*, Crisis Management and Resolution for a European Banking System, IMF Working Paper WP/10/70 at 5 (March 2010), *available at* http://www.imf.org/external/pubs/ft/wp/2010/wp1070.pdf.

[69] Louis W. Pauly, Political Authority and Global Finance: Crisis Prevention in Europe and Beyond, Global Economic Governance Working Paper, Oxford Univ. 13 (June 2007), *available at* http://www.globaleconomicgovernance.org/wp-content/uploads/Pauly_Political%20Authority%20and%20Global%20Finance.pdf ("The idea of a reliable ex ante agreement on burden sharing directly confronts the questions of what Europe actual [sic] is, whether its constituent members are fundamentally obliged to assist one another in an emergency, whether they trust one another to minimize financial losses, whether they share the same risk culture, and whether they are guided by similar regulatory approaches").

[70] Council Directive 2001/24, Reorganisation and winding-up of credit institutions, O.J. (L 125) (EC).

[71] *Id.* Art. 20 (employment contracts and contracts for immovable property) and Art. 27 (contracts in regulated markets).

[72] *See, e.g.*, Jean Dermine, Bank Mergers in Europe, the Public Policy Issues, 2000 Journal of Common Market Studies 409, *available at* http://faculty.insead.edu/jean-dermine/documents/8_jcms2000.pdf (discussing the "unsatisfactory" institutional arrangements in the EU for effecting a "bail-out" of a large European bank, particularly one headquartered in a small country, such as Belgium, the Netherlands and Switzerland); Andrew Campbell, Issues in Cross-Border Bank Solvency: The European Community Directive on the Reorganization and Winding-Up of Credit Institutions, IMF Seminar on Current Developments in

Monetary and Financial Law May 2002, *available at* http://www.imf.org/external/np/leg/sem/2002/cdmfl/eng/campb.pdf (discussing the objectives of the Winding-Up Directive); Eva Hüpkes, Insolvency — Why a Special Regime for Banks?, IMF Seminar on Current Developments in Monetary and Financial Law, *available at* http://www.imf.org/external/np/leg/sem/2002/cdmfl/eng/hupkes.pdf (discussing the need for a specialized bank insolvency regime and surveying the differences in insolvency regimes in Europe); C.A.E. Goodhart and Dick Schoenmaker, Burden Sharing in a Banking Crisis in Europe, LSE Financial Markets Group March 2006, *available at* http://www.lse.ac.uk/fmg/documents/specialPapers/2006/sp164.pdf (discussing the difficulties for a host country in managing financial stability if the home country supervisor of a large cross-border European bank determines that it cannot support the host country operations); Martin Cihák and Jörg Decressin, The Case for a European Banking Charter, IMF Working Paper WP/07/173 July 2007, *available at* http://www.imf.org/external/pubs/ft/wp/2007/wp07173.pdf (noting that even if a country had the necessary reserves, it might not be willing or politically able to make massive cross-border transfers to benefit foreign depositors and proposing a EU-level charter and prudential regime to plug the gaps in Europe's financial stability framework); Pauly, *supra* note 69 (discussing how a truly integrated pan-European banking market, like a truly global banking market, would push a home-country control regime past its limit).

[73] *See, e.g.*, Zdenek Kudrna, Cross-border resolution of failed banks in the EU: search for the second-best policies, Mar. 2010, *available at* http://eif.univie.ac.at/downloads/workingpapers/wp2010-08.pdf; Pauly, *supra* note 69, at 12-13.

[74] *See* David G. Mayes, *Resolution Methods for Cross-Border Banks in the Present Crisis*, *in* FINANCIAL CRISIS MANAGEMENT AND BANK RESOLUTION 303, 304 (John Raymond Labrosse, Rodrigo Olivares-Caminal, and Dalvinder Singh eds., 2009).

[75] *See* Pauly, *supra* note 69, at 12; IMF, *Global Financial Stability Report* 123 (Apr. 2007), *available at* http://www.imf.org/external/Pubs/FT/GFSR/2007/01/index.htm. *See also* David G. Mayers *et al.*, IMPROVING BANK SUPERVISION 217 (2001) (arguing that the drawback to the notion of "constructive ambiguity" in the EU is that people place exactly the opposite construction on the ambiguity and assume that in the case of difficulty a financial institution will be bailed out, making the ambiguity "anything but constructive").

