

*If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.*

**Chris Mallon**

London  
+44.20.7519.7236  
chris.mallon@skadden.com

**Sven G. Mickisch**

New York  
+1.212.735.3554  
sven.mickisch@skadden.com

**William J. Sweet, Jr.**

Washington, D.C.  
+1.202.371.7030  
william.sweet@skadden.com

**Patrick Brandt**

London  
+44.20.7519.7155  
patrick.brandt@skadden.com

**Sebastian Way**

London  
+44.20.7519.7158  
sebastian.way@skadden.com

\* \* \*

*This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.*

Four Times Square, New York, NY 10036  
Telephone: +1.212.735.3000

**WWW.SKADDEN.COM**

## EU Banking Union: Political Agreement Reached on Single Resolution Mechanism

On March 20, 2014, the European Parliament announced that it had reached political agreement with the European Council on the regulation implementing a single resolution mechanism (SRM), which is an essential element of the proposed EU Banking Union, the new regulatory system to formally cover banks headquartered either in a eurozone country or in a participating non-eurozone EU country.<sup>1</sup>

The SRM will apply to banks and other financial institutions in the eurozone and also in other EU member states (Participating Member States)<sup>2</sup> that decide to join another critical element of EU Banking Union, the single supervisory mechanism (SSM). The SRM is intended to ensure the orderly and efficient resolution under central supervision of failing banks and other financial institutions that are established in Participating Member States. Institutions established in other EU member states will be covered by the EU Bank Recovery and Resolution Directive (BRRD).

This development will allow the European Parliament sufficient time to formally approve the proposals in April's final plenary session, which is due to take place between April 14-17, before the May 2014 elections. In light of the "trilogue" agreement between the European Parliament, the European Commission and the European Council, no significant opposition to the measures is expected. Although there are some last-minute detailed negotiations ongoing, the SRM is expected to enter into force from January 1, 2015, with the bail-in and resolution functions applying from January 1, 2016. The BRRD also is expected to enter into force from January 1, 2015, with the bail-in functions applying from January 1, 2016. Until these dates, therefore, individual national resolution regimes will continue to apply to institutions established in EU member states.

### The SRM and EU Banking Union

The SRM constitutes the second of the three so-called "pillars" needed to underpin EU Banking Union and, as European Commission President José Manuel Barroso stated, "break the vicious link between sovereigns and their banks." The first pillar, the SSM, will be fully operational in November 2014, giving the European Central Bank (ECB) direct supervision over the most significant banks in the Participating Member States. The SRM is intended to complement this supervision by providing an efficient cross-jurisdictional process to ensure that failing banks can be resolved sufficiently with minimal cost to taxpayers and economies.

The third pillar, a common deposit guarantee scheme, is intended to prevent banks from relying on the strength of their sovereign. However, the political will to enact such a

1 See "The EU Banking Union: Will the New Regulatory Framework Restore Confidence in European Banking?" available at <http://insights.skadden.com/>.

2 Participating Member States are, at time of writing: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Luxembourg, Malta, Netherlands, Portugal, Slovakia, Slovenia and Spain. The U.K., Sweden and the Czech Republic have indicated that they will not participate.

scheme is not yet present. A March 2014 European Commission memo indicates that a deposit guarantee scheme governed at national level, funded *ex ante* and coupled with a voluntary mechanism of mutual borrowing between different EU member states is “the only form of mutualisation foreseen at this stage.”

### **SRM Implementation, Scope and Impact on Insolvencies**

The SRM will be implemented for the most part by means of an EU regulation. The text of the proposed regulation will not become available until the European Parliament has given formal approval at its April plenary session. Therefore, information on the SRM proposals depends at present on other published documents.

The SRM is intended to cover the same institutions as the SSM and, therefore, will apply to the approximately 6,000 Participating Member States’ banks and other financial institutions. The SRM will not draw the SSM’s distinction between the approximately 150 “significant” institutions directly supervised by the ECB and other “nonsignificant” institutions, whose day-to-day supervision will be delegated to national supervisory authorities. Instead, the SRM will apply directly to all institutions established in Participating Member States.

