XI. **Financing Approved for the EU’s “Single Resolution” Fund**

A. Introduction

The 2008 financial crisis shocked Europe as much as it did the United States, with major European banks sustaining significant losses in U.S.-based asset-backed securities.\(^1\) As international investment and financing halted, the global crisis disproportionately affected smaller European countries that heavily relied on external funding.\(^2\) By 2009, as several countries amassed huge amounts of sovereign debt, multiple European countries reported large increases in deficit-to-GDP ratios.\(^3\) What began as financial shock had transformed into what is known as the European sovereign debt crisis.\(^4\)

Bank failures in Spain, Ireland, Portugal, Cyprus, and Greece prompted significant bailouts,\(^5\) financed in part by the International Monetary Fund, but largely by the taxpayers of other Eurozone countries like Germany, France, and Italy.\(^6\) In the process, the EU determined that euro-currency nations required a more integrated banking system.\(^7\) Thus, the European Union: (1) unified its banking

---

2. Id.
3. Id. at 56 (“In late 2009, the European sovereign debt crisis entered a new phase. Late that year, a number of countries reported larger-than-expected increases in deficit/GDP ratios.”). In 2009, Greece’s newly elected officials famously doubled the former government’s estimated 6% deficit to GDP ratio for the year to 12.7%. Id. The new government also revised the numbers for previous years showing “significantly larger deficits” than had been reported by the former government officials. Id.
law; (2) implemented measures designed to foster safer banking practices; (3) required a more robust deposit insurance program; (4) set up new oversight; and (5) proposed a bailout fund that would be financed by banks and financial institutions themselves rather than ordinary taxpayers.  

B. The Single Rulebook

After determining that banking policy should be handled at the EU level rather than the national level, the EU issued comprehensive yet unitary reforms. These common rules, known as the “single rulebook,” apply to all banks in the EU, not only those in euro currency states. The single rulebook consists of three parts: (1) The Capital Requirements Regulation and Directive, (2) The Deposit Guarantee Scheme Directive (DGSD), and (3) The Bank Recovery and Resolution Directive (BRRD).

1. The Capital Requirements Regulation and Directive

shared the euro and were even more interdependent, a deeper integration of the banking system was needed.

9 Id.
10 Id.
Similar to the Dodd-Frank Act in the United States, Article 92 of the CRD IV adopts the recommendations of Basel III.\(^\text{15}\) Thus, institutions, defined as “a credit institution or an investment firm,”\(^\text{16}\) must maintain at least a common equity risk-based capital ratio of 4.5%, a tier-1 risk-based capital ratio of 6%, and a total risk-based capital ratio of 8%.\(^\text{17}\) The theory behind increased capital requirements is that because banks are so highly leveraged, an inadequate capital cushion puts the institution (and sometimes the larger financial system) at risk if large, unexpected losses occur.\(^\text{18}\) The hope is that banks would remain solvent during a crisis.\(^\text{19}\)

2. The Deposit Guarantee Scheme Directive

DGSD eliminates differences in national laws regarding depository insurance and provides that in the case of bank failure, should deposits be unavailable, each depositor of a regulated institution is covered up to €100,000.\(^\text{20}\) As such, depositors will have at least some of their funds protected from potential bank failures.\(^\text{21}\) “From a financial stability perspective, this promise prevents depositors from making panic withdrawals from their bank, thereby preventing severe economic consequences.”\(^\text{22}\)

3. The Bank Recovery and Resolution Directive

Finally, the EU determined that the financial crisis and subsequent sovereign debt crisis “revealed serious shortcomings in the


\(^{16}\) Capital Requirements Directive, supra note 12, art. 1.

\(^{17}\) Id. art. 92, at 1.


\(^{19}\) Id.

\(^{20}\) Deposit Guarantee Directive, supra note 13, art. 6, at 1.


\(^{22}\) Id.
existing tools available to authorities for preventing or tackling failures of systemic banks.” BRRD is designed to provide the missing tools, and in the case of major bank failure, “to ensure the continuity of its critical functions, preservation of financial stability and restoration of the viability of all or part of that institution.”

C. The EU Banking Union

With the single rulebook providing the foundation, two initiatives make up the Banking Union that now regulates banking institutions in all euro currency states: (1) the Single Supervisory Mechanism, and (2) the Single Resolution Mechanism.

