A Comparative Analysis of the EU and the US Bank Resolution Regimes: The Resolution Tools under the BRRD and the Dodd Frank Act

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A Comparative analysis of the EU and the US bank resolution regimes: The resolution tools under the BRRD and the Dodd Frank Act

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I hereby declare that the work submitted is mine and that where I have made use of another’s work; I have attributed the source(s) according to the Regulations set in the Student’s Handbook.

February 2019
Thessaloniki - Greece
Abstract

This dissertation was written as part of the LLM in Transnational and European Commercial Law, Banking Law, Arbitration/Mediation at the International Hellenic University.

The global financial crisis of the late 2000s has been the subject of much debate and analysis. The crisis of 2007-2008 had a massive impact on banks and financial institutions as well as the way in which they were regulated. The beginning of the ‘trouble’ can be traced back to 2007, when a downturn in the United States real estate market fuelled the crisis around the world. The deep integration of global banking, funding and securities markets were the key parameters which led to the spread of the US recession, affecting many European states. Clearly, the most large financial institutions failed to measure and manage the risks to which they were exposed, while the public authorities were proved to be ill-equipped to deal adequately with bank crises.

The financial crisis demonstrated the need for closing the gaps and weaknesses in the system for bank regulation and supervision, demanding a better legal framework. The response to the crisis by the US and European authorities was significant and unprecedented. The passing of the US Dodd-Frank Wall Street Reform and Consumer Protection Act in July 2010, the biggest reform in the US since the Great Depression, was a timely reflection of the need to promote financial stability and to protect US economy from any abusive financial services practices. Similarly, the European authorities introduced the European Banking Union aimed at providing future guarantees for eurozone banking system, and especially the Bank Recovery and Resolution Directive as a legislative measure to harmonize and improve the tools for dealing with future bank crises. This paper aims to clearly illustrate the resolution scheme and specifically the resolution tools that are able to be applied to the financial institutions which are failing or likely to fail under the Dodd-Frank Act and the BRRD.

I would like to express my sincere gratitude to my professor and dissertation supervisor Dr. Thomas Papadopoulos for his support, comments and sharing his time so generously to discuss the topics of my dissertation. I wish to thank my family for being my biggest support during the process of writing this dissertation. I am also grateful to the academic and administrative members of the International Hellenic University for their help and support in my academic path.

Keywords: resolution tools, Dodd-Frank Wall Street Reform and Consumer Protection Act, Bank Recovery and Resolution Directive (BRRD), institution under resolution, public interest.

Charis Panagiotidou
05 February 2019
Preface

This paper is depicting my desire to deal with issues relating to banking law and specifically the adopted banking resolution regimes after the credit crunch of 2007-2008 both in Europe and in the United States. According to my view, the study of a relatively new legal framework, i.e. the banking resolution tools under the BRRD and the Dodd-Frank Act, constitutes the most interesting part of public banking sector.

This dissertation is original, unpublished, independent work of the author Panagiotidou Charis. All errors remain my own.

Charis Panagiotidou
05 February 2019
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<td>Basel Committee on Banking Supervision</td>
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<td>BHC</td>
<td>Bank Holding Company</td>
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<td>BRRD</td>
<td>Bank Recovery and Resolution Directive</td>
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<td>CBRG</td>
<td>Cross-Border Bank Resolution Group</td>
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<td>CRR</td>
<td>Capital Requirements Regulation</td>
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<td>CRD</td>
<td>Capital Requirements Directive</td>
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<td>DGS</td>
<td>Deposit Guarantee Scheme</td>
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<td>DGSD</td>
<td>Deposit Guarantee Scheme Directive</td>
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<td>EBA</td>
<td>European Banking Authority</td>
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<td>ECB</td>
<td>European Central Bank</td>
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<td>EMU</td>
<td>Economic and Monetary Union</td>
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<td>EIOPA</td>
<td>European Insurance and Occupational Pensions Authority</td>
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<td>ESFS</td>
<td>European System of Financial Supervision</td>
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<td>ESMA</td>
<td>European Securities and Markets Authority</td>
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<td>ESRB</td>
<td>European Systemic Risk Board</td>
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<td>EU</td>
<td>European Union</td>
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<td>FDI Act</td>
<td>Federal Deposit Insurance Act</td>
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<td>FDIC</td>
<td>Federal Deposit Insurance Corporation</td>
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<td>FHC</td>
<td>Financial Holding Company</td>
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<td>FRB</td>
<td>Federal Reserve Board</td>
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<td>FSB</td>
<td>Financial Stability Board</td>
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<td>FSOC</td>
<td>Financial Stability Oversight Council</td>
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<tr>
<td>G-SIFI</td>
<td>Global Systemically Important Financial Institution</td>
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<td>IBA</td>
<td>International Banking Act</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>KAs</td>
<td>Key Attributes</td>
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<td>MPOE</td>
<td>Multiple Point of Entry</td>
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<td>MREL</td>
<td>Minimum Requirement for own funds and Eligible Liabilities</td>
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<td>OCC</td>
<td>Office of the Comptroller of the Currency</td>
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<td>OLA</td>
<td>Orderly Liquidation Authority</td>
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<td>OLF</td>
<td>Orderly Liquidation Fund</td>
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<td>PONV</td>
<td>Point of Non-Viability</td>
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<td>SPOE</td>
<td>Single Point of Entry</td>
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<td>SRB</td>
<td>Single Resolution Board</td>
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<td>SRF</td>
<td>Single Resolution Fund</td>
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<td>SRM</td>
<td>Single Resolution Mechanism</td>
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<td>SSM</td>
<td>Single Supervisory Mechanism</td>
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<td>TBTF</td>
<td>Too Big To Fail</td>
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<td>US</td>
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Introduction

It is strongly supported—even before the global financial crisis of 2007-2008— that banks even are nothing more nor less than financial intermediaries, they are regarded as a special business type, receiving a differentiated regulatory treatment.¹ The response of the US and European authorities to the recent credit crisis confirms the fact that financial institutions differ fundamentally from other institutions or business types. A series of major reforms in bank regulation, supervision and monitoring was introduced and gradually implemented in the US and Europe. Both global financial markets and the related eurozone sovereign debt problems still suffer from the 2007-2008 large-scale banking rescues (‘Too Big To Fail’), strengthening the necessity for a tough legal stance on global financial institutions to make sure that they are able to face a future credit ‘shock’.

In the new era, the international developments on the banking sector underlined the necessity for national authorities to reinforce cross-border cooperation and to review their national resolution regimes. The European Union proposed and implemented a new regulatory and supervisory architecture, introducing the European Banking Union. The European Banking Union is still ‘under construction’ and comprises three main pillars: a) the Single Supervisory Mechanism (SSM); b) the European resolution scheme; features of which are incorporated in the Bank Recovery and Resolution Directive and c) the European deposit insurance scheme. The United States’ response to the global financial calamity of 2007-2008 was the adoption of the Dodd-Frank Act. The Dodd-Frank Act sought to improve the safety of the financial system by: a) establishing a Financial Stability Oversight Council; b) setting up new measures for Systemically Important Financial Institutions (hereinafter SiFIs or SiBs); c) creating a Consumer Financial Protection Bureau; d) reforming the Federal Reserve; e) improving transparency in derivatives; and f) introducing new rules on executive pay and credit rating agencies.

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Considering the bank resolution regime as an alternative to normal insolvency procedures, the need for a lexis specialis in banking is rooted in their role as financial intermediaries, as the lexis generalis is unsuited to stop a stampeding panic. Bank resolution regime is a tool that aims at ‘public interest’ objectives, as well as the failure of restructuring a financial institution that is failing or likely to fail, could threaten the financial stability and the retail depositors. There is much of discussion about the applicable resolution tools under the BRRD and Dodd Frank Act, as both of them share the same goal but follow different paths. The present paper takes us from Europe to the US in an effort to discern patterns in policy-making that may or may not suggest an ideological and cultural shift from the norms of pre-crisis liberalism.

1. The International Regulatory Developments on Bank Resolution

Beyond Europe and the US, there is a lot of policy discussion about the need to establish an effective management and coordination framework at international level. During the crisis, meetings of the G7 and G20 started highlighting the weaknesses of the international banking architecture, pledging to strengthen the international coordination and to rebuild the international banking architecture so as to achieve a sound and stable financial market. Other international organizations, such as IMF, underlined the necessity to reassess the analysis of risks and the effectiveness of surveillance; while the BCBS introduced through Basel III - new guidelines for capital

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and banking regulation. In parallel, the FSB mentioned the necessity to fix the fault lines of the global financial crisis, promising reforms that are designed to prevent systemic crises.10

1.1. The Basel Committee's on Banking Supervision Resolution Reforms

The Committee's reform package includes efforts to strengthen the resolution regime of systemically important cross-border financial institutions. The Cross-Border Bank Resolution Group (CBRG) of the BCBS issued recommendations for cross-border crises resolutions,11 pointing the necessity for: i) effective national resolution powers; ii) frameworks for a coordinated resolution of financial groups; iii) convergence of national resolution measures; iv) cross-border effects of national resolution measures; v) reduction of complexity and interconnectedness of group structures and operations; vi) planning in advance for orderly resolution; vii) cross-border cooperation and information sharing; viii) strengthening risk mitigation mechanisms; ix) transfer of contractual relationships and x) exit strategies and market discipline.12

The Committee addressed the absence of appropriate resolution tools during the crisis and the ad hoc national response which most of the times was based on the public support.13 The Committee, in line with the weakness of the competent authorities to act quickly due to the absence of well-designed resolution tools, underlined the challenges in resolving a cross-border financial institution, as their complexity is incompatible with the national resolution frameworks that are largely designed to deal with domestic failures.14 An effective resolution regime prerequisites the appropriate resolution tools to deal with all types of financial institution in difficulties in order to

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maintain stability, minimize systemic risk\textsuperscript{15}, protect deposits, limit moral hazard and promote market discipline.\textsuperscript{16} The Committee continued, referring tools that will improve national resolution frameworks such as bridge financial institutions; private-sector or market-based solutions.\textsuperscript{17} Lastly, the Committee pointed the need through special resolution tools, the competent authorities to achieve continuity of the failed or likely to fail financial institution's key functions; or to achieve an orderly resolution that will apply perfectly not only at national, but also at international levels.\textsuperscript{18}

1.2. The Financial Stability Board's Key Attributes of effective resolution regimes for Financial Institutions

A start was made in discussing the gaps and weaknesses of international financial regime at the G20 Summit in Pittsburgh when G20 leaders called for action to address the 'Too Big To Fail' (hereinafter TBTF) institutions as the large-scale banking rescues during the crisis have raised serious concerns about the social and economic costs of 'too systemically important to fail'. The FSB adopted the twelve Key Attributes ('KAs') in October 2011 and the G20 Heads of States and Government subsequently endorsed the FSB comprehensive policy framework\textsuperscript{19}, comprising 'a new international standard for resolution regimes'; more intensive and effective supervision; requirements for cross-border cooperation and recovery and resolution planning; and additional loss absorbency for those banks determined as global systemically important financial institutions (G-SIFIs).\textsuperscript{20}

The KAs set out the core elements that the FSB considers to be necessary for an effective resolution regime relating to: 1) scope; 2) resolution authority; 3) resolution powers; 4) set-off; netting; collateralisation; segregation of client assets; 5) safeguards; 6) funding of firms in resolution; 7) legal framework conditions for cross-border