[76] *See, e.g.*, Nicolas Véron, Is Europe Ready for a Major Banking Crisis? Brueghel policy brief (Aug. 2007), *available at* http://www.bruegel.org/publications/publication-detail/publication/234-is-europe-ready-for-a-major-banking-crisis. Writing on the cusp of the crisis, this observer outlined the likely responses of

home and host authorities:

> If problems emerge in a pan-European bank, there are no agreed rules on early intervention and remedial action. Because of different interests or a different assessment of risks, different national authorities may have different priorities, the more so as the crisis becomes acute. Speed, crucial in handling crises, might be hampered by coordination difficulties, compounded by the lack of agreement between countries on the role (if any) public funding should play in crisis resolution and on the division of tasks between supervisors in 'home' (headquarters) and 'host' (local) jurisdictions. At every step, agreement may take so long to reach that it might be overtaken by events on the ground, with consequent increases in the cost of any remedies.
>
> If a bank's insolvency becomes a realistic scenario, minds will focus on the possible public cost of crisis resolution, which has been a factor in past crises, and countries will act to minimize losses to their own citizens. They may seek advantage by withholding information or otherwise delaying cooperation. Host countries may try to 'ring-fence' subsidiaries or branches and limit their operational freedom, to prevent higher-quality assets from leaving the country or additional liabilities being imposed on the local level. In doing so, they may compound difficulties and prevent solutions at the group level. Conversely, home authorities may be unwilling to spend their taxpayers' money for the benefit of depositors in host countries, or lack the capacity to do so.

The IMF in its April 2007 Global Financial Stability Report, *supra* note 75, identified many of these same risks. It noted that although financial systems globally had held up well in recent years, financial systems and policymakers had not been tested to date by a full-blown crisis involving a significant cross-border failure or by simultaneous failures of several internationally active financial institutions. The report observed that "[w]hile such an event may be unlikely, the need for effective coordinated arrangements to deal with it is pressing because, in their absence, the costs may be very large indeed." *Id.* at 121.

[77] *See, e.g.*, Gillian G.H. Garcia, Rosa M. Lastro, and Maria J. Nieto, Bankruptcy and reorganization procedures for cross-border members in the EU: Towards an integrated approach to the reform of the EU safety net, LSE Financial Markets Group Special Paper 186 (May 2009), *available at* http://www.lse.ac.uk/fmg/documents/specialPapers/2009/186.pdf (outlining the complications of reorganizing and liquidating banks with cross-border activities in the EU and proposing reforms in the EU); Martin Cihák and Erlend Nier, The Need

for Special Resolution Regimes for Financial Institutions — The Case of the European Union, IMF Working Paper WP/09/200 (Sept. 2009), *available at* http://www.imf.org/external/pubs/ft/wp/2009/wp09200.pdf (discussing deficiencies in various Member State resolution regimes); Wim Fonteyne *et al.*, Crisis Management and Resolution for a European Banking System, IMF Working Paper WP/10/70, *supra* note 68 (proposing an integrated crisis management and resolution framework for the EU's banking system in the form of a European Resolution Authority).

78 *See* Bank of England, Financial Stability Report 65 (Oct. 2007), *available at* http://bankofengland.co.uk/publications/Pages/fsr/default.aspx ("One important tool that is currently unavailable in the United Kingdom is an insolvency process specifically adapted to banks."); Peter Brierley, The U.K. Special Resolution Regime for failing banks in an international context, Bank of England Financial Stability Paper No. 5 (July 2009), *available at* www.bankofengland.co.uk/publications/Documents/fsr/fs_paper05.pdf.

79 Banking Act 2009, c. 1, pt. 1 (U.K.), *available at* http://www.legislation.gov.uk/ukpga/2009/1/pdfs/ukpga_20090001_en.pdf.

80 Banking Act 2009, c. 1, § 1.

81 Banking Act 2009, c. 1, pt. 2 & pt. 3.

82 Independent Commission on Banking, Final Report Recommendations (Sept. 2011) (U.K.), *available at* www.ecgi.org/documents/icb_final_report_12sep2011.pdf .

83 Financial Services (Banking Reform) Bill, 2013-14, H.L. Bill [083].

84 *Id*. §§ 1-9.

