

## **The Single Resolution Mechanism – The Second Pillar of the European Banking Union♦**

### **Abstract**

The financial crisis from 2008 has exposed all the imperfectness of the EU financial infrastructure threatening to endanger the existence of the common currency and of the entire project for European integration. Profound reforms in the financial sector have started in order to make European financial system more resilient to crises. As part of a broader plan for completing the Economic and monetary union the European banking union has provided a sound base for more institutional integration for regulation, supervision and resolution of the credit institutions in the EU. One of the key elements of the Banking union is the Single Resolution Mechanism that should provide resolution on supranational level for EU banks with cross border activities. This article explains the need for a common resolution mechanism on the EU level presents the legal framework regulating the Single Resolution Mechanism, gives an overview of the resolution procedure and the structure of the newly created mechanism. Furthermore, the paper explores possible impact of the creation of the Single Resolution Mechanism in the EU integration process of a candidate country for EU membership.

### **I. INTRODUCTION**

The European financial integration has contributed to the process for more diversification and to the creation of an enlarged market for financial services while offering more and cheaper products for consumers. This process of integration of the European market for financial services without boundaries for financial operators where the capital can move freely across the national borders was neither a single shot operation nor a straight ward process. The changes that were made gradually, step by step, were substantial over long period but they were not noticeable on the short run<sup>1</sup>. The result was highly integrated market where the financial institutions have cross border activities while the financial infrastructure and the authorities responsible for supervision and resolution were within the national borders. In the good times this situation does not pose a problem but in times of economic or financial crisis different level of integration of the markets and the institutions that are part of the financial infrastructure is great challenge for maintaining the financial and overall economic stability. This problem was noticed even at the time of the negotiation of the Maastricht treaty but as it is the case with the fiscal union the Member States were not willing to transfer more powers to the union and decided to keep their sovereignty in this field<sup>2</sup>.

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<sup>1</sup> See, Erik Jones, The Forgotten Financial Union, *How You Can Have a a Euro Crisis Without a Euro*, in The Future of the Euro, Edited by Matthias Matthijs and Mark Blyth, Oxford University Press, 2015, p. 46

<sup>2</sup> See, Nicolas Jabco, *The Elusive Economic Government and the Forgotten Fiscal Union*, in The Future of the Euro, Edited by Matthias Matthijs and Mark Blyth, Oxford University Press, 2015, pp. 70-73

Additional problem in the integration process was the choice of the most suitable model for regulation and supervision in the EU<sup>3</sup>.

The turning point in their positions in this regard was the 2008 when the spillovers from the US *subprime* crisis have shown that the current financial system infrastructure is not prepared to face and tackle with massive market shocks. During the crisis many European banks and investment funds were exposed to bad loans not only on the international but also on the national markets and marked considerable losses. Moreover, there was no clear information about the situation in different banks so the mistrust between banks has led to a situation where banks were not lending to other banks. Hence, the crisis has shown all the imperfectness of the European financial system and risks it poses for the existence and the functioning of the entire monetary integration project i.e. the *Eurozone*.

This paper is a modest attempt to contribute to the debate for the need for more integration in the financial system of the EU. After this short introduction, this text will try to explain the need for a common resolution authority at the European level and the legal framework on which the SRM is based (I). Secondly, the structure and the decision making process of the SRM with its core elements are presented (II). Finally, the impact of the SRM for a candidate country for EU membership is given (III). The conclusion follows.

## **II. THE NEED FOR A COMMON RESOLUTION AUTHORITY AND THE LEGAL FRAMEWORK REGULATING IT**

The financial crisis from 2008 which has provoked a severe economic downturn in all the developed economies was the trigger that launched serious reforms in the European financial sector. European leaders were fully aware not only about the seriousness of the moment but also for the need for profound reforms in this sector. Thus, the high-level working group chaired by de Larosière made recommendations for strengthening the European financial system<sup>4</sup>. Based on these recommendations the European Systemic Risk Board was established. Alongside with the authorities that have competences in different sectors it should provide supervision on the stability of the financial system as a whole. The reforms continued. In its Roadmap towards a banking union<sup>5</sup> the European Commission proposed a plan that in several steps should establish a European banking union. It includes a creation of a Single Supervisory Mechanism, Single Resolution Mechanism and European Deposit Insurance Scheme<sup>6</sup>.

In 2013, the SRM has been proposed by the European Commission. As a legal basis, the Article 114 of the TFEU which gives powers to the EU to adopt measures for the approximation of national provisions in order to support the establishment and better functioning of the Internal Market was used<sup>7</sup>. The SRM entered into force in 2014 and became fully operational on 1 January 2016.