\textsuperscript{15} See more for the elements of the systemic risk and the 'domino effect' in Cranston, Ross., 'Principles of Banking Law', 2nd edition, Oxford University Press, 2002, p. 66 et seq.


cooperation; 8) crisis management groups (CMGs); 9) institution-specific cross-border cooperation agreements; 10) resolvability assessments; 11) recovery and resolution planning and 12) access to information and information sharing.\textsuperscript{21}

The KAs present that an effective resolution regime should: (i) ensure continuity of systemically important financial services, and payment, clearing and settlement functions; (ii) protect, where applicable and in coordination with the relevant insurance schemes and arrangements such depositors; insurance policy holders and investors as are covered by such schemes and arrangements, and ensure the rapid return of segregated client assets; (iii) allocate losses to firm owners (shareholders) and unsecured and uninsured creditors in a manner that respects the hierarchy of claims; (iv) not rely on public solvency support and not create an expectation that such support will be available; (v) avoid unnecessary destruction of value, and therefore seek to minimise the overall costs of resolution in home and host jurisdictions and -where consistent with the other objectives- losses for creditors; (vi) provide for speed and transparency and as much predictability as possible through legal and procedural clarity and advanced planning for orderly resolution; (vii) provide a mandate in law for cooperation, information exchange and coordination domestically and with relevant foreign resolution authorities before and during a resolution; (viii) ensure that non-viable firms can exit the market in an orderly way; and (ix) be credible, and thereby enhance market discipline and provide incentives for market-based solutions.\textsuperscript{22}

In 2014, the FSB adopted additional guidance on implementing and interpreting specific KAs, while the twelve KAs remain the umbrella standard for resolution regimes covering financial institutions of all types that could be systemic in failure.\textsuperscript{23} The guidance defines a SIFI as 'resolvable' if it is feasible and credible for the resolution authorities to resolve it in a way that protects systemically important functions without severe systemic disruption and without exposing taxpayers to loss.\textsuperscript{24} Lastly, the sector-specific guidance characterises the resolution of cross-border financial institutions as


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feasible, when the authorities have the necessary legal powers - and the practical capacity to apply them - to ensure the continuity of functions critical to the economy; while for resolution to be credible, the application of those resolution tools should not itself give rise to unacceptably adverse broader consequences for the financial system and the real economy.25

2. The European Regulatory Developments on Bank Resolution

In the European Union, a new regulatory architecture started taking place along the lines initially highlighted in the de Larosiere Report.26 In this second chapter of the paper, the European steps towards a robust regulatory and supervisory framework of the financial institutions will be outlined. Also, an analysis of the resolution tools in light of the Bank Recovery and Resolution Directive will be attempted.

2.1. Background

Undoubtedly, the financial crisis in 2008 demonstrated the lack of a clear and predictable legal framework in Europe to reorganize or liquidate, in an orderly way, any type of distressed financial institution, without undermining financial stability.27 The Directive on the Recognition and Winding-up of Credit Institutions28 was focused on issues of conflicts of laws and mutual recognition without providing any substantive provisions for bank insolvency laws throughout the EU.29 Once the dust from the initial credit crunch started to settle,30 Europe made the first steps for a new regulatory and supervisory framework for the financial institutions started in 2010 -mainly through Regulations- and specifically: Regulation 1092/2010 that established the European Systemic Risk Board (ESRB); Regulation 1093/2010 that established the European

25 Ibid.,
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Banking Authority (EBA); Regulation 1094/2010 establishing the European Insurance and Occupational Pensions Authority; Regulation 1095/2010 establishing the European Securities and Markets Authority (ESMA) and the Regulation 1096/2010 about the assigned competencies of the European Central Bank (ECB) in relation to ESRB’s operations, composing the so-called European System of Financial Supervision (ESFS).

2.2. European Banking Union

In 2012, Europe, outlined proposals for the European Banking Union (EMU) as a future safeguard scheme for the eurozone banking system including decoupling both banking sector and sovereign risk. The establishment of the EMU has brought central banking governance into the spotlight. The three pillars of the EMU were gradually regulated through the following legal instruments: the Regulation 1024/2013 about the ECB’s prudential supervision of credit institutions; the Capital Requirement Regulation; the Capital Requirement Directive IV - while the CRD V package is on its way; the Bank Recovery and Resolution Directive; and the Deposit Guarantee Scheme Directive, as the ‘complete’ banking union in Europe in still under political discussion.

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31 See Miglionico., Andrea, ‘Rethinking the resolution tools for the distressed banks: a new challenge in the banking union?’ (2018), J.I.B.L.R. 33(9), p. 314 where the author parallels the greek word ‘crepidoma’ with the three pillars of the EBU. Specifically, ‘in ancient Greek architecture, crepidoma was a three-level platform upon which the pillars supporting the super-structure of an ancient temple were erected. Each level decreased in size but increased in height in order to ensure a strong support to the pillars and a panoramic view of the temple by being slightly curved in contrast to the complete linearity of the pillars. The single rulebook, which aims to harmonise financial safety-net rules across the EBU, can be paralleled with the crepidoma upon which the three-pillars structure of the EBU is established. In particular, the crepidoma of the EBU is formed by the three steps of the capital requirements framework, bank recovery and resolution and deposit guarantee directives’.


34 For a comprehensive analysis of the central banking governance before and after the establishment of the EMU in the EU, see Quaglia, Lucia., ‘Central Banking Governance in the European Union: A comparative analysis’, Routledge/UACES Contemporary European Studies, 2008.


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2.2.1. The Second Pillar

The second pillar or key element towards a European Banking Union is referred to a European resolution scheme that has to be mainly funded by financial institutions and is able to support in the application of measures to institutions overseen by the European competent supervisory authorities. The main aim is to provide a mechanism for an orderly shutdown or winding-up of 'troubled' financial institutions, protecting the public funds. The minimum harmonizing features of the European resolution scheme are incorporated in the Recovery and Resolution Directive which applies to all credit institutions and certain investment firms; and requires firms to have 'living wills' (meaning resolution plans), provides for supervisory early intervention powers; specifies minimum harmonized resolution tools, establishes pre-funded resolution funds and national deposit guarantee schemes, as elements that will be configured for resolution funding purposes.37

2.3. The Bank Recovery and Resolution Directive

The BRRD38 sets out a common recovery and resolution regime for the European Union that aims to 'help member states prevent bank crises from emerging in the first place and; if such bank crises still emerge, to manage them in a more orderly and effective way'.39 The BRRD40 is a minimum harmonizing legal framework that allows national authorities to retain a degree of discretion regarding their national bank insolvency legislation to the extent that they meet and preserve the objectives and principles of the Directive 2014/59.41

40 Member States were required to transpose into national laws the Directive by 31 December 2014 and to apply them from 1 January 2015; and to delay the application of the bail-in measures until 1 January 2016. See BRRD, Art 130 (1) according to which "1. Member States shall adopt and publish by 31 December 2014 the laws, regulations and administrative provisions necessary to comply with this Directive. They shall forthwith communicate to the Commission the text of those measures. Member States shall apply those measures from 1 January 2015. However, Member States shall apply provisions adopted in order to comply with Section 5 of Chapter IV of Title IV from 1 January 2016 at the latest".
41 BRRD, Recital (1) "The financial crisis has shown that there is a significant lack of adequate tools at Union level to deal effectively with unsound or failing credit institutions and investment firms (‘institutions’).
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The BRRD applies to credit institutions that are established in the Union, to the investment firms that hold a particular minimum initial capital and are established in the Union, to the subsidiaries of a parent credit institution or an investment firm that is supervised in the European Union or financial holding companies, and to financial holding companies, mixed financial holding companies and mixed-activity holding companies that are established in the Union.\textsuperscript{42}

Under the Directive, the resolution authorities\textsuperscript{43} are equipped with new tools and powers to restructure an ailing bank to avoid the destructive effects of liquidation by means of a bail-in, take-over of the business, separation of it into good bank and bad bank, and/or using a bridge bank.\textsuperscript{44}

2.4. The Resolution Tools under the BRRD

Resolution tools consist of special bank restructuring measures applicable by the administrative authorities empowered to handle crisis management outside of ordinary judicial insolvency proceedings, producing different effects on the bank and on third parties.\textsuperscript{45}

The BRRD’s resolution objectives and general principles do not constitute a mere ‘wish-list’ of the resolution authority but play a critical role in the application of the resolution tools.\textsuperscript{46} According to the BRRD\textsuperscript{47}, the resolution authorities when applying

\textit{Such tools are needed, in particular, to prevent insolvency or, when insolvency occurs, to minimise negative repercussions by preserving the systemically important functions of the institution concerned. During the crisis, those challenges were a major factor that forced Member States to save institutions using taxpayers’ money. The objective of a credible recovery and resolution framework is to obviate the need for such action to the greatest extent possible".}\textsuperscript{48}

\textsuperscript{42} BRRD, Art 1(1) according to which “This Directive lays down rules and procedures relating to the recovery and resolution of the following entities:(a) institutions that are established in the Union, (b) financial institutions that are established in the Union when the financial institution is a subsidiary of a credit institution or investment firm, or of a company referred to in point (c) or (d), and is covered by the supervision of the parent undertaking on a consolidated basis in accordance with Articles 6 to 17 of Regulation (EU) No 575/2013, (c) financial holding companies, mixed financial holding companies and mixed-activity holding companies that are established in the Union, (d) parent financial holding companies in a Member State, Union parent financial holding companies, parent mixed financial holding companies in a Member State, Union parent mixed financial holding companies, (e) branches of institutions that are established outside the Union in accordance with the specific conditions laid down in this Directive”. See BRRD, Art. 2 (1) (2-15) about definitions.

\textsuperscript{43} The BRRD does not define the national authorities to which authority to entrust crisis resolution must be provided (central bank, supervisory authorities, a special crisis management authority or the Finance Ministry), resulting in adopting different solutions from member-state to member-state, depending on the respective legal framework. See a further analysis of this problem in Bocuzzi, Giuseppe., ‘The European Banking Union: Supervision and Resolution’, Palgrave Macmillan Studies in Banking and Financial Institutions (series editor: Philip Molyneux), 2016, p. 7.


\textsuperscript{46} Ibid p. 78.