85 George Osborne, Chancellor of the Exchequer, Remarks at JPMorgan Bournemouth Office (Feb. 4, 2013), *available at* http://www.gov.uk/government/speeches/speech-by-the-chancellor-of-the-exchequer-rt-hon-george-osborne-mp-on-the-reform-of-banking. Chancellor Osborne drew a direct comparison to the situation faced by the U.K. government in the financial crisis of 2008:

> When RBS [Royal Bank of Scotland] failed, my predecessor Alistair Darling felt he had no option but to bail the entire thing out. Not just the RBS on Britain's high streets, but the trading positions in Asia, the mortgage books in sub-prime America, the property punts in Dubai. I want to make sure that the next time a Chancellor faces that decision they [sic] have a choice.

Alistair Darling drew a somewhat different conclusion from his experience. *See*

Alistair Darling, *A Crisis Needs a Firewall Not a Ring-fence*, FIN. TIMES, Feb. 4, 2013.

[86] *See* Joint Paper, *supra* note 23, at 8.

[87] *Id.*

[88] *Id.* at ii.

[89] *Id.* at ii & 4-5.

[90] *Id.* at 5.

[91] *Id.* at 11.

[92] *Id.* at 13.

[93] *Id.*

[94] *Id.* at 11 & 13.

[95] *Id.* at 13-14.

[96] *See* FINMA, Resolution of global systemically important banks 4 (Aug. 7, 2013), available at http://www.finma.ch/e/finma/publikationen/Documents/pos-sanierung-abwicklung-20130807-e.pdf. S*ee also* James Shotter & Daniel Schäfer, *Credit Suisse switches focus back to growth*, FIN. TIMES, Sept. 10, 2013, at 15.

[97] *See Final report of the Commission of Experts for limiting the economic risks posed by large companies* (Sept. 30, 2010), *available at* www.sif.admin.ch/dokumentation/00514/00519/00592index.html?lang=en.

[98] FINMA, Annual Report 2012 at 44, *available at* http://www.finma.ch/e/finma/publikationen/Documents/jahresbericht-2012-e.pdf.

[99] FINMA, Addressing "Too Big To Fail," The Swiss SIFI Policy 5 (June 23, 2011), *available at* http://www.finma.ch/e/finma/publikationen/Documents/be-swiss-SIFI-policy-june-2011-summary-20110624-e.pdf.

[100] FINMA, Resolution of global systemically important banks, *supra* note 96.

[101] *Id.* at 3.

[102] *Id.*

[103] *Id.* at 7.

[104] *Id.* at 10-11.

[105] *Id.* at 11.

[106] *Id.* at 13.

[107] Annex A to the FSB 2013 Thematic Review, *supra* note 56, contains a high-level summary of recent legislative reforms in various FSB jurisdictions, including Germany, Spain, and the Netherlands.

[108] *See, e.g.*, Barbara Jeanne Attinger, Crisis Management and Bank Resolution — Quo Vadis, Europe?, European Central Bank Legal Working Paper Series No. 13

(December 2011), *available at* http://www.ecb.europa.eu/pub/pdf/scplps/ecblwp13.pdf ("Within the EU, insolvency law has been firmly in the clutches of national sovereignty and no harmonization of the substantive law in this area has taken place.").

[109] Fonteyne *et al.*, *supra* note 68, at 6.

[110] European Commission, An EU Framework for Crisis Management in the Financial Sector (2010), COM (2010) 579 final, *available at* http://ec.europa.eu/internal_market/bank/docs/crisis-management/framework/com2010_579_en.pdf.

[111] *Id.* at 15.

[112] European 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 (2012), COM (2012) 280 final, *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52012PC0280:EN:NOT [hereinafter Proposed RRD].

[113] European Commission, An EU Framework for Crisis Management in the Financial Sector — Frequently Asked Questions 1 (Oct. 2010), *available at* http://europa.eu/rapid/press-release_MEMO-10-506_en.htm?locale=en.

[114] European Commission, Press Release, New crisis management measures to avoid future bank bail-outs (June 6, 2012), *available at* http://europa.eu/rapid/press-release_IP-12-570_en.htm?locale=en.

[115] European Commission, Commission Staff Working Document, *Impact Assessment Accompanying the document 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*, Annex XVI (Impacts on Fundamental Rights) (June 6, 2012) [hereinafter Impact Assessment].

[116] *Id.* at 4 & 93.

[117] Proposed RRD, *supra* note 112, Art. 38.

[118] European Banking Federation, *EBF Positioning on European Commission Proposals for Bank Recovery and Resolution Directive* 17 (Sept. 17, 2012), *available at* http://www.ebf-fbe.eu/uploads/D1359D-2012_C_EBF_Position_on_the_COM_Proposals_for_a_Bank_Recovery_and_Resolution_Directive.pdf.

