CEPS COMMENTARY
Thinking ahead for Europe

The Bank Resolution Compromise: Incomplete, but workable?

Daniel Gros

19 December 2013

The Finance Ministers of the eurozone have finally agreed to disagree. Their compromise solution on the Single Resolution Mechanism (SRM) is clearly incomplete and extremely complex. But these problems are likely to be resolved over time given that in future the resolution of large banks will be financed by a Single Resolution Fund (SRF).

This common fund constitutes the key advance. It implies a considerable mutualisation of risks and will require changes over time in the extremely complex decision-making mechanisms agreed today. The intergovernmental nature of the separate SRF Treaty is of course not ideal. But there was a real, albeit only 'tail' risk that the existing Treaty might not have provided a sufficient legal basis for an SRF and a Resolution Board based on the Community institutions. But this is also likely to be revisited because the next ten years will give ample time to investigate all the legal problems and, hopefully, also allow for a revision of the Treaties which would put the banking union on a sound legal basis.

The decision-making mechanism of the future Resolution Board is so complex that in practice it will work quite differently from what one would imagine by looking at the formal rules. In an emergency the people with the necessary information will decide and all the others who are formally also involved will probably just have to agree.

Today's SRM compromise is also incomplete because there is no explicit agreement on how to provide the SRF with a backstop in case of a really large crisis. But once the SRF is up and running, the incentives will change. At that point the member states participating in the SRM/SRF will have a common interest in backing up their common investment in case of need.

It will take some time (ten years) for the SRF to reach its target of €55 billion. But a long transition period was unavoidable given that one could not expect the creditor countries to accept a mutualisation of the risks from the past. The gradual increase in the degree of mutualisation agreed corresponds exactly to the proposal made by Gros & Schoenmaker (2012).

The size of SRF has often been criticised as being insufficient. But this is wrong. A fund of €55 billion would be enough to resolve all but the very largest banks in Europe; and would also be sufficient to deal with even a systemic crisis in small- to medium-sized countries (Spain needed €40 billion from the ESM).

Daniel Gros is Director of the Centre for European Policy Studies.

CEPS Commentaries offer concise, policy-oriented insights into topical issues in European affairs. The views expressed are attributable only to the author in a personal capacity and not to any institution with which he is associated.

Available for free downloading from the CEPS website (www.ceps.eu) • © CEPS 2013

The SRM is of course relatively small compared to the overall assets of SSM banking system (which amount to over €25,000 billion) and also small relative to the overall capital of the sector (about €1,000 billion). But one cannot expect a resolution fund to deal with the chronic undercapitalisation of the European banking sector (see also Gros, 2013). The resources of the SRF will be significant relative to the capitalisation of most individual banks (the 30 German banks directly under the SSM have on average a capitalisation of only €10 billion). Moreover, the resources of the SRF will loom large relative to the budget of any single member state, bar the largest ones.

Any restructuring fund can only be a first-aid kit dealing with a single accident. A systemic crisis always requires a fiscal back-up. Implicitly this exists as experience has shown; when there was a need for public funds, they were found. The process was of course slow and cumbersome and this made the crisis even worse. But this memory is likely to lead to an agreement that the natural backstop of the SRF must be the ESM whose full lending capacity should be available once the current programmes have ended and been reimbursed.

This compromise on the SRM is an inelegant step in the right direction. It leaves as many problems unresolved as it addresses. The riders on the European bicycle will have to continue to pedal for some time.

References

Gros, Daniel (2013), "The Asset Quality Review and Capital Needs: Why re-capitalise banks with public money?", CEPS Policy Brief No. 311, CEPS, Brussels, 19 December.

Gros, Daniel and Dirk Schoenmaker (2012), "Cleaning up the mess: Bank resolution in a systemic crisis", CEPS Commentary, CEPS, Brussels, 7 June.