\textsuperscript{48} Aloupi., Olga, ‘The interaction of deposit insurance and bank resolution, in particular under the legal framework of the European Banking Union’ (2018), J.I.B.L.R. V.33, N.8, 260-261.
the resolution tools and exercising the resolution powers, must have regard to the resolution objectives and choose the tools and powers that best achieve the objectives that are relevant in the circumstances and the nature of each case. The Directive\textsuperscript{48} promotes the equal significance of the \textit{resolution objective}, \textit{i.e.} to ensure the continuity of critical functions;\textsuperscript{49} to avoid a significant adverse effect on the financial system, in particular by avoiding contagion to market infrastructures and by maintaining market discipline; to protect public funds by minimizing reliance on extraordinary public financial support; to protect insured depositors and insured investors; to protect client funds and client assets.\textsuperscript{50} The Directive adopts an additional consideration when pursuing the resolution objectives, that is the obligation of the national authorities to seek to minimise the cost of resolution and avoid destruction of value unless necessary to achieve the resolution objectives.\textsuperscript{51}

The BRRD’s\textsuperscript{52} \textit{key principles} put losses first to shareholders, and after the shareholders, losses must be borne by creditors in accordance with the order of priority of their claims (under national -normal- insolvency proceedings and the BRRD); the board of directors and the management body must be replaced, unless their continuance in office is necessary to pursue the resolution objectives; the parties responsible for the institution’s failure are subject to civil or criminal liability; the application of the ‘\textit{No Creditor Worse Off}’ principle according to which creditors of the same class are treated in an equitable manner (exceptions are introduced by the BRRD\textsuperscript{53}) and no creditor shall incur greater losses than would have been incurred if the

\begin{flushleft}
\textsuperscript{47} BRRD, Art 31 (1) and (3).
\textsuperscript{48} BRRD, Art. 31 (3).
\textsuperscript{49} Milione., Lara and Victor de Seriene, ‘De-politicising European bank resolution processes’, (2019) J.I.B.L.R. 34(2), 73-74, where it is mentioned that “...BRRD’s and SRMR’s regimes, and the recovery and resolution plans that must be put into place, focus primarily on the need to guarantee continuance of what are called the "critical functions" of a bank. But governments may hesitate to simply rely on the implementation of these rules; in their perception, the European resolution rules as applied by European and national resolution authorities may not be effective to deal with crises on the national level and funding for implementation of the European resolution tools may be insufficient. There is doubt whether supervisory agencies are sufficiently equipped to fully take into account political and social consequences of a bank failure...”. For a comprehensive analysis of the doubts to the effectiveness of the European rules, see Milione., Lara and Victor de Seriene, ‘De-politicising European bank resolution processes’, (2019) J.I.B.L.R. 34(2), p. 72 et seq.
\textsuperscript{50} BRRD, Art 31 (2).
\textsuperscript{51} Ibid.,
\textsuperscript{52} BRRD, Art. 34 (1).
\textsuperscript{53} An exception to the NCWO principle is the write down of Cocos instruments. A distinction should be made between capital instruments that convert at the point of non-viability (which pursuant to the BRRD coincides with the existence of the pre-requirements for resolution except the public interest) and CoCos instruments that convert when the capital falls below a certain quantitative threshold. Conversion of the CoCos does not require the application of the NCWO principle, because these instruments contain a contractual clause according to which the creditors have accepted that their debt will convert into equity when certain conditions occur. In this case, the conversion is an effect of the clause and not of the
institution or entity had been wound up under normal insolvency proceedings, and the protection of the covered deposits.\textsuperscript{54}

At the opening of a resolution procedure, three conditions must be met: 1) The bank supervisor or the resolution authority (after consulting SRB or ECB, respectively) must have determined that the financial institution is failing or is likely to fail.\textsuperscript{55} An institution is failing or is likely to fail when objective elements support the determination that: (a) the institution infringes or will infringe the requirements for continuing authorization; or (b) the assets of the institution are or will be less than its liabilities; or (c) that the institution is or will be unable to pay its debts or liabilities as they fall due; or (d) extraordinary public financial support is required.\textsuperscript{56} The \textit{trigger event} is characterized by the magnitude of the cases that can be taken into consideration in order to determine that the bank is failing or is likely to fail; its purpose is to allow the authorities to take the measures necessary for resolution before the bank reaches the point of insolvency, from a capital and liquidity point of view.\textsuperscript{57} Under the Directive's framework, the resolution authorities are called to decide on the basis of a comprehensive assessment of both quantitative and qualitative elements; 2) the lack of reasonable prospect that any alternative private sector measures would prevent the failure of the institution within a reasonable timeframe;\textsuperscript{58} and 3) the commencement of the resolution proceedings and selection of the appropriate resolution tools, as a resolution action is necessary in the public interest.\textsuperscript{59} In the application of the third and last condition for statutory action of public authorities. Thus, if convertible Cocos exist at the time of the resolution decision and they are converted, because the event triggering their conversion has occurred, the NCWO principle does not apply to the Coco holders. For a further analysis, see European Banking Authority, 'Single Rulebook Q & A: Resolution objectives and triggers' (11.11.2016), available online at <https://eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2015_2181>, accessed 13 January 2019.

\textsuperscript{54} According to the Deposit Guarantee Scheme Directive, €100,000 is an appropriate level of protection and should be maintained. Deposits are covered per depositor per bank. This means that the limit of €100,000 applies to all aggregated accounts at the same bank. Depositors must be informed that deposits held under different brand names of the same bank are not covered separately. However, deposits by the same depositor in different banks all benefit from separate protection. See also, Bocuzzi, Giuseppe., 'The European Banking Union: Supervision and Resolution', Palgrave Macmillan Studies in Banking and Financial Institutions (series editor: Philip Molyneux), 2016, p. 71.

\textsuperscript{55} BRRD, Art. 32 (1) (a).

\textsuperscript{56} BRRD Art 32 (4) (a-d). Especially, the last provision [Art. 32 (4) (d)] is subject to exceptions when, in order to remedy a serious disturbance in the economy of a Member State and preserve financial stability, the extraordinary public financial support takes any of the following forms: (i) a State guarantee to back liquidity facilities provided by central banks according to the central banks’ conditions, (ii) a State guarantee of newly issued liabilities, or (iii) an injection of own funds or purchase of capital instruments at prices and on terms that do not confer an advantage upon institution, provided that the institution is solvent and viable at the time the public support is granted.

\textsuperscript{57} Bocuzzi, Giuseppe., 'The European Banking Union: Supervision and Resolution', Palgrave Macmillan Studies in Banking and Financial Institutions (series editor: Philip Molyneux), 2016, p. 73.

\textsuperscript{58} BRRD, Art. 32 (1) (b).

\textsuperscript{59} BRRD Art 32 (1) (c) and (5), \textit{i.e.} the resolution objectives would not be met in the same extent if the bank were would up under normal insolvency proceedings.
triggering bank resolution, the resolution objectives play the most crucial role, being the interpretative tools for the 'public interest test'.

Entering the resolution process, the resolution authorities have the most penetrating intervention powers which include the authority to write down or convert relevant capital requirements into shares or other instruments of ownership at the point of non-viability (hereinafter PONV). The sequence of the power to write down or convert capital instruments at the PONV provides that capital (based on CRR) should bear losses first, before other liabilities or - in other words - before using any resolution tools. Although it is possible that a PONV write down or conversion alone could restore a financial institution to viability where losses are limited and the business model remains sound, it is more likely that it will be applied at the same time as the resolution tools.

The BRRD requires Member States to ensure that resolution authorities have full powers to apply resolution tools, providing a minimum set of tools for the orderly restructuring of the failed bank, i.e. the sale of business tool, the bridge institution tool that acts as intermediary, the asset separation tool, and the bail-in tool, which may be applied either singularly or jointly, with an exception relating to the asset separation tool which can be applied only in combination with another resolution tool.

In practice, the distinction of the applied resolution tools is not so clear, since a resolution action may be the result of a set of operations involving the joint use of various resolution tools, such that the survival of the bank may be compatible with the sale or liquidation of parts of the group or of the non-viable components of the financial institution.

60 Aloupi, Olga, 'The interaction of deposit insurance and bank resolution, in particular under the legal framework of the European Banking Union' (2018), J.I.B.L.R. V.33, N.8, 260-261.
61 BRRD, Art. 59; According to Art. 2 (81) of BRRD "the point of non-viability should be understood as the point at which the relevant authority determines that the institution meets the conditions for resolution or the point at which the authority decides that the institution would cease to be viable if those capital instruments were not written down or converted".
62 BRRD, Art. 60.
63 Kleftouri Nikoletta, Deposit Protection and Bank Resolution (Oxford: Oxford University Press, 2015), p. 171; see also, Art. 37 (2) of Directive 2014/59/EU "the resolution authority shall exercise the power to write down and convert capital instruments...immediately before or together with the application of the resolution tool".
64 BRRD, Art. 37 (1).
65 BRRD, Art. 31 (3).
66 BRRD, Art. 37 (4).
67 BRRD, Art. 37 (5), e.g. in combination with the sale of the sound elements of the financial institution.
2.4.1. The sale of Business Tool

The sale of business tool ‘means the mechanism for effecting the exercise by a resolution authority of shares or other instruments of ownership issued by an institution under resolution, or assets, rights or liabilities, of an institution under resolution to a purchaser that is not a bridge institution’.\textsuperscript{69}

The sale of business tool enables the resolution authorities to transfer to third-party shareholders shares or other instruments of ownership, assets, rights or liabilities of an institution under resolution.\textsuperscript{70} The purchaser is usually another bank and must hold authorizations to exercise the activity or to provide the services resulting from the sale.\textsuperscript{71} The transfer is taking place without the consent of the shareholders or any procedural obligations based on Member States company or security law.\textsuperscript{72} The resolution authority may exercise the transfer power more than once in order to make supplemental transfers of shares or other instruments of ownership issued by an institution under resolution.\textsuperscript{73}

The transfer is final\textsuperscript{74} and the transferred financial instruments of property are included in the property of the acquirer; the purchaser is considered to be a continuation of the institution under resolution, and may continue to exercise any right that was exercised by the institution under resolution in respect of the assets, rights or liabilities transferred.\textsuperscript{75}

The Directive sets out the general operating context, general rules and procedural requirements when applying the sale of business tool,\textsuperscript{76} while the specialization of the procedure is entrusted to the national legislator.\textsuperscript{77} The resolution authority must carry out the marketing process when applying the sale of business tool in a rapid\textsuperscript{78} and transparent\textsuperscript{79} way, without unduly favoring or discriminating the

\textsuperscript{69} BRRD, Art 2 (58).
\textsuperscript{70} BRRD, Art. 38 (1) (a-b).
\textsuperscript{73} BRRD, Art. 38 (5).
\textsuperscript{74} BRRD, Art. 38 (9) (a) “such a transfer of shares or other instruments of ownership to the acquirer shall have immediate legal effect”.
\textsuperscript{75} BRRD, Art. 38 (9) (a) & (11-12).
\textsuperscript{76} BRRD, Art. 39.
\textsuperscript{77} BRRD Art. 39 (2).
\textsuperscript{78} BRRD, Art. 39 (2) (e).
\textsuperscript{79} BRRD, Art. 39 (2) (a).
potential purchasers,\textsuperscript{80} or conferring any unfair advantage on them,\textsuperscript{81} with the objective of maximizing the sale price.\textsuperscript{82}

In case of partial transfer of assets, rights and liabilities, the shareholders and the creditors whose claims have not been transferred must be no worse off than that they would have been if the bank had been liquidated according to ordinary insolvency proceedings immediately before the transfer.\textsuperscript{83}

### 2.4.2. The Bridge Institution Tool

The BRRD adopts as a resolution tool the transfer of all or any property rights and liabilities of the institution under resolution to a bridge institution.\textsuperscript{84} A bridge institution must be a legal person that is wholly or partially owned by one or more public authorities (including the resolution authority) and is created for the purpose of receiving or holding all or some of the shares, other instruments of ownership, assets, rights and liabilities of one or more institutions under resolution, maintaining access to critical functions and selling the institution.\textsuperscript{85} The resolution authority establishes an independent,\textsuperscript{86} temporary legal person\textsuperscript{87} -without obtaining the consent of the shareholders of the institution under resolution\textsuperscript{88} and- with a specific purpose, i.e. the acquisition of property rights of the institution under resolution, preserving the essential banking functions\textsuperscript{89} and the further sale of the bridge institution or its assets, rights or liabilities. The bridge institution tool must be licensed in accordance with the Capital