[119] *Id*. at 17-18. *See also* British Bankers Association, *BBA briefing on Recovery and Resolution Directive* (Aug. 28, 2012), *available at* http://www.bba.org.uk/download/8120 (noting that it believes that the exclusion from bail-in for liabilities of less than a month is the "least optimal solution" and proposing that the exclusion either be removed completely or extended to cover liabilities of less

than 12 months even though such an extension would expand the incentive for short-term financing).

[120] Proposed RRD, *supra* note 112, Art. 93.

[121] *Id*. Art. 97(2).

[122] Impact Assessment, *supra* note 115, at 57.

[123] European Commission, Bank recovery and resolution proposal: Frequently Asked Questions 2 (June 6, 2012), *available at* http://europa.eu/rapid/press-release_MEMO-12-416_en.htm.

[124] European Commission, Communication from the Commission to the European Parliament and the Council, A Roadmap towards a Banking Union (Sept. 12, 2012) COM (2012) 510 final, *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0510:FIN:EN:HTML [hereinafter Roadmap].

[125] European Commission, Press Release, Commission proposes new ECB powers for banking supervision as part of a banking union (Sept. 12, 2012), *available at* http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/137627.pdf [hereinafter Commission Press Release].

[126] Roadmap, *supra* note 124, at 7. As subsequently revised in the trilogue process, the SSM proposal now envisions that the ECB would assume direct supervisory responsibility for the 130 largest banks in the Eurozone and the national supervisors would retain first-line supervisory responsibility for approximately 600 smaller banks in the Eurozone.

[127] Commission Press Release, *supra* note 125, at 1.

[128] *Id*. at 2.

[129] *Id*. at 3.

[130] Roadmap, *supra* note 124, at 10. The European Commission had previously proposed reform measures for the EU regime governing deposit guarantee schemes in July 2010. *See* European Commission, Press Release, Commission proposes package to boost consumer protection and confidence in financial services (July 12, 2010), *available at* http://europa.eu/rapid/press-release_IP-10-918_en.htm. The proposed reform measures related *inter alia* to strengthening the funding mechanisms for the deposit guarantee schemes.

[131] Statement of Commissioner Barnier following agreement in ECOFIN on bank recovery and resolution (Jun 27, 2013) Memo/13/601, *available at* http://europa.eu/rapid/press-release_MEMO-13-601_en.htm [hereinafter Barnier Statement]; Council of the European Union, Press Release, Council agrees position on bank resolution (Jun 27, 2013), *available at* http://www.consilium.

europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/137627.pdf [hereinafter Council Press Release].

[132] Council Press Release, *supra* note 131, at 2.

[133] *Id.*

[134] *See, e.g.*, European Banking Federation, Press Release, Banks welcome last minute agreement in Council on BRRD "Bank Recovery and Resolution Directive" (Jun 27, 2013), *available at* http://www.ebf-fbe.eu/uploads/EBF_003023%20-%20Press%20release%20-Banks%20welcome%20last%20minute%20agreement%20in%20Council%20on%20BRRD%20-%20Bank%20Recovery%20and%20Resolution%20Directive.pdf.

[135] Council Press Release, *supra note* 131, at 2.

[136] *Id.* at 3.

[137] *Id.*

[138] *See* Barnier Statement, *supra note* 131, at 2.

[139] European Commission, Press Release, Commission proposes Single Resolution Mechanism for the Banking Union (July 10, 2013), *available at* http://europa.eu/rapid/press-release_IP-13-674_en.htm [hereinafter SRM Press Release].

[140] Council of the European Union, Press Release, Council agrees position on bank supervision (Dec. 13, 2012), *available at* http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/134265.pdf; Statement of Commissioner Barnier following the trilogue agreement on the creation of the Single Supervisory Mechanism for the eurozone (Mar. 19, 2013) Memo/13/251, *available at* http://europa.eu/rapid/press-release_MEMO-13-251_en.htm?locale=en.

[141] For a discussion of some of the legal, policy, and operational issues involved in establishing the SSM, see Eilis Ferran and Valia Babis, The European Single Supervisory Mechanism, 13 Journal of Corporate Law Studies (2013) (forthcoming); Stijn Verhelst, Assessing the Single Supervisory Mechanism: Passing the Point of No Return for Europe's Banking Union, Egmont Royal Institute for International Relations (June 2013), *available at* http://www.egmontinstitute.be/paperegm/ep58.pdf.