1. The Single Supervisory Mechanism

This mechanism places the European Central Bank as the chief “prudential supervisor of financial institutions in the euro area.” The European Central Bank is now responsible for supervising the largest and most systemically important banks while the national governments continue to monitor the remaining banks under the single rulebook. This supervision consists mainly of ensuring that covered institutions comply with the new comprehensive regulations, and to identify and “tackle problems early on.”

2. The Single Resolution Mechanism and Fund

---

24 Id. (“‘Resolution’ means the restructuring of a bank by a resolution authority, through the use of resolution tools, to ensure the continuity of its critical functions, preservation of financial stability and restoration of the viability of all or part of that institution, while the remaining parts are put into normal insolvency proceedings.”).
25 Banking Union, supra note 7.
26 Id.
27 Id.
28 Id.
Regulation (EU) No 806/2014 establishes the Single Resolution Mechanism that is triggered in the event of a bank failure. On January 1, 2016, the Single Resolution Mechanism “became fully operational.” A key component of the resolution plan in case of failure is the Single Resolution Fund. The general policy behind creating this fund is to minimize, if not eliminate, the taxpayer burden in the event a banking institution must be bailed out. The Banking Union has decided that the private sector should bear this cost.

Under Article 70 of the Regulation, the fund is to be financed through annual payments made by all “institutions authorised in the territories of all of the participating Member States.” The fund is to be built up over the next eight years through ex-ante contributions that are calculated based on a banking institution’s size and riskiness.

---


31 Id.

32 Recovery and Resolution Directive, supra note 14, at 190 (“The financial crisis has shown that there is a significant lack of adequate tools at Union level to deal effectively with unsound or failing credit institutions and investment firms (‘institutions’) . . . . During the crisis, those challenges were a major factor that forced Member States to save institutions using taxpayers’ money. The objective of a credible recovery and resolution framework is to obviate the need for such action to the greatest extent possible.”).


34 Id. art. 69, at 77 (“By the end of an initial period of eight years from 1 January 2016 . . . the available financial means of the Fund shall reach at least 1 % of the amount of covered deposits of all credit institutions authorised in all of the participating Member States . . . . Each year the calculation of the contributions for individual institutions shall be based on: (a) a flat
Article 70(2) of the Regulation provides that each year, the contributions for individual institutions consist of “(a) a flat contribution, that is pro-rata based on the amount of an institution's liabilities . . . with respect to the total liabilities . . . of all of the institutions authorised in the territories of the participating Member States; and (b) a risk-adjusted contribution.” In other words, all liabilities incurred by covered banking institutions will be aggregated, at which point it can be determined what percentage of the total liabilities each institution is responsible for. Each institution will then pay a corresponding pro rata share after a risk-based adjustment.

Article 6 of Delegated Regulation (EU) 2015/63 sets out “four risk pillars”: (1) risk exposure, (2) stability and variety of source of funding, (3) importance of an institution to the stability of the financial system or economy, and (4) additional risk indicators to be determined by the resolution authority. The pillars themselves consist of inquiries into indicators such as leverage ratios, risk-based capital ratios, trading activities, off-balance sheet exposures, and the extent of any previous public financial support. Article 7 of the Regulation then sets out a specific risk weight to each pillar as well as a specific contribution . . . with respect to the total liabilities . . . and (b) a risk-adjusted contribution.”

35 Id. art. 70, at 77; Recovery and Resolution Directive, supra note 14, art. 103, at 7 (“The Commission shall be empowered to adopt delegated acts… in order to specify the notion of adjusting contributions in proportion to the risk profile of institutions… taking into account all of the following: (a) the risk exposure of the institution, including the importance of its trading activities, its off-balance sheet exposures and its degree of leverage; (b) the stability and variety of the company’s sources of funding and unencumbered highly liquid assets; (c) the financial condition of the institution; (d) the probability that the institution enters into resolution; (e) the extent to which the institution has previously benefited from extraordinary public financial support; (f) the complexity of the structure of the institution and its resolvability; (g) the importance of the institution to the stability of the financial system or economy of one or more Member States or of the Union; (h) the fact that the institution is part of an IPS.”).