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\textsuperscript{80} BRRD, Art. 39 (2) (b).
\textsuperscript{81} BRRD, Art. 39 (2) (d).
\textsuperscript{82} BRRD, Art. 39 (2) (f).
\textsuperscript{84} BRRD, Art. 40.
\textsuperscript{85} BRRD, Art. 40 (2).
\textsuperscript{86} BRRD, Art. 41 (1) '(a) the contents of the bridge institution’s constitutional documents are approved by the resolution authority, (b) subject to the bridge institution’s ownership structure, the resolution authority either appoints or approves the bridge institution’s management body, (c) the resolution authority approves the remuneration of the members of the management body and determines their appropriate responsibilities, (d) the resolution authority approves the strategy and risk profile of the bridge institution, (e) the bridge institution is authorised in accordance with Directive 2013/36/EU or Directive 2014/65/EU, as applicable, and has the necessary authorisation under the applicable national law to carry out the activities or services that it acquires by virtue of a transfer made pursuant to Article 63 of this Directive, (f) the bridge institution complies with the requirements of, and is subject to supervision in accordance with Regulation (EU) No 575/2013 and with Directives 2013/36/EU and Directive 2014/65/EU, as applicable, (g) the operation of the bridge institution shall be in accordance with the Union State aid framework and the resolution authority may specify restrictions on its operations accordingly'.
\textsuperscript{87} BRRD, Art 2 (60).
\textsuperscript{88} BRRD, Art. 40 (1).
\textsuperscript{89} BRRD, Art. 40 (10) "Member States shall ensure that the bridge institution may continue to exercise the rights of membership and access to payment, clearing and settlement systems, stock exchanges, investor compensation schemes and deposit guarantee schemes of the institution under resolution, provided that it meets the membership and participation criteria for participation in such systems".
Requirement Directive and will be operated as a commercial concern within any limits prescribed by the State aids framework. The bridge institution tool aims to set up a bank that can be disposed (preserving the critical functions of the failing bank) and to separate it from the rest, while searching for a third party purchaser.

The resolution authorities is competent for the transfer of the property rights and liabilities from the institution under resolution to the bridge institution and vice versa; as well as the transfer from the latter to a third -private- party purchaser. The resolution authority must ensure that the total value of transferred liabilities to the bridge institution does not exceed the total value of the rights and the assets transferred from the institution under resolution (known as funding gap). This element is crucial for the smooth operation and sustainability of the bridge institution (known also as a 'bridge bank') and the quick and easy finding of a purchaser.

The Directive is referred to the principle of continuity that governs the purposes of preserving essential banking functions or facilitate continuous access to deposits through the temporary structure of a bridge institution. According to the Directive, a bridge institution -for the purposes of exercising the rights to provide services or to establish itself in another EU state in accordance with the European legal framework or for other purposes-, must be considered to be a continuation of the institution under resolution, and may continue to exercise any such right that was exercised by the institution under resolution in respect of the assets, rights or liabilities transferred.

The further purpose of establishing a bridge institution is to sell the transferred property rights and liabilities to one or more third purchasers when the market conditions are appropriate. The bridge institution is able either to sell all or substantially

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92 BRRD, Art. 40 (6).

93 BRRD, Art. 40 (3).


95 See, footnote 74.


97 BRRD, Art. 40 (9).

98 See Directive 2013/36/EU or Directive 2014/65/EU.
all of its rights or liabilities to a third party\(^99\) or to be merged with another institution.\(^{100}\) The resolution authority must terminate the operation of a bridge institution two years after the date on which the last transfer from an institution under resolution to the bridge institution was made,\(^{101}\) while it is possible to extend the two year period after a reasoned and detailed assessment, that justifies the extension.\(^{102}\)

In cases that the operations of the bridge institutions are terminated because of the sale of all or substantially all of the bridge institution’s assets, rights or liabilities to a third party or resolution of the bridge institution due to time limitations, the bridge institution must be wound up under normal insolvency proceedings.\(^{103}\) The proceeds generated as a result of the termination of the operation of the bridge institution must benefit the shareholders of the bridge institution.\(^{104}\)

An important issue to bridge bank resolution tool is the treatment of the shareholders and creditors who do not have any right on the bridge bank, but only on the residual value realized from its sale after paying other creditors and the expenses associated with the management of the crisis.\(^{105}\)

Lastly, the application of the bridge institution tools requires the assets’ evaluation in order to transfer the good assets, and to leave the net of the doubtful positions back into the financial institution under resolution.\(^{106}\)

2.4.2.1. The sale of Business Tool versus the Bridge Institution Tool

The sale of business and the bridge institution tool constitute the so-called transfer of property resolution structure. The resolution is taking place through the separation of the instruments of ownership and liabilities of the institution under resolution in order to be transferred to a third -sound- private legal person that will

\(^99\) BRRD, Art. 41 (3) (c).
\(^{100}\) BRRD, Art. 40 (3) (a).
\(^{101}\) BRRD, Art. 41 (5).
\(^{103}\) BRRD, Art. 41 (8).
\(^{104}\) BRRD, Art. 41 (8).
\(^{106}\) \textit{Ibid.}
preserve and exercise the bank’s critical functions. Both resolution tools take steps to ensure liquidity of the institution under resolution through the proceeds from the sale - directly or indirectly through the bridge institution- of the bank’s critical functions.\(^{107}\)

The definition under Art. 2 (55) and Art. 38 (1) of the Directive separates the sale of institution from the bridge institution resolution tool. Both resolution tools resemble a lot; as a transfer of instruments of ownership is taking place from the institution under resolution to a private purchaser.

However, the different articles that specify the two resolution tools under the BRRD and their operating procedure; as the bridge institution maintains the transferred property rights from the institution under resolution, until the market conditions are appropriate for their profitable sale (i.e. a two step sale process); while the sale of business tool transfers directly (i.e. one step sale process) the instruments of ownership, shares, assets or liabilities to a third purchaser, by way of sale of financial instruments.\(^{108}\)

### 2.4.3. The Asset Separation Tool

The asset separation tool should enable authorities to transfer assets, rights or liabilities of an institution under resolution to a separate vehicle. The asset separation tool is the mechanism for effecting a transfer by a resolution authority of assets, rights or liabilities of an institution under resolution to an asset management vehicle.\(^{109}\) The asset management vehicle (AMV) is a legal person that is temporarily created to receive deteriorated assets or assets that are difficult to measure on the balance sheet of the troubled financial institution or of a bridge institution,\(^{110}\) with a view to maximizing their value for an eventual sale.\(^{111}\) This resolution tool must be used only in conjunction with other tools to prevent an undue competitive advantage for the failing institution.\(^{112}\)


\(^{108}\) Ibid.

\(^{109}\) BRRD, Art. 2 (55).


The asset separation tool is also known as the split between the 'good' and the 'bad' bank and the further separation of the 'good' assets (e.g. performing loans, property rights) that is transferred from the institution under resolution to the asset management vehicle, while the 'toxic' assets (e.g. non-performing loans, doubtful debts) portfolio remains with the institution under resolution.113

The purpose of the asset separation tool is to enable resolution authorities to transfer impaired or problem assets to an asset management vehicle to allow them to be managed and worked out over time.114 Assets should be transferred at market or long term economic value, so that any losses are recognised at the moment when the transfer takes place.115 The AMV will manage the transferred assets with a view to maximising their value through eventual sale or orderly wind down.116

The AMV is wholly or partially owned by one or more public authorities which may include the resolution authority or the resolution financing arrangements.117 In line with the general resolution powers of the resolution authority to take over shareholder rights, the transfer may take place without the consent of shareholders of the institution under resolution or any third party, and without complying with any procedural requirements under company or security law.118

The resolution authority must ensure that the AMV operates and respects the following provisions, i.e. the resolution authority approves the content of the AMV’s constitutional documents; the resolution authority either appoints or approves the AMV’s management body; the resolution authority approves the remuneration of the members of the management body and determines their appropriate responsibilities; and the resolution authority approves the strategy and risk profile of the AMV.119

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114 Ibid.

115 Ibid.

116 BRRD, Art. 42 (3).

117 BRRD, Art. 42 (2) (a).


119 BRRD, Art. 42 (4) (a-d).
The resolution authority must use the asset separation vehicle to transfer assets, rights and liabilities only in one of the following three scenarios\(^\text{120}\): i) the market conditions for those assets is of such a nature that their liquidation under normal insolvency proceedings could have an adverse effect on one or more financial markets; ii) the transfer is necessary to ensure the proper functioning of the institution under resolution or bridge institution; and iii) the transfer is necessary to maximize the liquidation proceeds.

The funding structure of the AMV will depend on the value and characteristics of the assets transferred.\(^\text{121}\) If combined with the bail-in tool, the amount of bail-in has to take into account a prudent estimate of the capital needs of an AMV.\(^\text{122}\) Any consideration paid by the AMV in respect of the assets, rights or liabilities transferred directly from the institution under resolution may be paid in the form of debt issued by the AMV.\(^\text{123}\)

The Directive\(^\text{124}\) restricts the liability of the AMV’s management body or senior management to the shareholders or creditors of the institution under resolution for acts or omissions in heir discharge of their duties who are liable only for gross negligence or serious misconduct.

Lastly, the difficulty in using the asset separation tool can be traced back to the way in which the choice of the transferred assets, rights or liabilities from the institution under resolution to the AMV will be made.

\textbf{2.4.3.1. The Bridge Institution Tool versus the Asset Separation Tool}

The bridge institution and the asset separation tools are set up for a specific purpose, \textit{i.e.} the transfer of rights, assets and liabilities from the institution under resolution. Both resolution tools are wholly or partially owned by one or more public authorities under the control of the national resolution authority. However, the main difference is the even more specific purpose of the asset management vehicle; as it is used to ‘isolate’ the impaired or under-performing assets from the performing assets of the institution under resolution; as the former are transferred to the AMV with a view to increasing their value before selling them in the open market.

\(^{120}\) BRRD, Art. 42 (5).


\(^{122}\) Ibid.

\(^{123}\) BRRD, Art. 42 (7).

\(^{124}\) BRRD, Art. 42 (13).
2.4.4. The Bail-in Tool

In contrast to all the previous resolution tools, the bail-in tool enables primarily the resolution authorities to recapitalize a failing bank by means of the write-down of liabilities and/or conversion to equity, so that the bank can continue as a going concern- known as an 'open firm bail-in'.\textsuperscript{125} In other words, the bail-in tool will give resolution authorities the power to write down the claims of unsecured creditors of a failing bank and to convert debt claims to common equity instruments, such as a share\textsuperscript{126} in order to preserve the insolvent bank as an autonomous legal entity (going concern solution).\textsuperscript{127}

The Directive permits the use of the bail-in tool before the bank has been placed into insolvency proceeding, when the institution is still a going concern ('open' firm bail-in) in order to restore its ability to comply with the conditions for authorization and so to continue performing its authorized activities, and to sustain market confidence in the institution,\textsuperscript{128} or the bank as a 'gone concern' subject to the exercise of the resolution powers ('closed' firm bail-in).\textsuperscript{129} When the bail-in tool is applied to recapitalise a bank (Article 51(1)), it must be accompanied by a business reorganisation plan (Article 52) aimed at restoring long-term viability, subject to the approval of the resolution authority.

