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Resolution irresolution

Blog post by Partner Stephen Adams, 23 May 2016

Another week, another banking union/disunion issue. A draft set of European Commission proposals in the public domain this week seem to confirm the intent not to seek explicit EU harmonisation of minimum eligible liability requirements (so-called MREL) for bail in. This is an EU counterpart for TLAC, although applicable to all banks, not just SIFIs, and accounted in different ways and on different scope.

The European Banking Authority had proposed an 8% minimum for liabilities available for bail in 2015 and a 4 year minimum phase in. The Banking Union Single Supervisor has called for the same. The Commission has stuck to not proposing a standardised minimum, instead making this an ad-hoc choice for resolution authorities. The Commission has also declined to enforce a minimum phase in time for requirements, which potentially exposes banks to some big expedited demands for loss absorbing issuance.

Frankfurt clearly wants more compulsion. But the ECB resolution authorities would probably still be able to impose an 8% minimum where their remit runs and they can make the case – and they will make their own judgement on transitions. The line of tension that it exposes will be between this pan-Banking Union standard for the largest banks and the behaviour of authorities overseeing smaller banks at the national or sub-national level. Where politics has been…known to be an issue. This fragmentation is compounded by the fact that different national regimes in the EU still define 'bail in-able' debt in different ways and subordinate creditors in different ways.

So there are two big potential lines of divergence in approaches sub-dividing the EU landscape: between levels of absorbent liabilities, and among definitions of what absorbs and when. Italian authorities again this week flagged concerns about the scope for retail bank customers to be exposed to debt-equity conversions through parallel debt holdings. The Germans have proposed to subordinate all current senior debt holders. The French want to create a new class of bank liabilities to sit under existing senior debt. No wonder investors are confused.

The Commission may yet use a review of the EU Bank Resolution and Recovery Directive this year have a go at harmonising on the classification point. But the MREL experience shows that attempts at harmonisation remain a political minefield, and the invocation of the crisis for imposed change may be losing steam. Delegating the choice to the ECB/SSM provides the effect of harmonisation and will defacto impose a minimum at the SSM's desired level - for the 140-odd banks it oversees. But it leaves the line between the biggest and the rest to be governed by national sensitivities, politics and preferences.

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