37 Id. art. 6, at 1.
risk weight to each component of each pillar.\textsuperscript{38} For example, the “risk exposure” pillar is to be weighted at 50\%, more than twice as much as any other pillar, and the four components of the “risk exposure” pillar (such as leverage ratio and risk-based capital ratios) are each to be given an equal 25\% weight.\textsuperscript{39}

To ensure that payments into the fund are made, the Banking Union has tasked the euro Member States with designating a resolution authority that is empowered to raise ex-ante contributions from covered institutions within that Member State’s territory.\textsuperscript{40} Similar to how the EU appointed the European Central Bank as chief prudential supervisor under the Single Supervisory Mechanism, Member State resolution authorities “may be national central banks, competent ministries or other public administrative authorities or authorities entrusted with public administrative powers.”\textsuperscript{41}

\section*{3. Resolution Fund Commentary}

An intriguing aspect of the resolution fund is the basic way contributions to the resolution fund are determined; contributions are calculated by pro rata share of the total liabilities that euro currency institutions hold.\textsuperscript{42} A banking institution’s major liabilities are deposits.\textsuperscript{43} Thus, the resolution fund primarily seeks to collect the highest contributions from institutions holding the most deposits, institutions otherwise known as the biggest banks, some of which may be “too big to fail.” Especially in a case of “too big to fail,” it seems that a resolution fund, financed primarily by those institutions, is a cogent safeguard from what has previously resulted in massive taxpayer-funded bailouts.

\begin{footnotesize}
\textsuperscript{38} Id. art. 7, at 1 (“When assessing the risk profile of each institution the resolution authority shall apply the following weights to the risk pillars: (a) Risk exposure: 50 \%; (b) Stability and variety of sources of funding: 20 \%; (c) Importance of an institution to the stability of the financial system or economy: 10 \%; (d) Additional risk indicators to be determined by the resolution authority: 20 \%.”).

\textsuperscript{39} Id. art. 7, at 2.

\textsuperscript{40} Id. at 1.

\textsuperscript{41} Recovery and Resolution Directive, supra note 14, art. 3, at 3.

\textsuperscript{42} See Single Resolution Mechanism and Fund Regulation, supra note 33.

\end{footnotesize}
Next, the banking institution is subject to a holistic risk analysis.\textsuperscript{44} This aspect of the contribution calculation ensures that the biggest banks with the riskiest assets and practices pay the most into the resolution fund.\textsuperscript{45} This not only makes logical sense, it also seems to be designed to discourage risky behavior. A big bank already paying a hefty fee based on its sheer portion of liabilities will want to reduce its bill, and the only way to do that without downsizing is to pursue a lower risk rating. The Banking Union hopes the Single Resolution Fund will total “at least 1% of the amount of covered deposits of all credit institutions authorised in all of the participating Member States” by 2024.\textsuperscript{46}

D. Further Resolution Tools

Should the resolution fund be insufficient to remedy a financial crisis, the Banking Union provides two other significant

---

\textsuperscript{44} See Ex Ante Contributions, \textit{supra} note 36; Recovery and Resolution Directive, \textit{supra} note 14, art. 103(7) (“The Commission shall be empowered to adopt delegated acts . . . in order to specify the notion of adjusting contributions in proportion to the risk profile of institutions . . . , taking into account all of the following: (a) the risk exposure of the institution, including the importance of its trading activities, its off-balance sheet exposures and its degree of leverage; (b) the stability and variety of the company’s sources of funding and unencumbered highly liquid assets; (c) the financial condition of the institution; (d) the probability that the institution enters into resolution; (e) the extent to which the institution has previously benefited from extraordinary public financial support; (f) the complexity of the structure of the institution and its resolvability; (g) the importance of the institution to the stability of the financial system or economy of one or more Member States or of the Union; (h) the fact that the institution is part of an IPS.”).


safeguards designed to further shield taxpayer money: (1) the authority to demand *ex-post* contributions,\(^47\) and (2) the bail-in system.\(^48\)

### 1. Ex-Post Contributions

“Where the available financial means are not sufficient to cover the losses...*ex-post* contributions from the institutions authorised in the territories of participating Member States shall be raised, in order to cover the additional amounts.”\(^49\) If the resolution fund falls short, the institutions responsible for financing the fund, ordinarily through ex-ante contributions, may be required to supply additional capital. The Regulation provides that the total ex-post contribution cannot exceed three times the annual amount of ordinary ex-ante contributions;\(^50\) however, if the EU’s projection of €55 billion after eight years is correct, that’s an annual contribution of almost €6.9 billion. If the maximum of three times the annual amount is collected from each institution, the Banking Union will have about €20.5 billion more to navigate through a financial crisis, still without having spent any taxpayer money.