The power to write-down capital instruments (Art. 59 of the BRRD) is not meant to be a resolution tool, but it works as an ancillary tool or a tool that can be exercised outside any resolution measures, as it looks very similar to the bail-in tool, as long as debt instruments can be either written down or converted into equity.\textsuperscript{130} A clear distinction with bail-in appears in a group context, as on bail-in, the Directive follows a clear entity-by-entity approach, this principle is loosened regarding the write-down

\textsuperscript{130} Ibid.
instrument, because article 59(4) rules that the point of non viability refers not only to a single institution but rather to the group itself.  

The bail-in is used to convert to equity or reduce the principal amount of claims or debt instruments that would be transferred to a bridge institution or that would be transferred under the sale of business tool or asset separation and the residual part of the institution ceases to operate and is wound up.  

The resolution authorities must ensure that the institutions avoid to structure their liabilities in a manner that impedes the effectiveness of the bail-in tool, as it is appropriate to establish that the institutions meet at all times a minimum requirement for own funds and eligible liabilities expressed as a percentage of the total liabilities and own funds of the institution.  

Under the bail-in resolution tool, the shareholders and creditors of a failing bank suffer appropriate losses and bear an appropriate part of the costs arising from the failure of the institution. This is the key principle of the new resolution framework, as shareholders and creditors must contribute first to cover the losses and the recapitalization of the insolvent or near insolvent bank, in place of taxpayers, increasing at the same time, the investors’ incentives to monitor banks in an adequate way.  

The write-down or conversion will follow the ordinary allocation of losses according to creditor hierarchy in normal insolvency proceedings, equity must absorb

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131 Ibid.,


133 BRRD, Art. 2 (79) and Art. 45; Art 2 (80) "The Directive adopts a ‘top down’ approach to the determination of the minimum requirement for own funds and eligible liabilities (MREL) within a group. The approach further recognises that resolution action is applied at the level of the individual legal person; and that it is imperative that loss-absorbing capacity is located in; or accessible to; the legal person within the group in which losses occur. To that end; resolution authorities should ensure that loss-absorbing capacity within a group is distributed across the group in accordance with the level of risk in its constituent legal persons. The minimum requirement necessary for each individual subsidiary should be separately assessed. Furthermore; resolution authorities should ensure that all capital and liabilities which are counted towards the consolidated minimum requirement are located in entities where losses are liable to occur; or are otherwise available to absorb losses. This Directive should allow for a multiple-point-of-entry or a single-point-of-entry resolution. The MREL should reflect the resolution strategy which is appropriate to a group in accordance with the resolution plan. In particular; the MREL should be required at the appropriate level in the group in order to reflect a multiple-point-of-entry approach or single-point-of-entry approach contained in the resolution plan while keeping in mind that there could be circumstances where an approach different from that contained in the plan is used as it would allow; for instance; reaching the resolution objectives more efficiently. Against that background; regardless of whether a group has chosen the single-point- of-entry or the multiple-point-of entry approach; all institutions and other legal persons in the group where required by the resolution authorities should; at all times; have a robust MREL so as to avoid the risk of contagion or a bank run”.

134 BRRD, Art. 2 (67).

losses in full before any debt claim is subject to bail in. Specifically, the resolution authorities should apply the bail-in tool in a way that respects the pari passu treatment of creditors and the statutory ranking of claims under the applicable insolvency law. Losses should first be absorbed by regulatory capital instruments and should be allocated to shareholders either through the cancellation or transfer of shares or through severe dilution. Where those instruments are not sufficient, subordinated debt should be converted or written down. Senior liabilities should be converted or written down if the subordinate classes have been converted or written down entirely.

The BRRD provides that the bail-in tool can be applied to all liabilities that are not expressly excluded from the scope of the bail-in. The Directive excludes the following liabilities: the holders of covered deposits; secured liabilities including covered bonds and liabilities to the extent that they are secured; client assets or client money to the extent that they are protected under the applicable insolvency law; liabilities that arise by virtue of a fiduciary relationship between the institution and another person; liabilities owed to institutions with an original maturity of less than seven days (excluding entities that are part of the same group); liabilities owed to central counterparties with a remaining maturity of less than seven days; liabilities owed to employees (except variable remuneration); liabilities to 'critical' trade creditors; liabilities owed to tax and social security authorities provided that they are preferred under the normal insolvency proceedings; and liabilities arising from contributions to deposit guarantee scheme.

In contrast, the mechanism of optional exclusions is more diversified, including exclusions left to the resolution authority's decision when exceptional circumstances occur. The optional exclusions from bail-in regards the liabilities that cannot bail-in within a reasonable time and their exclusion is strictly necessary and is proportionate to achieve the continuity of critical functions and core business lines of the institution.

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136 BRRD, Art. 47.
138 BRRD, Art. 2 (77) and Art 48.
139 BRRD, Art. 44 (1).
140 BRRD, Art. 2 (71) “The exercise of the bail-in powers would ensure that depositors continue to have access to their deposits up to at least the coverage level which is the main reason why the deposit guarantee schemes have been established”; see also, Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes Text with EEA relevance, available online at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A3A32014L0049>, accessed 3 January 2019.
141 BRRD, Art. 44 (2).
under resolution or to avoid giving rise to widespread contagion\footnote{BRRD, Art. 44 (3) (c): "In particular as regards eligible deposits held by natural persons and micro, small and medium sized enterprises, which would severely disrupt the functioning of financial markets, including of financial market infrastructures, in a manner that could cause a serious disturbance to the economy of a Member State or of the Union".} and to avoid a destruction in value.\footnote{BRRD, Art. 2 (70 & 72) and 44 (3).} However, the use of optional exclusions is clearly linked to the possibility of increasing the bail-in burden on other eligible liabilities, and must comply with the no creditor worse-off principle.\footnote{Boccuzzi, Giuseppe., 'The European Banking Union: Supervision and Resolution', Palgrave Macmillan Studies in Banking and Financial Institutions (series editor: Philip Molyneux), 2016, p. 88.}

The delineation of the scope of bail-in indicates that all unsecured debt with an original maturity of seven days or more will be bail-inable, while the main loophole derives from the special rules that apply to derivatives (to the extent that they are not excluded from the application of the bail-in tool, they may be bailed), liabilities arising from repos, other title transfer collateral agreements and short-term debt. To this end, in order to prevent banks from holding only exempt debts, there is a need to establish a minimum requirement for eligible liabilities,\footnote{A. Fantuzzi, A modern resolution tool to TBTF, in Riv. dir. banc., dirittobancario.it, 20, 2016, available online at <http://www.dirittobancario.it/rivista/crisi-bancarie/modern-resolution-tool-tbtf>, accessed 3 January 2019.} so as to ensure adequate loss coverage capacity and to prevent banks from changing the composition of liabilities in favour of excluded liabilities.\footnote{Boccuzzi, Giuseppe., 'The European Banking Union: Supervision and Resolution', Palgrave Macmillan Studies in Banking and Financial Institutions (series editor: Philip Molyneux), 2016, p. 83.}

Lastly, the scenario of possible contagion effects on investors and other financial institutions that hold bonds eligible for bail-in is present, demanding an accurate calculation of the possible negative effects deriving from the existence of such powers of cancellation, as creditors might withdraw their deposits at the first signals of difficulties of the bank, thus exacerbating the bank’s crisis.\footnote{Ibid, p. 90.} 

\textbf{2.4.4.1. Bail ins- versus Bail-outs}

A Bail-out occurs when outside persons, \textit{i.e.} persons other than shareholders or creditors, such as governments, rescue an institution by injecting public capital to prevent negative consequences to the financial system or the economy that would arise from the institution's failure.\footnote{European Commission, 'MEMO: EU Bank Recovery and Resolution Directive (BRRD): Frequently Asked Questions' (15 April 2014), available online at <http://europa.eu/rapid/press-release_MEMO-14-297_el.htm>, accessed 2 January 2019.} The bail-out is connected with 'the too big to fail'
test and the 'too interconnected to fail' test. During the previous decade, governments inject money into banks on an unprecedented scale. After the recent crisis, the Financial Stability Board declared that 'an effective resolution regime must not rely on public solvency support and not create an expectation that such support will be available'. In the same line, the EU legal framework for bank recovery and resolution specified the powers of the resolution authorities to intervene both before problems occur and early on in the process if any problems arise, securing the rescue of the institution's critical functions in case the financial situation is beyond repair while the costs of restructuring and resolving failing banks fall upon the bank's owners and creditors and not on taxpayers.

In contrast, a bail-in occurs when the institution's shareholders and creditors bear the burden by having an appropriate portion of their debt written off or converted into equity. The bail-in tool will therefore give shareholders and creditors of institutions a stronger incentive to monitor the health of an institution during normal circumstances and meets the FSB's Key Attributes.

2.5. Additional Provisions: Government Financial Stabilization Tools

The final version of the BRRD added another tool, known as government financial stabilization tools. The BRRD does not exclude the possibility of 'putting' public money into the banks in an extraordinary situation (i.e., systemic crisis), following the strict conditions of Arts. 37 (10), 56, 57 and 58 of the Directive and the

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152 Miglionico, Andrea, 'Rethinking the resolution tools for the distressed banks: a new challenge in the banking union?' (2018), J.I.B.L.R. 33(9), p. 314-320, which article argues 'that the introduction of new resolution tools for distressed banks in the banking union has not changed the recourse to public bail-out programmes: credit institutions rely on domestic financial support with the consent of EU institutions which seemed unprepared on how to decide on a suitable restructuring option for the bank in crisis'.


154 BRRD, Art. 2 (67).
Commission’s approval in accordance with the state aid framework of Art. 107 TFEU.\textsuperscript{155}

According to Art. 37 (10) of the Directive, the resolution authority has the possibility to seek funding through the use of government stabilization tools in case that a bail-in of at least 8\% of bank liabilities has been applied and authorisation for the use of State aid has been obtained. According to Art. 56 (3) of the Directive, the government financial stabilization tools must be used as a last resort after having assessed and exploited the other resolution tools to the maximum extent predictable whilst maintaining financial stability and after determining that the application of the resolution tools would not suffice to avoid a significant adverse effect on the financial system and to protect the public interest where extraordinary liquidity assistance from the central bank or equity support has already been provided.\textsuperscript{156} When applying the tool of temporary public ownership, no other resolution tool (i.e. sale of business, asset separation, bridge tool, bail-in) can adequately protect the public interest. The activation of financial stabilisation tools is entrusted to government authorities, in collaboration with the resolution authority,\textsuperscript{157} and may consist of public equity support (Art. 57 of the BRRD) and a temporary public ownership (Art. 58 of the BRRD).

According to Art. 57 (1) of the Directive, Member States when participate in the recapitalisation of the institution -in compliance with their national company law- by providing capital in exchange for Common Equity Tier 1 (CET 1), additional Tier 1 instruments or Tier 2 instruments. Additionally, the financial institutions subject to public equity support tool must be managed on a commercial and professional basis and be transferred to the private sector when the market circumstances allow (Art. 57 para. 3).

Lastly, under Art. 58 of the Directive, Member States are allowed to fully take over an institution, ensuring that the institutions subject to the temporary ownership are managed on a commercial and professional basis and that they are transferred to the private sector as soon as commercial and financial circumstances allow.

