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Evolving key risks in the banking sector and related priorities for the SRB: the lack of an effective transfer-based bank crisis framework

Supporting Banking Union scrutiny

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Evolving key risks in the banking sector and related priorities for the SRB:

the lack of an effective transfer-based bank crisis framework

Abstract

This paper shows that to successfully deal with bank crises, the EU framework needs to facilitate the smooth transfer of funds, assets and liabilities from financially troubled entities to other entities. Currently, the EU framework does not guarantee that. The reasons are identifiable, and can be remedied.

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LIST OF ABBREVIATIONS

AGRI	Agriculture and Rural Development Committee
ALDE	Alliance of Liberals and Democrats for Europe
BAS	Brake-assist systems
CAP	Common Agricultural Policy
CFP	Common Fisheries Policy
CMO	Common market organisation
CoR	Committee of the Regions
CULT	Culture and Education Committee
ECOSOC	Economic and Social Committee
ECR	European Conservatives and Reformists
ECTS	European Credit Transfer System
EFDD	Europe of Freedom and Direct Democracy Group
ENF	Europe of Nations and Freedom
EPP	Group of the European People's Party (Christian Democrats)
FAO	Food and Agriculture Organisation of the United Nations
FPS	Frontal protection systems
GDP	Gross Domestic Product
GM	Genetically-modified
Greens/EFA	The Greens/European Free Alliance
GUE/NGL	European United Left - Nordic Green Left
IFI	International Fund for Ireland
S&D	Group of the Progressive Alliance of Socialists and Democrats in the European Parliament

1. GENERAL INFORMATION

KEY FINDINGS

There is possibly no greater risk for the EU banking system than the obstacles to implement transfer strategies in bank crisis management. Simply put: the resilience of the EU banking system may depend less on exogenous shocks than on its ability to deal with them, and the EU can do less to prevent the shocks than to make it easier to deal with them. This will depend on the availability of strategies that allow banking groups, national authorities or the SRB to swiftly execute transfers of funds, assets, liabilities or shares (hereby called "transfer strategies").

The EU's single-minded focus on (i) dealing with the largest banks, and (ii) minimizing taxpayer losses has resulted in a bank crisis management system that is skewed towards resolution and bail-in, to the neglect of transfer strategies. Yet, national practice in different Member States, and the SRB's own experience in cases like Popular or Sberbank shows that successful bank crisis management requires transfer strategies more often than bail-in. It is necessary to acknowledge the relevance of transfer strategies, and address the current limitations to give them effect.

First, current rules lack sufficient clarity as to when intra-group transfers of resources, or repayment of liabilities can take place to avert the crisis of a subsidiary, or maximize its transfer value, even in a situation where the parent itself may be in financial distress. National contract, corporate or insolvency law can present obstacles, and lack certainty about how to execute the transfers.

Second, the current resolution framework is primarily "regulatory", while successful transfer strategies require a more M&A-oriented approach. Once the authorities visualize the M&A process, some limitations of the current framework become evident, including cross-border recognition, the treatment of SPVs, the coordination between authorities, or the potential liability of the transferee, or the parent company.

Third, successful transfers often need funding, and the current framework makes it difficult for the Single Resolution Fund (SRF) to adequately fulfil that role, and for national deposit Guarantee Schemes (DGS) to offer additional funding in coordination with the SRF.

Fourth, currently there seems to be no intention to explore the idea of an EU-wide market of Non-Performing Loans (NPLs) using mechanisms like securitisation, which straddle across banking and capital markets. Such mechanisms could make NPL management more efficient, improve both crisis management and the liquidity of secondary loan markets, and deepen the Capital Markets Union.