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<sup>3</sup> For different concepts of international financial regulation and supervision see: Rolf H. Weber, *Multilayered Governance in International Financial Regulation and Supervision*, in *International Law in Financial Regulation and Monetary Affairs*, ed. Thomas Cottier, John H. Jackson and Rosa M. Lastra, OUP, 2012, pp. 155-169

<sup>4</sup> Report of the High level group on financial supervision in the EU, chaired by Jacques de Larosière, available at: [http://ec.europa.eu/internal\\_market/finances/docs/de\\_larosiere\\_report\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf)

<sup>5</sup> Communication from the Commission to the European Parliament and the Council, A Roadmap towards a Banking Union, Brussels, 12.9.2012 COM(2012) 510 final

[https://ec.europa.eu/info/business-economy-euro/banking-and-finance/banking-union/what-banking-union\\_en](https://ec.europa.eu/info/business-economy-euro/banking-and-finance/banking-union/what-banking-union_en)

<sup>6</sup> On the main constitutive elements of the European banking union see: Bodil S. Nielsen, *Main Features of the European Banking Union*, *European Business Law Review*, Issue 6, 2015, pp. 805-822

<sup>7</sup> This decision is somehow controversial from a legal viewpoint. Namely, taking into consideration the *Meroni* principle settled by the European Court of Justice in 1958 the delegation on such vast discretionary powers to the

There are several reasons why the European financial system needs common resolution procedure for financial institution and why a supranational authority is the best solution for resolution of the credit institution having cross border activities in different Member States. The fragmented resolution procedure might undermine the competition on the financial markets. Different resolution practices when dealing with a bank with problems might put investors in different position when they are facing same economic or legal problem but in different country<sup>8</sup>. The basic goal of the SRM is to provide uniform implementation of the resolution rules and procedures concerning EU level banks. The SRM is responsible for the resolution of the banks under authority of the SSM which makes both the supervision and resolution on EU operating banks to be conducted at supranational level. This will promote competition and will undermine the creation of the competitive disadvantages based of the rules where the possible resolution is taken.

The SRM is a complex mechanism that includes collaboration and task sharing between national and EU authorities.

The legal framework regulating the newly created mechanism for centralized EU resolution is consist of the Directive establishing a framework for the recovery and resolution of credit institutions and investment firms<sup>9</sup> (hereinafter BRRD) and the Regulation establishing uniform rules and uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund<sup>10</sup> (hereinafter SRM Regulation). The Mechanism is settled mainly on the principles and recommendation made by the Cross-border Bank Resolution Group of Basel Committee of Banking Supervisors of 2010 in their Report<sup>11</sup>. The Directive had to be transposed into national law by the end of 2014 and it is compulsory for all the Member States while the Regulation is directly applicable in the *euroarea* or the same application as the SSM regulation regulating the supervision of the credit institutions in the *euroarea*.

### III. The institutional framework and the decision making process of the SRM

For an effective resolution of the credit institutions there is a need for supranational authority (a) that will conduct the resolution process under precise resolution procedure (c) involving also the national resolution authorities while the process is supported by the common resolution fund providing necessary financial resources for the bank resolution (b).

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SRB which is not an institution of the EU should be justified by inclusion in the decision process of the EU institutions.

<sup>8</sup> For more information about different resolution practices worldwide see: Gillian G.H. Garcia and Maria j. Nieto, *Banking crisis management in the European Union: Multiple regulators and resolution authorities*, Journal of Banking Regulation, Vol. 6, No. 3, 2005, pp. 213-215

<sup>9</sup> Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council, available at: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0059&from=EN>

<sup>10</sup> Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010, available at: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0806&from=EN>

<sup>11</sup> See: Basel Committee on Banking Supervision, Report and Recommendations of the Cross-border Bank Resolution Group, March 2010, available at: <http://www.bis.org/publ/bcbs169.pdf>

a) The Single Resolution Board

The Single Resolution Board is created by the SRM Regulation and it is the central element in the resolution process responsible for resolution of the systemically important banks with cross border activities and the financial institutions under direct supervision of the SSM i.e. the ECB. As an independent EU agency, it is the decision-making body within SRM. The Board is based in Brussels and has legal personality or It has most extensive legal personality under national law, meaning that the Board may *acquire or dispose* movable or immovable property and take part in legal proceedings<sup>12</sup>. It is composed of a Chair, members appointed by Member States, four full time members and observers of the ECB and the European Commission. Each member has one vote. The Board undertakes its tasks on different levels in the administrative and management structure that includes: a plenary session, an executive session, a Chair and a Secretariat<sup>13</sup>. The Board and the national resolution authorities are acting independently and in the interest of the Union as a whole. Also, when performing the tasks conferred on them the representatives are fully independent and should neither seek nor take instructions from national governments or Union's institutions or bodies<sup>14</sup>. For implementation of the Union law and the Regulation in particular the Board is accountable to the European Parliament, the Council and the Commission. The Chair presents a report in public to the European Parliament and the Council while the Board also submits the annual report to the national parliaments and the European Court of Auditors<sup>15</sup>. However, the supranational approach in the resolution process does not mean that the Board is the sole authority involved in the resolution process. The Board has cooperation with the national resolution authorities which assist the SRB in drawing up and implementing the resolution plans.