\textit{2.6. An Overview of the BRRD’s Resolution Strategy}

The BRRD has expressly recognized both the Single Point of Entry (SPOE) and the Multiple Point of Entry (MPOE) approaches for resolving global financial

\textsuperscript{155} BRRD, Recital 57.
\textsuperscript{156} BRRD, Art. 54 (4) (a-c).
institutions. In a Single Point of Entry strategy, there is one resolution entity, while in the Multiple Point of Entry there is more than one resolution entity. The two polar resolution strategies are applicable to very different business models. The MPOE resolution strategy is applicable to the decentralized business model while the SPOE to the centralized business model. The SPOE is more consistent with wholesale banking under the legal structure of branches, centralised capital and liquidity management, and significant intragroup positions; while the MPE fits better with retail banking, funded with local deposits, under the legal structure of subsidiaries, decentralised capital and liquidity management, and very limited intragroup positions. Under the MPOE resolution strategy, each resolution authority performs a separate resolution (if necessary), drawing on loss-absorbing capital that is held separately by national holding companies in each jurisdiction which is not shared across jurisdictions. In the SPOE model, a global bank is recapitalized by writing off debt or equity issued by a single global holding company that owns banking subsidiaries in multiple jurisdictions while the loss absorbing capacity is shared across jurisdictions.

3. The US Regulatory Developments on Bank Resolution

The banking sector has been one of the most highly regulated sectors in the US due to their special role in allocating credit and operating the payments system. The financial crisis of 2007-2009 disrupted the US economy and its banking sector. It is widely compared to the Great Depression of 1929, as the financial and economic circumstances associated with the US subprime mortgage crisis and the following financial institutions' failures that led to a severe worldwide economic disaster. The US regulatory framework developed a more promising strategy for dealing with troubled financial institutions.

160 Ibid.
3.1. Background

The US law provides several legal frameworks for resolving distressed or failed financial institutions. The US has developed the so-called 'dual banking system', meaning that in the US financial institutions can be chartered by one of the 50 states or at federal level.163

The US federal banking statutes can be traced back to 1860s when the National Bank Act of 1863 created the basic framework for the US banking system and the chartering of national banks; the Federal Reserve Act enacted in 1914 creating the Federal Reserve System; the US Banking Act of 1933 created the system of federal deposit insurance; established the Federal Deposit Insurance Corporation (hereinafter FDIC) and separated the commercial from the investment banks; the Federal Deposit Insurance Act of 1950 (FDI Act) consolidated the prior FDIC legislation into one act and authorizing FDIC as the receiver and restructurer of failed banks; the Bank Holding Company Act of 1956 (BHC Act) requires Federal Reserve approval for a company to acquire a bank (and thereby become a BHC) and requires BHCs to obtain prior Federal Reserve approval to acquire an interest in additional banks and certain non-bank companies; the International Banking Act of 1978 (IBA) established the framework for federal supervision of foreign banks operating in the US; the Gramm-Leach-Bliley Act of 1999 repealed the provisions of the Banking Act of 1933 that separated investment banks from commercial banks and authorized the creation of the Financial Holding Companies (FHCs); and the Dodd-Frank Act of 2010 that was enacted in response to the financial crisis of 2007-2009 (before the publication of the Key Attributes).164

3.2. The Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act (known as the Dodd-Frank Act) enacted in 2010 and constituted the greatest legislative overhaul of financial services regulation in the American history since the Great Depression of the 1930s and made significantly changes to the US bank regulatory framework.165 The US bank regulators have frequently implemented a more stringent ('super equivalent') version of rules that are part of the post-financial regulatory agenda

164 Ibid.
165 Ibid.
established by the Dodd-Frank Act and by the international standards as were set out by the G20, the BCBS and the FSB. 166 The central aim of the Act was to avoid a re-occurrence of the 2007 financial calamity, by including measures to improve systemic stability and policy options for dealing with financial institutions, to increase transparency and to protect consumers and investors.167

In 2017 President Donald Trump signed an executive order directing regulators to review the Dodd-Frank Act, arguing at the same time that the Dodd-Frank Act needs to be abolished.168 In response to this direction, the House of Representatives passed the Financial Choice Act of 2017 rolling back sections of the Dodd-Frank Act.

The Dodd-Frank Wall Street Reform and Consumer Protection Act enacted on the 24th May 2018169, made changes that will have the greatest impact on small financial institutions. Some of the Act’s more noteworthy changes include removal of certain Volcker Rule limitations on hedge fund and private equity fund naming conventions, the exemption of most small banks from the purview of the Volcker Rule170, reduced regulatory burdens for small and medium-sized bank holding companies, changes favorably affecting custodial banks’ supplementary leverage ratio calculations, expansion of public securities offering rules to closed-end exchange listed funds, and beneficial capital treatment of certain real estate exposures and municipal obligations that make investments in such assets more attractive to banks under bank capital rules.171

166 Ibid.
170 Volcker’s proposal for banning many forms of short-term trading by federally insured banks to reduce risk to taxpayers and the world economy; issuing a final rule that limited bank’s ability to buy and sell stock, bonds, currencies and risky derivative instruments for their own accounts. For a comprehensive analysis of the Volcker Rule see Federal Deposit Insurance Corporation, available online at <https://www.fdic.gov/regulations/reform/volcker/index.html>, accessed 5 January 2019.
3.2.1. An Overview of the Banking Regulatory Agencies in the US

The American law introduces several federal regulatory agencies dealing with the banking legal framework. The US bank regulatory agencies are the following: 172

- The Board of Governors of the Federal Reserve System (‘Federal Reserve Board’): The Federal Reserve System is the central banking system of the US and conducts its monetary policy. The Federal Reserve supervises Bank Holding Companies (BHCs) and Financial Holding Companies (FHCs), state-chartered banks that are members of the Federal Reserve System, the US activities of Foreign Banks Operations (FBOs), and Systemically Important Financial Institutions (SIFIs) designated by the Financial Stability Oversight Council (FSOC). The Dodd-Frank Act provided substantial regulatory authority to the Board of Governors of the Federal Reserve to ensure the stability and survival of the SIFIs. 173

- The Federal Deposit Insurance Corporation (FDIC) which is the primary regulator for state-chartered banks that are not members of the Federal Reserve System as well as state-chartered thrifts. The FDIC insures bank and thrift deposits and has receivership powers over banks and certain other financial institutions. 174

- The Office of the Comptroller of the Currency (OCC): Prior to the creation of the FDIC, the OCC was in charge of supervising the liquidation of national banks. The OCC is an independent bureau of the US Department of the Treasury led by the Comptroller of the Currency that charters, regulates, and supervises all national banks and federal saving associations as well as federal branches and agencies of foreign banks.

- The Financial Stability Oversight Council (FSOC) which was created by the Dodd-Frank Act in order to oversee the stability of the US financial economy and is empowered to designate non-bank SIFIs for supervision by the Federal Reserve.


174 The receivership process is the closing down process of a failed bank that includes the liquidation of any remaining assets, distribution of any proceeds of the liquidation to the FDIC, to the failed institution’s uninsured depositors, to general creditors and to those with approved claims. For a comprehensive analysis of the receivership process and receivership powers see Federal Deposit Insurance Corporation, ‘Resolution Handbook’, available online at <https://www.fdic.gov/bank/historical/reshandbook/>, accessed 5 January 2019.
3.3. The Financial Institutions falling under the scope of the Dodd- Frank Act

During the crisis, the absence of an adequate and credible resolution regime on the part of the systemically important financial institutions (SIFIs) in combination with the complexity of their structure as ‘international institutions’, highlighted some of the deficiencies in the American resolution legal framework. At that time, the FDIC’s receivership authorities were limited to federally insured banks and thrift institutions, while the lack of authority to place a holding company or affiliates of an insured depository institution (IDI) or any other non-bank financial company into an FDIC receivership to avoid systemic consequences limited policymakers’ options, leaving them with the poor choice of bail-outs or disorderly bankruptcy. In the aftermath of the crisis, the US enacted the Dodd-Frank Wall Street and Consumer Protection Act of 2010 which introduced a set of changes to financial regulation, and was amended in 2018, cited as the Dodd-Frank Wall Street Reform and Consumer Protection Act.

3.3.1. The Dodd Frank Act of 2010

Under the Dodd-Frank Act of 2010, a new resolution regime was introduced to resolve large Bank Holding Companies (BHCs) and Foreign Bank Operations (FBOs) with total global consolidated assets of $50 billion (now $250 billion), and non-bank financial companies designated by FSOC as SIFIs. Title I and II of the Dodd-Frank Act provides new authorities to the FDIC and other regulatory agencies (i.e. FSOC) to deal with the failure of a SIFI. In other words, prior to the enactment of the Dodd-Frank Act, bank regulators had extensive resolution powers with commercial bank subsidiaries but did not have resolution authority over the bank holding company or nonbank affiliates, each of which was subject to the ordinary bankruptcy process. Title I requires all companies covered under it to prepare resolution plans, or “living wills”, to demonstrate how they would be resolved in a rapid and orderly manner under the Bankruptcy Code (or other applicable insolvency regime) in the event of material financial distress or failure. Title II provides a back-up authority to place a SIFI into an FDIC receivership process if no viable private-sector alternative is available to prevent the default of the financial company and if a resolution through the bankruptcy process would have serious adverse effects on US financial stability, providing the FDIC new Orderly

176 Ibid, p. 38.
Liquidation authority (OLA) that provides the tools necessary to ensure the rapid and orderly resolution of a covered financial company.\textsuperscript{177}

\subsection*{3.3.2. The Dodd-Frank Act of 2018}

The Dodd-Frank Act of 2018, raised the threshold at which a bank is considered as a SIFI from $50 billion to $250 billion-keeping the main pillars of post-crisis regulation intact.\textsuperscript{178} A win for the mid-sized banks is a change to the threshold at which banks must comply with additional regulatory requirements that are applicable under the systemically important threshold. Firms with between $50 billion and $100 billion in total assets are released immediately from mandatory application of additional regulatory requirements, while “middle tier” BHCs with $100 billion to $250 billion in total assets will be released in 18 months although they will still need to meet certain additional regulatory requirements.\textsuperscript{179}

Even the Dodd-Frank Act of 2018 changed the threshold for additional regulatory requirements; the Federal Reserve System and other regulatory agencies will decide whether to adjust other thresholds, such as the Federal Reserve Board’s Comprehensive Capital Analysis and Review (CCAR), the OCC’s heightened standards and recovery planning, and the FDIC’s insured depository institution resolution requirements that apply to banks with over $50 billion in assets.\textsuperscript{180}

The foreign bank counterparts of the US banks have been left with questions and an ongoing debate under the 2018 Act. Currently, the Federal Reserve Board applies additional scrutiny to Foreign Banking Organizations (FBOs) holding $50 billion or more in total global assets, but applies increasingly stringent requirements based on US asset size, including the requirement to establish an Intermediate Holding Company (IHC) in the US for Foreign Bank Operations (FBOs) that also hold $50 billion or more in combined US non-branch assets.\textsuperscript{181} Dashing hopes that the increased SIFI threshold would also apply to FBOs, the law clarifies that the Fed still maintains

\begin{flushleft}
\textsuperscript{177} Ibid.
\textsuperscript{179} Ibid.
\textsuperscript{180} Ibid.
\textsuperscript{181} Ibid.
\end{flushleft}
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discretion to apply additional regulatory requirements and Intermediate Holding Company (IHC) requirements to FBOs with global assets over $100 billion.182