2. BANK CRISIS MANAGEMENT AND TRANSFER STRATEGIES: HARD TO OVERLOOK

The current bank resolution framework is an impressive achievement. However, it was decisively shaped by the Great Financial Crisis (GFC) concerns over (i) Global, Systemically Important Banks or Financial Institutions (G-SIBs or G-SIFIs); (ii) moral hazard and Too-Big-To-Fail (TBTF), and (iii) the minimization of taxpayer losses. In the EU these were exacerbated by the added concern that the use of public money could favour some Member States' banks over others. This explains the Banking Communication's message of "burden sharing" by shareholders and debtholders, and the emphasis of the Bank Recovery and Resolution Directive (BRRD) and Single Resolution Mechanism Regulation (SRMR) on "bail-in", and on asking banks comply with Minimum Requirements of Own Funds and Eligible Liabilities (MREL).

Yet, even with a framework skewed towards bail-in and MREL, bank crisis management *practice* has primarily involved transfers of shares, assets, liabilities and losses. At an EU level, the crisis of Banco Popular Español was resolved by transferring the bank to Banco Santander. The crisis of Sberbank was resolved by transferring the Croatian and Slovenian subsidiaries of the bank to acquirers. At a national level, in Portugal the Banco Espirito Santo (BES) crisis involved a transfer of assets and liabilities to a bridge bank (Novo Banco), and the Banif crisis a sale to Santander Totta, together with an asset separation tool for non-performing assets to an asset management vehicle (Oitante). Asset Management Companies (AMCs) were used to transfer non-performing assets in Ireland (NAMA), Slovenia (DUTB), Spain (SAREB), or Hungary (MARK), and for nationalisation schemes in Austria (HETA) and Germany, involving a spin-off (FMS-WM, for Hypo Real Estate). Italy's extensive experience with different bank crises has shown examples of all kinds of transfer strategies, including acquisitions, spin-offs or demergers and a variety of NPLs transactions, including, notably, securitisations, using a national vehicle (AMCO).

Despite their importance, the EU framework on bank resolution dedicates scant attention to transfer tools, (e.g., BRRD dedicates a mere 5 articles 38-42) and largely relies on non-resolution provisions, such as domestic contract, corporate or insolvency law, or the law of deposit insurance. The resulting combination is less than optimal, and yet provisions on transfer tools remain mostly unaltered since 2014, when BRRD and SRMR were first adopted. Even the success of bail-in strategies depends on an efficient intra-group loss transfer, which is also not present.

Thus, although when talking about "key risks" for banking it is customary to focus on exogenous factors (inflation spikes, war, energy crisis, cybersecurity or climate risks), the resilience of the banking sector is also largely dependent on its ability to deal effectively with shocks, which is largely endogenous, and dependent on effective transfer strategies. This briefing paper explores how those transfer strategies could work more effectively.

3. INTRA-GROUP LOSS TRANSFER

An habitual step when a bank subsidiary sustains heavy losses is for its parent entity (or, generally, "assisting company") to financially assist that subsidiary (or, generally, "assisted company"), to pay its liabilities and/or to absorb its losses by writing off own funds or converting liabilities. At least four considerations constitute sources of tension. First, the board and/or management of the assisting company, e.g., the parent, will be reluctant to promise unconditional support, because national company law assesses directors' duties in light of the interest of the individual company, and this may bar assistance that endangers the viability of the assisting company, or is contrary to that company's interest, exposing directors to liability. Insolvency law may reinforce this entity bias. Second, that same board or management will seek to secure arrangements that have the authorities' blessing, but without incurring disproportionate costs. Third, the authorities (supervisory authorities or resolution authorities) will try to ensure that the intra-group support is designed to be enforced at the critical moment, taking into consideration potential obstacles under national law. This may increase the costs of the assistance or loss-transfer mechanisms. Fourth, the uncertainties as to the enforceability of assistance mechanisms may amplify the tensions between home and host authorities, and ring-fencing. These tensions are addressed, but not resolved, by the relevant framework.

