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Clear crisis management rules - basis for the stability of the financial system

In order to prevent uncontrolled bank failures and safeguard public interest, as part of the 'lesson learned' following the 2007–2008 global financial crisis, in 2014 the European Parliament and the Council adopted the Bank Recovery and Resolution Directive (BRRD) and the Deposit Guarantee Schemes Directive (DGSD). The experience, gained also in Poland, in practical application of that regulatory framework has shown that it is necessary to introduce changes to the crisis management solutions. Those necessary changes are partly included in a legislative package on Crisis Management and Deposit Insurance (CMDI)¹, published by the European Commission (EC) in April of this year, aiming at adjusting and strengthening the EU's existing legal framework, with a focus on medium-sized and smaller banks.

Nevertheless, the to-date experience related to the application of the BRRD regime demonstrates, that future regulatory priorities in the field of crisis management should also include additional elements.

In this paper I briefly mention the key objectives that should also be taken into account in connection with further steps of the reform.

1. Ensuring an effective mechanism for supplying liquidity in the resolution procedure.
 - Due to high dynamics of crisis situations the liquidity needs of banks are extremely urgent, while the current EU State aid framework foresees in the case of banks of significant size a requirement of obtaining each time an approval of the European Commission for granting State aid, which is time-consuming.
 - In the case of small and medium-sized institutions the need to obtain the EC approval every six months for prolonging the State aid programme is an additional complication.
 - The requirement of 8 percent bail-in before receiving liquidity support may be an additional hindrance for financial institutions, regardless of their type.
2. Reforming and harmonising insolvency law in the European Union so that restructuring tools similar to those foreseen in the BRRD (in particular, the takeover and the asset separation tools) may be applied also in the case of entities that do not meet the public interest condition in insolvency proceedings.

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3. Preventing a so-called 'limbo effect', which occurs in a situation in which a financial institution does not meet the conditions for insolvency and the public interest condition, but it meets the FOLTF (failing or likely to fail) condition, and as a result it may neither be subject to the resolution procedure, nor to the insolvency procedure. The BRRD in its new wording clearly states that in the case where the FOLTF condition is satisfied but the public interest condition is not, the institution should be subject to insolvency procedure. However,

because the proposal for a directive does not harmonise the insolvency law (including the conditions for insolvency), in legislative regimes of different Member States such a financial institution may not be meeting the conditions for opening insolvency proceedings against it. That means that such an institution may be obligated to maintain a certain part of the MREL recapitalisation requirement.

4. Changing a paradigm according to which, in the current proposals, insolvency (notably – conducted in the absence of harmonisation of the insolvency law, as mentioned above) is foreseen as the default option, although one of the intentions declared by the authors of the legislative proposal is to propagate the use of resolution, especially in the case of small and medium-sized institutions. The crisis management framework should be based on the assumption that the default option is resolution and not insolvency.
5. Providing clear conditions for an entity to be considered as failing – according to the BRRD, an institution shall be deemed to be failing or likely to fail, if the institution is unable to pay its debts or other liabilities as they fall due or there are objective elements to support a determination that the institution will, in the near future, be unable to pay its debts or other liabilities as they fall due. It is not clear what other liabilities are considered – whether or not, for example, the inability to repay liabilities owed to employees or pay social security contributions is sufficient for commencement of the resolution process.

It is without doubt that further legislative activity in the above-identified areas would help improve the effectiveness of the bank crisis management framework in the European Union.

1. https://ec.europa.eu/commission/presscorner/detail/en/ip_23_2250.