b) Single Resolution Fund

The centralized process of decision for resolution of the failing or likely to fail bank is not sufficient for achievement of the uniform resolution process promoting stability and equal treatment of the credit institutions in the *Euroarea* and in the EU in general. The process of resolution is strongly connected to the need for refinancing of the failing bank. In other words, the entire process needs adequate financial resources to support the resolution process. If only the decision for the resolution is made on the EU level, while the resolution funds are generated and distributed on national levels the entire process of resolution will be jeopardized. Therefore, under the virtue of the Regulation<sup>16</sup> the Single Bank Resolution Fund is created that as second most important instrument, alongside with the Board, will provide resolution on a EU level.

The purpose of the Fund is to provide financial support for the banks under resolution. Also, the Fund has to ensure the application of the resolution tools and exercise of the resolution powers conferred to the Board as an owner of the Fund.

When it comes to the common financial schema at a supranational level the problem that is difficult to resolve is the model for financing the Fund. The question is if it should be the national funds that should be merged for the purpose of the supranational fund or another model including creation of a new fund that will be gradually provided with financial resources by contributions from the financial institutions that are in the scope of application of

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<sup>12</sup> Article 43 of the SRM Regulation

<sup>13</sup> Article 45 of the SRM Regulation

<sup>14</sup> Article 47 of the SRM Regulation

<sup>15</sup> Article 45 of the SRM Regulation

<sup>16</sup> Article 67 et seq.)

the newly created mechanism. In the case of the SRM the solution found was that the Fund will be financed through contributions from the banking sector and it should gradually replace the national resolution funds for the Member States that are part of the European Banking Union.

c) Decision making in the resolution process

The decision-making process in the resolution of the financial institutions under the SRM is a unique model involving EU institutions, SRB and national supervisory authorities. In the debate whether a newly created SRB might have vast powers in the process of resolution with possibility for making of the final decision for resolution the arguments for inclusion of the EU institutions as final decision makers in the resolution process prevailed. Namely, the SRB has a significant role in the process. It is responsible for the preparation of the resolution, assessing of the bank's resolvability and preparation of the resolution plans. The decision on whether a bank should be under resolution procedure is made under recommendation from the ECB as a supervisory authority. This solution might be justified by the fact the ECB when performing its supervisory tasks has all the information about certain bank and the future prospects on its work. When there is high probability for a bank failure the ECB alerts the SRB and launches the resolution procedure. In this process of preparation, the National Resolution Authorities have an important role in assisting on the SRB in the preparation of the draft plan for resolution. However, any decision adopted by the Board, including the resolution scheme becomes fully effective after 24 hours of their approval. The Council, acting on a Commission's proposal the within 12 hours of the adopted scheme by the Board, might object to the proposed resolution scheme<sup>17</sup>. The objection might be on grounds relating to the public interest or relating to the amount of the funds provided for the resolution. The use of the SRF by the SRM is controlled by the Commission which is granting that the State aid rules are respected and the competition is not endangered. With enrolment of the EU institution in the resolution process as final arbiters the entire procedure becomes more legitimate and trustfully setting aside all the speculations about the integrity of the SRB as decision making body in the resolution process<sup>18</sup>.

The resolution procedure is defined in the BRRD where there are three different phases. The first stage is the *preparatory phase*; the second phase is the *early intervention* while the third stage is the *resolution stage*.

#### **IV. THE REPUBLIC OF MACEDONIA AND THE SRM**

The Banking union and its second pillar i.e. SRM opens series of questions in the accession process of the Republic of Macedonia in the EU. As a candidate country for EU membership the entire institutional capacities are dedicated to the process of preparation for accomplishment of the membership criteria. In this respect, the country should also align its legislation with the *l'acquis communautaire* of the EU which opens series of changes in the legislation regarding the bank resolution and the supervision of the banks. Moreover, the country has to provide conditions for well functioning financial system that can be smoothly integrated into the EU's financial sector. The cooperation with the EU institutions is essential in this regard. Bankruptcy and liquidation procedure for Macedonian banks is regulated in the