3.4. The Resolution Tools under the Dodd-Frank Act

The Dodd-Frank Act adopted the Orderly Liquidation Authority (OLA) a new resolution regime to address systemic risk of non-bank financial companies. Title II183 of the Dodd-Frank Act regulates a bail-in process that is meant to provide an alternative to the US bankruptcy proceedings. Under the Dodd-Frank Act’s OLA provisions, the FDIC has been given enhanced resolution tools for use in the resolution of a systemically important financial company, including: an immediate liquidity source to maintain asset values and essential functions; the ability to transfer all qualified financial contracts with a counterparty so as to avoid immediate contract termination/netting of positions and the attendant shocks to the financial system; and the ability to conduct advance resolution planning, including through the use of detailed ‘living wills’, which institutions are required to prepare and keep on file in order to facilitate the wind up of their affairs.184

3.4.1. The Orderly Liquidation Authority (OLA)

Orderly Liquidation Authority covers the US bank holding companies with $250 billion or more in total consolidated assets, any foreign company bank or any company that controls a foreign bank that has a US bank, branch, agency or commercial lending company subsidiary and at least -until an adjustment of threshold is decided- $50 billion in total global consolidated assets; and any non-bank financial company designated by the Financial Stability Oversight Council (FSOC) as a SIFI.185 In determining whether a 'covered financial company' must be placed in receivership under Title II of the Dodd-Frank Act, certain distress financial findings are made. The 'covered financial company' must be in default or in danger of default, i.e. the company is insolvent or will be unable to pay its debts as they come due in the ordinary course of

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182 Ibid.
185 Dodd-Frank Act, sec. 165 (d); see Kleftouri Nikoletta, Deposit Protection and Bank Resolution (Oxford: Oxford University Press, 2015), p. 222.
its business or in danger of becoming such,\textsuperscript{186} and the reorganization or liquidation of the 'covered financial company' under the normal proceedings of the US bankruptcy code would pose serious adverse effects on the financial stability of the US.\textsuperscript{187}

Therefore, the choice between Bankruptcy code and the OLA is a 'two part test' that is made upon failure on the individual merits of the case.\textsuperscript{188} If these findings are made and the US Treasury, Federal Reserve and FDIC agree, they file a secret petition in a federal Court in Washington, D.C. The court approves the authorization of the aforementioned bank regulators to intervene so long as the 'toxic' financial institution is engages primarily in financial activities and is in default or in danger to default.\textsuperscript{189} Then, the FDIC is appointed as receiver for a 'covered financial company' and becomes the manager of the assets, liabilities and operations of the 'covered financial institution'. Under Title II of the Act, the FDIC must replace the management members who were responsible for the institution's financial condition, to impose losses on shareholders and creditors, and to liquidate the 'covered' financial institution.\textsuperscript{190}

Specifically, the FDIC is responsible for transferring or selling the company's assets (asset sale) or other liabilities to a third party at a fair value, or establishing bridge institutions.\textsuperscript{191} The FDIC has the power to cancel any previous transfers, agreements or leases that prevent the FDIC's mission.\textsuperscript{192} The FDIC is the manager of the Orderly Liquidation Fund (OLF) that is a separate fund in the US Treasury and its aim is to assist fund the liquidation procedure.\textsuperscript{193} In case that the financial company is a broker or dealer, the Securities Investor Protection Corporation (SIPC) is additionally - to the FDIC's appointment- appointed as trustee that will take over any remained assets that were not transferred to a bridge institution from the FDIC.\textsuperscript{194} The Securities Protection Investor Corporation (SIPC) shares responsibility for customer accounts.

\textsuperscript{186} Dodd-Frank Act, sec. 203.
\textsuperscript{187} Dodd-Frank Act, sec. 203 (b); see A. Fantuzzi, A modern resolution tool to TBTF, in Riv. dir. banc., dirittobancario.it, 20, 2016, available online at <http://www.dirittobancario.it/rivista/crisi-bancarie/modern-resolution-tool-tbtf>, accessed 3 January 2019.
\textsuperscript{188} Kleftouri Nikoletta, Deposit Protection and Bank Resolution (Oxford: Oxford University Press, 2015), p. 222.
\textsuperscript{189} Dodd-Frank Act, sec. 202 (a).
\textsuperscript{190} Marinc, Matej. and Vlahu, Razvan., 'The Economics of Bank Bankruptcy Law', Springer, 2012, p. 119.
\textsuperscript{191} Ibid.
\textsuperscript{192} Dodd-Frank Act, sec. 210.
\textsuperscript{193} Dodd-Frank Act, sec. 210 (n); see also sec. 210 (n)(2) "Amounts received by the Corporation, including assessments received under subsection (o), proceeds of obligations issued under paragraph (5), interest and other earnings from investments, and repayments to the Corporation by covered financial companies, shall be deposited into the Fund".
\textsuperscript{194} Dodd-Frank Act, sec. 205.
Title II of the Dodd-Frank Act defines the claim process against a failed financial company and the list of priority payments.\(^\text{195}\) The list's aim is to ensure that directors, executives and shareholders will bear the losses as they cannot receive any payment until all the other claims are paid. Title II includes provisions regarding the management and board members' liability, including their removal as responsible for the company's financial condition.\(^\text{196}\)

Under Title II, SIFIs have to produce plans for a rapid and orderly wind-up in the event of financial distress or failure. The FDIC has issued rules -jointly with the Federal Reserve Board- to establish standards for resolution plans and credit exposure reports, that 'covered financial companies' must submit to the FRB, the FDIC and the FSOC.\(^\text{197}\) Separately, the large FDIC-insured depository institutions are required to submit periodic contingency plans to the FDIC, which provides depositors access to insured deposits and minimizes loss to creditors.\(^\text{198}\) The former provisions focus on minimizing systemic risk while the latter aims to protect the insured depositors and to minimize loss.

Lastly, the Act stipulates the FDIC's role as a receiver can be a maximum of 3 years, with the possibility of two 1-year extensions,\(^\text{199}\) as Title II of the Dodd-Frank Act requires the liquidation of any 'received' financial institution.

### 3.4.1.1. Questioning the Orderly Liquidation Authority (OLA) of the Dodd-Frank Act

The Orderly Liquidation Authority (OLA) has many legal issues that could prevent its use.\(^\text{200}\) Although Title II of the Act provides a framework of rules, the rules

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\(^\text{195}\) Dodd-Frank Act, 210 (a)(2), 209 (b) according to which claims are paid in the following order: (1) administrative costs; (2) the government; (3) wages, salaries, or commissions of employees; (4) contributions to employee benefit plans; (5) any other general or senior liability of the company; (6) any junior obligation; (7) salaries of executives and directors of the company; and (8) obligations to shareholders, members, general partners, and other equity holders.

\(^\text{196}\) Dodd-Frank Act, sec. 206.


\(^\text{198}\) Code of Federal Regulations; Title 12; Chapter III; Subchapter B; Part 360 (10); available online at <https://ecfr.io/Title-12/cfr360_main>, accessed 6 January 2019.


provide only a sketchy picture of what a resolution might actually look like.\textsuperscript{201} Title II of the Dodd-Frank Act regulates the liquidation of any ‘covered’ financial institution. Title II does not force the American bank regulators to intervene in a timely stage, creating uncertainty about the application of the OLA regime. Furthermore, the uncertainty regarding the protection of the short-term creditors in case that the financial institution will be liquidated under the OLA process, challenging the effectiveness of the new resolution regime.

3.4.1.2. A more promising strategy for implementing Title II of the Dodd-Frank Act

Over the past several years, the FDIC\textsuperscript{202} tried to fill in the picture with a remarkable new strategy for implementing Title II, known as the Single Point of Entry (SPOE).\textsuperscript{203} By taking this approach the bank regulators are able can: 1) provide for the continuity of the company’s significant business operations; 2) preserve the material operating subsidiaries as going concerns, thereby preserving their value for the benefit of the company's creditors and reducing the risk of economic disruption; 3) impose the losses arising from the company’s failure on the shareholders and creditors of the parent company; 4) reduce the potential for conflict between regulators in different jurisdictions, as well as the risk that the subsidiaries' contractual counterparties will exercise termination rights as a result of the parent’s failure.\textsuperscript{204}

In a single point of entry resolution, the bank regulators would recapitalize a troubled systemically important bank rather than liquidating it. In a single-point-of-entry strategy, bank regulators would put the financial institution’s holding company into resolution, leaving subsidiaries to continue operations. The FDIC is appointed as receiver of the US parent holding company of the failed financial institution. Then, the FDIC transfers the top-tier holding company’s assets from the receivership, any short-term liabilities, and any secured obligations to a new bridge institution while leaving its stock and long-term unsecured debt (primarily bonds) behind in the old financial


\textsuperscript{202} Federal Register Insurance Corporate issued a statement outlining its proposed SPOE strategy for resolving US SIFIs, if and when Title II of the Dodd-Frank Act is invoked; see


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The transfer would create a well-capitalized new institution, as the FDIC would use 1) the available parent holding liabilities to recapitalize the new bridge holding company through a bail-in tool and 2) large amounts of liquidity from the US Treasury for the holding company or subsidiaries, and the FDIC would eventually distribute some or all of the equity of the new institution to the old long-term debt holders, while most likely wiping out the old stock.\textsuperscript{206}

The FDIC is responsible for the structure of the new bridge institution and so it must determine the value of the bridge financial company in order later to be able to conduct a claims process and thus, to establish a claims priority hierarchy, as there will be classes of claimants, each demanding their new share of equity.

In this sense, the single-point-of-entry strategy is made possible by the unusual structure of large US financial institutions, as the US financial institution groups generally have a top-level holding company whose capital structure includes substantial amounts of combined capital, \textit{i.e.} bonds and other long-term unsecured debt, but relatively few derivatives and other short-term debt, while the short-term debt and much of the group's operations are in subsidiaries.\textsuperscript{207} Under the SPOE approach, the liabilities of the top-level holding company are subordinated to the customer obligations at the institutions' operating subsidiaries, while at the same time, the equity and debt at the holding company form a buffer that must be absorbed before any subsidiary suffers losses. The success of the SPOE model depends on the sufficient amount of debt and equity at the holding company to both absorb losses in the failed firm and capitalize the new bridge holding institution.

The single of point strategy has gained recognition among regulators as imposes fewer demands on regulators than putting the entire holding company framework into resolution and reduces the risk that foreign subsidiaries would face liquidity crises at the outset of the resolution.\textsuperscript{208}

\subsection*{3.4.2. The Bail-out Tool under the Dodd-Frank Act}

Title II of the Dodd-Frank Act prohibits the use of taxpayer funds in order to prevent the liquidation of any institution that has been put into receivership under Title


\textsuperscript{206} \textit{Ibid}, p.3.

\textsuperscript{207} \textit{Ibid}, p.3.

\textsuperscript{208} \textit{Ibid}, p.3.
II. This provision, prohibits any future bail-out for struggling financial institutions, clarifying that there is no safety bailout net for troubled financial institutions that will have to liquidate under Title II of the Dodd-Frank Act. Even the elimination of government bailouts for struggling financial institutions is clearly declared, the Act is referred to the emergency lending program strategy or any facility that are provided for the purpose of providing liquidity to the financial system. The Act empowered the Federal Reserve to act as a lender of last resort, restricting at the same time its lending powers as it prohibits the Federal Reserve's power to make emergency loans in order to rescue a single financial institution.