[142] *See* SRM Press Release, *supra* note 139, at 1. *See also* European Banking Federation, Press Release, Single Resolution Mechanism: one step further to the Banking Union 1 (July 10, 2013), *available at* http://www.ebf-fbe.eu/uploads/EBF_003235%20-%20Single%20Resolution%20Mechanism.pdf. ("Europe's banks welcome the announcement today by the European Commission of a Single Resolution Mechanism as a complement to the Single Supervisory

Mechanism (SSM) within the project of the Banking Union.").

[143] European Commission, A comprehensive EU response to the financial crisis: a strong financial framework for Europe and a banking union for the Eurozone 6 (July 10, 2013), *available at* http://europa.eu/rapid/press-release_MEMO-13-679_en.htm.

[144] SRM Press Release, *supra* note 139, at 2.

[145] *Id.*

[146] *Id.*

[147] *Id.*

[148] *Id.*

[149] European Commission, Proposal for a Single Resolution Mechanism for the Banking Union — frequently asked questions 9 (July 10, 2013), *available at* http://europa.eu/rapid/press-release_MEMO-13-675_en.htm.

[150] Statement by President Barroso and Commissioner Barnier following the European Parliament's vote on the creation of the Single Supervisory Mechanism for the eurozone (Sept. 12, 2013) Memo/13/781, *available at* http://europa.eu/rapid/press-release_MEMO-13-781_en.htm.

[151] *See, e.g.*, Natixis Flash Economics, The Single Resolution Mechanism (SPM) as seen by the Commission: a stillborn project? (July 22, 2013), *available at* http://cib.natixis.com/flushdoc.aspx?id=72230. *See also* Jim Brunsden & Rebecca Christie, EU Unveils Bank-Failure Plan in Face of German Opposition, BLOOMBERG, July 10, 2013, *available at* http://washpost.bloomberg.com/Story?docId=1376-MPO1I86K50Y101-0UDUILD4BCLSVN9OBAECDA14L0 (quoting a legal source as saying that "the conferral of a power to wind up banks on the commission is arguably the greatest transfer of sovereignty in the history of the EU").

[152] *See, e.g.*, Wolfgang Schäuble, Banking union must be built on firm foundations, FIN.TIMES, May 13, 2013, at 11.

[153] *See, e.g.*, Deutsche Bank, DB Research, The Single Resolution Mechanism: Only starting shot for a long debate (July 15, 2013), *available at* http://www.dbresearch.com/servlet/reweb2.ReWEB?addmenu=false&document=PROD0000000000317296&rdShowArchivedDocus=true&rwnode=DBR_INTERNET_EN-PROD$NAVIGATION&rwobj=ReDisplay.Start.class&rwsite=DBR_INTERNET_EN-PROD.

[154] *See, e.g.*, Natixis Flash Economics, *supra* note 151, at 6-7.

[155] *See* Thomas Huertas and Marie J. Nieto, A game changer: The EU Banking recovery and resolution directive (Sept. 19, 2013), http://www.voxeu.org/article/banking-recovery-and-resolution-directive.

[156] *Id. See also* Natixis Flash Economics, *supra note* 151, at 5-6.
[157] *See, e.g.* Natixis Flash Economics, *supra note* 151, at 6-7.
[158] *See, e.g.*, Jeff Black and Stefan Riecker, *Asmussen Says ECB Stress Tests Last Chance for Confidence*, BLOOMBERG, Sept. 4, 2013, http://www.bloomberg.com/news/2013-09-04/asmussen-says-ecb-stress-tests-last-chance-for-confidence.html.
[159] *See, e.g.*, Rebecca Christie and Patrick Donahue, *Asmussen Says No Time to Lose on Bank Resolution Backstop*, BLOOMBERG, Sept. 13, 2013, http://www.bloomberg.com/news/2013-09-13/asmussen-says-no-time-to-lose-on-bank-resolution-backstop.html.
[160] Press Release, FSB, FSB consults on an Assessment Methodology for the Key Attributes of Effective Resolution Regimes (Aug. 28, 2013), *available at* http://www.financialstabilityboard.org/press/pr_130828.htm.
[161] FSB, *Progress and Next Steps Toward Ending "Too-Big-To-Fail" (TBTF)* (Sept. 2, 2013), *available at* http://www.financialstabilityboard.org/publications/r_130902.pdf.
[162] *Id*. at 22.