Articles 19-26 BRRD contemplate intra-group financial support agreements, which can be activated in case of early intervention. Yet, supervisors have already pointed out that the link between group support and recovery options is far from perfect.[1] Supervisory authorities lack the power to require the parent company (or another group company) to financially assist a subsidiary in financial difficulties as part of early intervention powers, even if this is envisaged in the recovery plan, when the parent (or financially assisting company) is not, itself, in a situation of early intervention.[2]

These difficulties are even more present in the context of resolution. For a resolution authority pre-positioning iMREL instruments in the subsidiary, i.e., own funds or eligible liabilities that are conceived to be written-off or converted if necessary, may be the more reassuring way to ensure loss transfer, given that the subsidiary and/or parent will be Failing-or-Likely to Fail. However, it is a costly one. On the other hand, personal assurances by the parent company may be less costly, and thus more convenient for said parent, but not reassuring enough. The tension between these interests is reflected in Articles 12g and 12h SRMR. For resolution, Article 12g SRMR requires subsidiaries of resolution entities to comply with MREL requirements on an individual basis. This forces the parent to position iMREL-compliant instruments in those subsidiaries. However, article 12h SRMR lets the resolution authority waive this requirement under certain conditions, including that "there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities by the resolution entity to the subsidiary" (article 12h (1) (c) SRMR).

However, there may be different opinions about what constitutes a "foreseen material practical or legal impediment". This constituted the basis for cases 2/2021 and 3/2021, decided by the SRB Appeal Panel (see Box no. 1). A commitment by a parent company to financially assist its subsidiary can be formulated in different ways, and its enforceability can depend on national contract law if, e.g., it is formulated as a parent guarantee. National contract laws may consider a guarantee enforceable or not depending on relatively subtle factors, such as whether the execution of the guarantee is subject to preconditions, or whether it is formulated as an obligation of means, or of result. Also, as explained above, corporate laws, in turn, may also limit the possibility of companies within a group to financially

[1] Enria; Fernández Bollo, 2020.
[2] Ibid.

assist each other when such assistance, regarded in a entity-centric perspective (as company law usually does), may be against the "individual company interest". One may adopt a long-term approach to construe the individual interest of the company taking into account the interest of the group, when being part of the group is positive for the company and outweighs possible costs associated to it. Yet, even then, the concept is an open-textured one, and it may be difficult, if not impossible, to state with precision whether a parent will face no legal or de facto constraints to financially assist its subsidiary should the need arise. The alternative could be to consider that resolution may prevail over national company or insolvency law. Some case law has already accepted that resolution objectives can prevail over provisions of company or securities law under certain circumstances.[3] However, the issue is uncertain, and there is no clarity as to what decisions may prevail, when, and how. The current *status quo* means that there may be greater reluctance to grant waivers, which, in turn, enhances the tendency towards ring-fencing.

Box 1: Appeal Panel Cases 2/2021 and 3/2021

Cases 2/2021 and 3/2021 decided by the Appeal Panel for the Single Resolution Board.

In each of these cases the Appellant challenged the Single Resolution Board (SRB) refusal to waive internal MREL (iMREL) in the case of a banking group.

The Appeal Panel found in both cases that the concept of an "impediment" to transfer was formulated in a sufficiently broad manner as to allow the SRB to require the issuance of a guarantee, depending on the circumstances of the case, although in case 2/2021 it found that the SRB had not satisfied the duty to state reasons when explaining why it rejected the guarantee offered by the parent.

Case 3/2021 was appealed before the General Court in case T-71/22, and thus the above findings are not final. The more relevant findings for present purposes are twofold. One, there was no discussion of whether the SRMR requires an assessment of national contract, corporate and insolvency law, which determine the effectiveness of the transfer mechanisms. Second, the matter was sufficiently uncertain to create a strong disagreement about the existence of "legal or practical impediments" to the transfer.