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<sup>17</sup> Article 18(4) of the SRM Regulation

<sup>18</sup> On the decision-making process in resolution see more: Giuseppe Boccuzzi, *The European Banking Union, Supervision and Resolution*, Palgrave Macmillan, 2016, pp.119-121

Banking law<sup>19</sup> as *lex specialis* for termination of operations of banks and other credit institutions while the provisions of the Bankruptcy Law respectively apply to the bank bankruptcy proceeding. For branches and subsidiaries of the banks established in the EU there is possibility for cooperation with the home country authorities<sup>20</sup>. Also, as far as the SRM is concerned the Directive offers a possibility for negotiation of agreements with third countries with regard to information sharing and other question related to resolution process. The possibility for agreement is related to situation where third country parent undertakings have subsidiary or branches in EU Member States or where a parent undertaking established in a Member State has subsidiary or branches in one or more third countries. The agreements, in accordance of the Article 218 TFUE, are proposed by the Commission to the Council<sup>21</sup>. However, in the pre-accession period some changes in the legislation are necessary for legal approximation of the Macedonian legislation regulating bank resolution. As it is the case with other provisions of the Banking law that will enter into force after the accession of the Republic of Macedonia in the EU, for subsidiaries and branches of banks established in the EU for example, it is good to have a chapter in the Banking law that will regulate the bank resolution founded on the principles settled in the SRM.

## V. CONCLUSION

The financial and economic crisis from 2008 has shown the fragility of the European integration project in the financial sector. The European financial infrastructure was neither prepared to prevent nor to resolve a systemic financial crisis. That jeopardized the existence of the single currency. The result was a profound reform of the financial infrastructure of the financial sector in the EU and the establishment of the European banking union based on the idea that integrated financial markets should be accompanied with integrated institution within the financial infrastructure of the EU.

One of the pillars of the Banking union is the SRM that should allow member states to go into default and banks to go bankrupt without provoking collapse of the entire financial system. The fragmented resolution procedure might undermine the competition on the financial markets. Different resolution practices might create different environment for investors and their decisions for investments in certain financial institutions depending on the treatment of the banks with difficulties in different Member states. That could seriously distort the competition and undermine the free movement of capital and freedom within the EU.

The SRM is a multi level mechanism that includes collaboration and task sharing between national and EU authorities with main objective to provide uniform implementation of the resolution rules and procedures concerning EU level banks The SRM is responsible for the resolution of the banks under authority of the SSM which makes both the supervision and resolution on EU operating banks to be conducted by supranational level.

There are two main parts of the SRM: The Single Resolution Board and the Single Resolution Fund. The Board is an independent EU agency based in Brussels that is the central element in the resolution process. The Fund, financed through contributions from the banking

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<sup>19</sup> Banking law, Official Gazette of the Republic of Macedonia No. 67/07, 90/09, 67/10, 26/13, 15/15, 153/15 and 190/16, available at: [http://nbrm.mk/WBStorage/Files/WebBuilder\\_Banking\\_Law\\_OGofRM\\_190\\_16.pdf](http://nbrm.mk/WBStorage/Files/WebBuilder_Banking_Law_OGofRM_190_16.pdf)

<sup>20</sup> The Macedonian Central Bank has signed a memorandum of cooperation with the European Banking Authority. On the progress in the area of financial services see: COMMISSION STAFF WORKING DOCUMENT The former Yugoslav Republic of Macedonia 2016 Report, Brussels, 9.11.2016 SWD(2016) 362 final, pp. 40-41, available at: [https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/pdf/key\\_documents/2016/20161109\\_report\\_the\\_former\\_yugoslav\\_republic\\_of\\_macedonia.pdf](https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/pdf/key_documents/2016/20161109_report_the_former_yugoslav_republic_of_macedonia.pdf)

<sup>21</sup> Article 93 of the Directive

sector, provides financial support for the banks under resolution. The decision-making process in the resolution process under the SRM involves SRB and national supervisory authorities. However, the decision on whether a bank should be under resolution procedure is made under recommendation from the ECB while any decision adopted by the Board, becomes fully effective after 24 hours of their approval. The Council, acting on a Commission's proposal the within 12 hours of the adopted scheme by the Board, might object to the proposed resolution scheme which makes the EU institution the final arbiters in the resolution process.

The creation of the SRM is also important for a candidate country for EU membership. In the pre accession phase the countries should harmonize the national legislation with the *l'acquis communautaire* of the EU. This implies changes in the legislation relating to bank resolution and the supervision of banks. As a candidate country for EU membership the republic of Macedonia is well advanced in the areas relating to the financial system. However, this newly adopted EU legislation should be incorporated in the national legislation.

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