The SRM will not provide an insolvency procedure to override national laws. Instead, the SRM obliges Participating Member States to implement national laws that contain a minimum set of resolution tools. Participating Member States will be permitted to go beyond SRM requirements, provided that there is no conflict with EU state aid rules. National rules covering areas such as priority of claims in insolvency will continue to apply. The resolution tools required by the SRM are designed to mirror those available under the BRRD and are similar to those currently available to national resolution authorities in the U.S. and the United Kingdom. The toolkit will include early interventions and preventative measures (such as recovery and resolution plans) as well as bail-ins and other resolution tools. The function of the SRM is, therefore, to coordinate the activities of national resolution authorities by ensuring that a common set of tools is available to them and by providing central oversight and direction as to the deployment of their powers. As discussed below, the SRM also will provide a central resolution fund to support institutions that are undergoing restructuring.

### **SRM Operation**

**The Single Resolution Board (SRB).** The SRB, an EU agency, will have a central role in the SRM’s operation. The SRB will comprise permanent members as well as the European Commission, the European Council, the ECB and the national resolution authorities and will be tasked with ensuring the SRM’s uniform application in the Participating Member States. Where an institution is established both in Participating Member States and others, resolution will proceed under the BRRD, and the SRB will act as the representative of the national resolution authorities of Participating Member States in the resolution colleges. In the event of conflict between the two regimes, the European Banking Authority is expected to play a mediating role.

The ECB also will play a critical role in the SRM’s operation. It will be primarily responsible for monitoring relevant institutions and triggering the SRM resolution procedure with respect to institutions that it considers to be at risk of failure. Once the SRM resolution procedure is triggered, the SRB will be tasked with preparing a resolution scheme for the failing institution, which will then be implemented by the national resolution authorities under SRB oversight. To ensure the scheme’s effectiveness, the SRB will have the power to issue directions to the national resolution authorities and also directly to the institutions when necessary.

The SRM's success is likely to hinge in part on the SRB's responsiveness. While the number of SRB participants remains substantial, the most recent proposals significantly have cut down the approval timeline for a resolution process, with the aim that a resolution scheme could be put in place over the course of one weekend, between the market closing in the U.S. on a Friday and opening in Asia on the following Monday.

The SRB also will establish a Single Bank Resolution Fund (SBRF) funded by a levy on all Participating Member State banks, with the size of contribution depending on size and business model. The SBRF is intended to provide financial support to troubled institutions so that they may continue operations during a SRM restructuring. It is hoped that within eight years of establishment, the SBRF will reach a value equivalent to approximately 1 percent of covered deposits of all authorized banks established in the Participating Member States (approximately €55 billion at present values). During the transitional period while the SBRF is being capitalized, the SBRF will be divided into national compartments, the resources of which are to be progressively mutualized until the SBRF is fully funded. The SBRF also will be able to borrow on the capital markets. A major appeal of the SBRF is the relative speed with which a pan-European resolution fund can reach a critical mass, as compared with national measures. However, some scepticism remains as to the sufficiency of the fund. €55 billion pales in comparison to the sums expended by national governments on financial sector bail-outs during the crisis.

**Intergovernmental Agreements.** The European Commission originally had intended that the SRM would be entirely governed by an EU regulation. However, it now appears that, although a regulation will cover the main aspects of the SRM, some arrangements relating to the SBRF and, in particular, the mutualization of the national fund compartments will be governed by an intergovernmental agreement among the Participating Member States. Significantly, this means that each Participating Member State will have a veto in respect of changes to the SBRF. It remains to be seen whether this will hinder the effectiveness of the SRM in the long term. At first glance it seems that legislators may have passed up their best opportunity of putting in place a more centralised framework for a resolution fund at a time when there appeared to be a degree of political consensus as to the desirability of more unified recovery and resolution measures.

### Looking Ahead

While the scope of the SRM is limited to Participating Member States, banks in other jurisdictions should nevertheless pay close attention to developments in this area as the detail of the proposals is revealed. Subsidiaries and branches of banks based in other jurisdictions may fall within the scope of the SRM if they operate in Participating Member States, and as such may be subject not only to the proposed recovery and resolution mechanism but also to levies to fund the SBRF. Banks also should be aware that despite the EU's harmonization efforts, the Member States will continue to exhibit different approaches to recovery and resolution both in their laws and in practice as a result of the differing legal and commercial cultures in each jurisdiction.