[3] Case C-410/20, *Santander v JAC* ECLI:EU:C:2022:351

4. TRANSFER STRATEGIES IN RESOLUTION

A second dimension of the problem concerns the use of transfer strategies in resolution. For the largest institutions (G-SIBs) it is habitual to select bail-in as the strategy in resolution, since a successful transfer of shares, or of all the assets and liabilities may be difficult to guarantee. Transfer strategies are less common in the case of Top-tier banks (with assets above 100 € bn) or O-SIBs, but more common for banks below 100 € bn. Even for banks where bail-in has been selected as the resolution strategy, resolution authorities may choose to deviate from the resolution plan, or to adopt a variant strategy foreseen therein (based on transfer tools) and pursue a (partial) transfer strategy instead (e.g., Sberbank), or to combine a write-down and conversion of own funds and liabilities with a partial or total transfer (e.g., Popular). The decision over a resolution scheme is a fluid process, where many variables interact simultaneously, and success may depend on swiftness and flexibility.

Transfer strategies may be the best option to serve resolution goals, but differ from bail-in in one important respect: they involve other parties, or the market. This may sound obvious, but it is not. In bail-in the authorities adopt a unilateral decision to write-down and convert instruments. In transfer strategies the authorities can act as the transferor, but there has to be a transferee for the strategy to succeed. The transferee will, most likely, be another financial institution like a bank, or a specialist entity (e.g., a fund specialised in NPLs) and used to a market standard, based on M&A practice, in terms of both process and documentation.

With these considerations in mind the problem is evident. Successful transfer strategies must rely on M&A market practice to foster market confidence, but neither the BRRD nor the SRMR are remotely M&A-friendly. They are regulatory texts, in scope, substance and style, which focus on public interest goals and public authorities' powers, and assume that a resolution scheme operates when "there is no reasonable prospect that any alternative private sector measures" (articles 32 (1) (b) BRRD, article 18 (1) (b) SRMR).

By that yardstick, the Court of Justice has found that the sale process for the transfer of business of Banco Popular, was lawful. The Court accepted the SRB's argument that the existence of a market mechanism resulted in a market price, which made it unnecessary to include a definitive *ex post* valuation.[4] Yet, the fact that the sale was "lawful" is not enough to instil confidence in the market. A robust, transparent and predictable process is needed.

Given that the rules say little in that respect, the priority for the SRB and NRAs should be to collaborate with the private sector to develop both a process that makes it possible to select external advisors, delineate the asset perimeter, draft the documentation, invite buyers, open a virtual data room, answer any questions and make any clarifications, and negotiate with counterparties, and move from non-binding to binding offers, during a weekend, and then finalise the transaction once all the information is available, including decisions over adjustments to the price and perimeter, and potentially the compensation to shareholders and creditors. The SRB has been working over the last years to develop these tools, in collaboration with some market actors. Even so, **the question is** whether the legal framework of the BRRD and SRMR need to be amended to **acknowledge more explicitly** the closer interplay between resolution authorities and market techniques. A good example is how to treat in a share transfer past liabilities of the transferred entity for mis-selling of its shares or bonds, when they are written down as part of the process and thus the **liability of the transferee**. In M&A transactions one of the key issues in the negotiation concerns the potential liability of the acquiror arising from claims by parties potentially harmed by acts of the transferee. When such risks are sufficiently

[4] Judgment of 21 December 2021, Case C-934/19 P *Algebris v SRB*, ECLI:EU:C:2021:1042.

identifiable, they can result in adjustments in the price. In other cases, where the likelihood of liability or the amounts involved may be less certain, the parties use Representations and Warranties (R&W) specific indemnities or conditions. Such tools may be unavailable when the resolution authority is on the other side of the transaction. However, the legal framework should be sufficiently flexible to grant equivalent protections (e.g., facilitating an avenue for compensation that does not involve suing the acquiror), if this can secure the success of the transaction, without endangering other interests (see below, the point on funding and the role of the Single Resolution Fund (SRF)). The Court of Justice, in *Banco Santander v JAC*[5], held that those liabilities should be taken into consideration in the valuation on the compensation due to affected shareholders or creditors (something that is easier said than done, if only one considers the number of variables to be factored in in a similar calculation, based on several hypotheticals), yet should not be considered transferred to the acquirer. The same result was achieved in Italy in the Banca Popolare di Vicenza and Veneto Banca case through a special law, whose constitutionality was challenged.[6]

