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SRM and SRF: a success − by European standards

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In mid-March, the European Commission, the Council of the European Union and the European Parliament reached an agreement on the design of the second pillar of the banking union. The legal regulations regarding a "Single Resolution Mechanism" (SRM) and a "Single Resolution Fund" (SRF) can now take effect on time, before the first pillar, in the shape of the ECB as single banking supervisor, becomes operational. This puts the banking union on a solid foundation, and the lessons learned from the financial and debt crisis have now been largely translated into institutional changes.

Key points

The SRM will be responsible for all banks under the direct supervision of the ECB, and in all cases when funds are required from the SRF. The SRM is led by the Single Resolution Board, which comprises both permanent members and representatives from the Commission, the Council, the ECB and national authorities.

The resolution process begins with the ECB notifying the Board of the imminent collapse of a bank. The Single Resolution Board decides whether the collapse of the bank represents a systemic risk, and whether there are any options that do not entail involvement by the public sector. If the answer to the second question is no, the Board reaches a decision regarding appropriate resolution instruments, and if applicable, the need for SRF funds.

The Commission then evaluates the Board's resolution plan. It can object to elements of the plan, and must make a decision on authorising the use of state aid. Only under certain circumstances does the Council have a right to object. If an objection is raised, the Board must revise its proposal. National authorities then implement the proposed measures.

The SRM Board manages the SRF, which is to have funds of EUR 55 billion generated from a levy on financial institutions. If these funds prove insufficient, particularly when the SRF is still being built up, money can be borrowed on the market. The SRF is to be set up over a period of eight years, ultimately reaching a volume of 1 % of all protected deposits. Until then, each participating Member State must have its own national sub-fund, the resources of which are to be gradually signed over to the EU. This level of communitisation should total 40 % in the first year, followed by another 20 % in the second year. The national sub-funds may also lend each other money.

Positive aspects

The plan which has now been agreed constitutes a marked improvement in certain areas compared to the Council's original proposal. In particular, the role of the Council, and therefore the influence of national interests, has been scaled back, thereby significantly enhancing the efficiency of decisions in the event of a bank failure.

The mechanism can arrange the resolution of an ailing bank without the involvement of the state, provided it is not a large systemically relevant bank. It is therefore much less likely that a state could also find itself in difficulty due to the collapse of a bank. The net cost of saving banks in Ireland between 2009 and 2011 for example amounted to EUR 41 billion. With the SRM, that can also employ bail-in tactics to involve creditors, this crisis would have been manageable. Without the SRM, the Irish state itself had to be bailed out.

The limitations of the SRM

Even though the decision-making mechanisms are much more efficient than in previous proposals, the plan to organise the resolution of a bank in the course of one weekend is still rather ambitious.

The SRM and SRF mean taxpayers' help will be required less frequently in future. However, proclaiming an end to government bail-outs, as the Commission recently did, is exaggerated. This only stokes expectations that cannot be fulfilled. The SRM would be overstretched if a large bank were to find itself in difficulty or cause a systemic crisis. In this event, countries would still have to make tax revenues available. However, this is not a weakness of the SRM alone. Any existing resolution regime would be too small in this situation.

The accusation that the banking union does not regulate how to cope with the legacy of the euro crisis in bank balance sheets or in the hands of taxpayers is more serious. Not all countries are starting the new union from an equally strong position.

Conclusion

Realistically, the SRM will be able to intervene appropriately in many situations, thereby fulfilling its purpose as the second pillar of the banking union. Consequently, a large portion of the criticism levelled at the new resolution regime is unwarranted.

Yet how well the mechanism actually functions will only become evident once it is deployed for the first time, and even if it is launched on 1 January 2015, hopefully we will have to wait a long time to find out. ■