### 2. Bail-in System

Before the Single Resolution Fund may be tapped, and before ex-post contributions are sought, a banking institution’s shareholders and creditors must make “a contribution to loss absorption and recapitalization” totaling at least 8% of the banking institution’s liabilities.\(^51\) The hierarchy of who must write down equity begins with holders of Common Equity (shareholders) then works down through Additional Tier 1 and Tier 2 holdings.\(^52\) This system compels creditors

---

\(^47\) Single Resolution Mechanism and Fund Regulation, *supra* note 33, art. 71, at 85. (“Where the available financial means are not sufficient to cover the losses, costs or other expenses incurred by the use of the Fund in resolution actions, extraordinary *ex-post* contributions from the institutions authorised in the territories of participating Member States shall be raised, in order to cover the additional amounts.”).


\(^49\) Single Resolution Mechanism and Fund Regulation, *supra* note 33, art. 71, at 78.

\(^50\) *Id.*


\(^52\) *Id.* art. 48, at 279 (“Member States shall ensure that, when applying the bail-in tool, resolution authorities exercise the write down and conversion
to bear the initial burden of a financial crisis by forfeiting some or all of their holdings in order to reduce an institution’s debt. The system also further separates the taxpayer from the debt. According to the Directive, the bail-in system ensures that “shareholders and creditors of the failing institution suffer appropriate losses and bear an appropriate part of the costs arising from the failure of the institution” and the system will “give shareholders and creditors of institutions a stronger incentive to monitor the health of an institution.” On the other hand, such a system may discourage investment in banking institutions because investors will be aware that their assets are the primary defense against collapse should the institution falter.

E. Conclusion

As the effects of the most recent financial crisis still reverberate in some Eurozone nations, the EU banking union presents interesting legislative protections against significant financial instability while shielding taxpayer money. Certain aspects of the plan, particularly the bail-in system, may discourage investment and powers…meeting the following requirements: (a) Common Equity Tier 1 items are reduced in accordance with point (a) of Article 60(1); (b) if, and only if, the total reduction pursuant to point (a) is less than the sum of the amounts referred to in points (b) and (c) of Article 47(3), authorities reduce the principal amount of Additional Tier 1 instruments to the extent required and to the extent of their capacity; (c) if, and only if, the total reduction pursuant to points (a) and (b) is less than the sum of the amounts referred to in points (b) and (c) of Article 47(3), authorities reduce the principal amount of Tier 2 instruments to the extent required and to the extent of their capacity…resolution authorities shall exercise the write down or conversion power in accordance with the priority of claims under normal insolvency proceedings, in a way that produces the following results . . . .”)


55 Kottasova, supra note 5.

56 Nicole Goebel, Banks Cry For Central Bank Help As Shares Tank, Woes Persist, DEUTSCHE WELLE (2016), http://www.dw.com/en/banks-cry-for-
commentators argue that increased banking regulation stifles economic growth. However, the EU has determined it to be most prudent to unify its banking law, tighten regulations on euro currency member state banking institutions, and to build a protective fund through private sector contributions.

Chris Dailey

central-bank-help-as-shares-tank-woes-persist/a-19051942 [https://perma.cc/HR6A-XYDR] (“Europe's banks are grappling with a combination of tighter regulation and a weak economic climate. Their shares have been pummeled, prompting managers to call on central banks to intervene.”).

57 Anna Brunetti, EC Worries Bank Rules Might Stifle Growth, REUTERS (July 15, 2015), http://www.reuters.com/article/regulations-bonds-idUSL5N0ZV2HE20150715 [https://perma.cc/DC76-KE97] (“The European Commission said Wednesday it will review capital rules imposed on banks after the financial crisis, looking to ensure that the strictures intended to prevent another meltdown don’t end up stifling economic growth by clamping down too tightly on lending.”).

58 Student, Boston University School of Law (J.D. 2017).