4. The EU versus US Resolution Tools under the BRRD and the Dodd-Frank Act

In the aftermath of the recent financial crisis, both the US and the EU made much effort to improve their resolution legal framework. In this regard, both regions established new resolution rules and guidance with common goals, i.e. providing powers to resolution authorities to resolve financial institutions in a quick and effective process that will ensure the stability of the financial system and to eliminate the taxpayers' contribution to resolution rescues. In the US and in the EU resolution approaches, the resolution is triggered when i) a failing or likely to fail institution is detected; ii) public interest and financial stability considerations are present and iii) there are no -private- alternative solutions according to existing market conditions that could prevent the institution's default. Besides these common principles, the two most affected financial markets, have developed different approaches to bank resolution.

Even as just mentioned, the US and the EU resolution regimes share the same trigger conditions for activating the resolution process, the US sets out one additional condition, i.e. when a US regulatory agency has ordered the financial company to convert all of its convertible instruments that are subject to the regulatory order.

Particularly in the US, the bank resolution approach depends on the legal entity in question. A US financial institution is normally resolved under the state banking laws (following the traditional resolution process) while the large and complex banks, i.e. SIFIs, are liquidated at federal level, under the Title II of the Dodd-Frank Act. The US federal law supersedes state laws, allowing the implementation of a standardized

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209 Dodd-Frank Act, sec. 214.
210 Dodd-Frank Act, sec. 1101.
211 Ibid.
process, while in the EU, the postponement of the Banking Union delays the so much needed uniformity on the aspects of central banking governance.\textsuperscript{212} The Dodd-Frank Act extends the Federal Reserve’s and FDIC’s powers when dealing with troubled SIFIs, as previously only bankruptcy was available and the bank regulators’ power in bankruptcy was limited.

In 2014, EU introduced the Bank Recovery and Resolution Directive (BRRD) as a response to the demands for a reliable resolution legal framework. While the scope of the Dodd-Frank Act is limited, the BRRD covers all credit institutions and certain investment firms established in the EU. As explained above, under the Dodd-Frank Act, the FDIC has the resolution authority to take over a SIFI and to initiate the SPOE resolution model using the bridge institution tool. Under the BRRD, each Member State is responsible to appoint its national resolution authority that will work together with the European competent resolution authorities. The resolution decision scheme is more complex and less agile than in the resolution decision scheme in the US, due to the ‘more complex’ EU institution structure.\textsuperscript{213}

As the FSB mentioned,\textsuperscript{214} there are two stylized global resolution strategies that global financial institutions must apply, \textit{i.e.} the Single Point of Entry and the Multiple Point of Entry. It is important to note that the majority of the US SIFIs are domestic and are generally organized in a holding company structure with a top-tier parent and operating subsidiaries that comprise hundreds, or even thousands, of interconnected entities.\textsuperscript{215} As a result of this, Dodd Frank Act establishes the SPOE strategy as the benchmark for resolving banks in the US while in the European context, the BRRD leaves more room for manoeuvre and allows both strategies, MPE and SPOE.\textsuperscript{216}

Precisely, Title II of the Dodd-Frank Act adopts the Orderly Liquidation Authority, a new bail-in strategy of SIFIs. Title II demands the liquidation of any ‘covered’ financial institution rather than its reorganization. The highly disputed

\textsuperscript{212} For a comprehensive analysis of the central banking governance before and after the establishment of the EMU in the EU, see Quaglia, Lucia., ‘Central Banking Governance in the European Union: A comparative analysis’, Routledge/UACES Contemporary European Studies, 2008.
\textsuperscript{216} Ibid.
effectiveness of the new OLA regime, initiated the FDIC’s response through the development of the Single Point of Entry (SPOE) approach, i.e. the resolution process was partially modified by the FDIC. The latter process generated much enthusiasm among regulators, promising the maintenance and continuity of the institution's critical services. The purpose of the SPOE process is to liquidate the top-tier bank holding company and to leave the subsidiaries continue their operations, either because the latter have remained solvent and viable, or because they can be recapitalized through the writing down of intra-group loans made from the holding company to its subsidiaries. In the US, a subsidiary would need to be resolved independently only in case it had large losses.

The European Union adopted a bail-in tool that aims at recapitalizing the troubled bank and keep it as a going concern. In contrast to the OLA regime, the BBRD allows also the use of the bail-in resolution tool before the troubled financial institution be treated as 'gone concern' (‘closed bank’ bail-in process). When the institution is in a 'going concern' stage ('open bank' bail-in process) the EU bail-in tool aims to restore the institution's to meet the authorization requirements, to continue its critical operations and to maintain the market confidence. The EU bail-in tool is a precondition for bank resolution and for implemented bank recapitalization. National authorities must impose losses representing 8% of the institution's liabilities on shareholders and creditors\(^{217}\) before using the national resolution fund to absorb losses or to inject capital into the institution. The time element is essential when applying the bail-in tool as if the supervisor trigger bail-in too early, it may be necessary other rounds of bail-in, if losses are not fully revealed; if bail-in is used at a later stage instead, there is a risk of run of bank creditors who do not bail-inable debt.\(^{218}\) The Directive suggests for an application of bail-in in a 'going concern' situation, while Title II of the Act is established at the moment the bank is closed without providing a specific timeframe based on which the regulators must intervene and take over the troubled financial company.

The EU and the US bail-in approaches raise practical implications for the cross-border financial markets. The uninsured depositors may be bailed-in under the BRRD,
the same in not true under the Dodd-Frank Act in the US. The insured and uninsured depositors are ranked ahead of unsecured creditors in the American system while in the BRRD, there are different layers differentiating therefore the seniority of certain deposits. The difference in the priority of claims may impede cross-border resolution by creating an uneven playing field for uninsured depositors. The two resolution regimes recognizes the deposit preference. Both legal frameworks have established a Deposit Guarantee Scheme (DGS) but the difference in the amount which is insured by the public deposit guarantee scheme in the US, deposits are guaranteed to a value which is at least twice the value of deposits guaranteed under schemes available in the EU- may exacerbated the just above mentioned impediment. The DGS will only absorb losses under liquidation but not in the resolution scheme while in the EU, the DGS has been excluded from the bail-in tool.

Moreover, under the BRRD's provisions, the categories of liabilities to which a bail-in applies will remain unclear, as the resolution authorities have the authority to exclude certain liabilities to achieve specific objectives, such as to avoid contagion. The BRRD establishes a 'minimum requirement for eligible liabilities' (MREL) to ensure that financial institutions have sufficient liabilities within the scope of the bail-in tool to achieve effective resolution and to avoid liquidation; an approach that derives from international regulatory commitments on bail-inable liabilities, referred as 'total loss absorbing capacity' (TLAC). However, the differences between the -quite stringent- MREL's and the TLAC's provisions with respect to the scope of eligible instruments, may create an uneven playing field for banks in different jurisdictions.

As regards the way in which the resolution fund is used and the discretionality that is applied in its use by the resolution tools are following different paths in the US

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222 Ibid.
225 Ibid.
226 Ibid.
and the EU framework. In the US, the Orderly Liquidation Fund (OLF) is established at the Treasury, and it is available to the FDIC in order to borrow funds (neither capital nor guarantees) while in the EU, each Member State establishes its own financing arrangements which would be available to support institutions under resolution via loans, guarantees, asset purchases or capital for bridge banks. In the US there is no preconditions in order to activate the OLF to funding the bridge institution while in the EU, when resolution authorities decide to exclude an eligible liability from bail-in, the resolution fund is used after a minimum level of 8% of total liabilities have been bailed-in and in addition to purchase shares or other instruments of ownership or capital instruments of the institution under resolution. The EU resolution fund must be financed ex ante while in the US in an ex post contributing level.

Furthermore, the Dodd-Frank Act bans struggling financial institutions that are under resolution process. However, the provisions are quite leaky as bank regulators can still bail-out the troubled financial institution, despite the restrictions imposed on the Federal Reserve's emergency lending powers. In Europe, in a very extraordinary situation the resolution authority and after the bail-in application, has access to the temporary public ownership and public equity support tool, while the US resolution regime does not envisage any public ownership.

Lastly, it must be mentioned that the US rules stem from a long-standing legal regime and the FDIC's resolution model has been tested significantly more often than in the EU. Despite the BBRD's new resolution framework that entered into force in 2015, the application of the bail-in tool was delayed until 2016. Most of the problematic EU cases occurred before the transposition of the BRRD and the implementation of the bail-in tool, but the credibility of the new resolution framework requires practical examples to prove that the bail-in tool actually works in practice.

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228 Ibid.
229 Ibid.
Conclusions

The 2007-2008 financial disaster brought a severe destabilization in the financial system and showed the failure of market discipline and the government responses to minimize the problem, confirming the idea that some financial institutions are too big to fail.234 The crisis demonstrated the lack of sufficient and effective bank resolution regimes both in the EU and the US financial markets. In the decade since, the only choice of a government in front of a failure of a financial institution was to bail-out the troubled company or to initiate a bankruptcy proceeding.235

In the aftermath of the crisis, international and regional regulators made efforts for setting out a more resilient financial resolution regime. Both the US and the EU regions, enacted new resolution frameworks as a buffer against market overconfidence. In the wake of the financial crisis, the US adopted the Dodd-Frank Act of 2010 with the aim of preventing the reoccurrence of a crisis. The new US President initiated the procedure for amending the 2010 Act, while the rolling back of Dodd-Frank Act's sections took place in May 2018, 'saving' -partially- the middle-class financial institutions. However, the American financial regulation has been roundly criticized on a number of grounds, mainly on the basis of over-regulating the financial institutions and of hindering the competitiveness of the US financial economy vis-a-vis foreign companies.236

Similarly, EU introduced the BRRD in 2014 as a response to the crisis, introducing a 'unified' resolution framework. The Directive set out a quite stringent framework for all credit institutions and certain investment firms. The key resolution tool of the Directive, i.e. bail-in tool, has been broadly characterised as 'too complex to work'.237 On 23 November 2016,238 the Commission presented its proposal to amend resolution framework: is there an issue with the middle class?’ (23 March 2018), available online at <https://www.bis.org/speeches/sp180323.htm>, accessed 8 January 2019.


235 Ibid.,


the BRRD in order to incorporate the FSB's standards on G-SIFIs' loss-absorbing and recapitalization. The two regions most greatly affected, the US and the EU, have developed distinct approaches to bank resolution; 'it is like comparing apples and pears, both are fruits that share similar colors'. What has been set up in Europe in the past four or five years is still in its infancy in comparison to the US powers, infrastructure, the people, or the training. It is a matter of time to see whether the plurality of national political pressures and interests will continue to keep back or will permit the completion of the European Banking Union, interests that don't exist in the US.

The arising question for the American continent is whether the US will permit the survival of the Dodd-Frank Act or will -even more- roll back its strict provisions, drafting another path for the financial industry that may or may not be based on the legal entity, the entity's assets, or its 'importance' for the American economy. In the EU, the main dilemma is whether the European authorities will be able to introduce a truly 'unified' resolution framework when managing banks or non-bank financial institutions and consequently, promote the process of integration; or will permit the national powers and the problems of political legitimacy that have plagued the EU for decades, to impose their sclerotic structures.

In conclusion, a common question is therefore: whether the 'converging air' between the two continents will be transformed into a 'home jurisdiction', creating an even playing field for the -without borders- financial institutions under resolution or will continue following different paths, showing a complete disregard for the need to harmonize and improve the resolutions regimes and especially, the resolution tools for dealing with financial institutions crises.

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