Demergers (or spin-offs) may help alleviate this problem because the liability of the acquirer for liabilities of the demerged entity is limited to the value of the net asset transferred to it. At the same time demergers may also defuse the controversy on the fair value of the transferee, by assigning, according to a fair exchange ratio, shares of the acquiror also to the past shareholders of the transferee, preserving in this way a chance for an upside in the future for shareholders otherwise cancelled in their ownership. Company law requirements for demergers, unless duly adjusted in the context of a bespoke regime for banks' resolution or liquidation, are hardly implementable in practice.

Additional legal challenges, which may be faced by the SRB and NRAs, include e.g., the following:

- The **recognition** of the transfer and its effects by other Member States under the BRRD and the Directive 2001/24/EC on the Winding Up of Credit Institutions. Notably, the resolution of Banco Espirito Santo (BES) gave rise to issues of recognition (Box 2[7]).
- The use of **Special Purpose Vehicles (SPV)**, in particular whether a decision can be adopted to set the vehicle up in an **investor-friendly jurisdiction**, different from the jurisdiction where the failed bank is located, and whether an NRA can be instructed to transfer assets and/or liabilities to that SPV, and whether it could object on grounds of national or EU Law.
- The **coordination between authorities (I).** This comprises their coordination in **resolution colleges**, in particular whether the extremely detailed procedure envisaged in articles 97-107 of Delegated regulation 1075/2016 for the joint decision on a cross-border resolution scheme is compatible with the swiftness and flexibility required, especially in the presence of a parallel process of negotiation and drafting of documentation, and whether more details more details are needed on the hypothesis where there is a disagreement between authorities, and these may act unilaterally, where relatively little is said (articles 108-109 Delegated regulation 1075/2016).

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5 Case C-410/20, ECLI:EU:C:2022:351

6 The Constitutional Court held that the challenge was inadmissible with judgment of 7 November 2022, No 225; in the merit, the issue is thus still unresolved for a future bank's crisis management.

7 See *Goldman Sachs v Novo Banco,* [2015] EWHC 2371 (Comm), [2016] EWCA Civ 1092, [2018] UKSC 34; Judgment of 29 April 2021, Case C-504/19 Banco de Portugal, Fundo de Resolução, Novo Banco SA, Sucursal en España v VR, ECLI:EU:C:2021:335.

- The **coordination between authorities (II)** for purposes of **licensing**. Transfer strategies will often consist in a *partial* transfer, while some assets and liabilities may be left behind as not being valid for such transfer. Especially impaired assets may need to be wound up. However, liquidation may not begin immediately, which means that, for some time, the entity may need to maintain at least a partial authorisation to operate while the liquidation takes place. There must be coordination with competent authorities to ensure that the application of licensing requirements do not hinder the effectiveness of transfer-based resolution strategies. Similar needs for coordination can arise in the **fit-and-proper assessment** of the prospective acquirer under a sale of business or other transfer mechanisms.
- The potential **parent company liability**. Some strategies may involve the transfer of some shares, assets or liabilities, but also the winding-up of a subsidiary. Some corporate and/or insolvency laws contemplate the possibility of extending liability to the parent company in case the assets in the subsidiary are insufficient to satisfy its liabilities. This could potentially endanger a transfer strategy.

Box 2: Cross-border recognition risk for transfer strategies

Cross-border recognition of transfers in the case of Banco Espirito Santo.

The resolution of Banco Espirito Santo (BES) involved the transfer of assets and liabilities to a bridge bank (Novo Banco). However, doubts arose with regard to assets and liabilities governed by foreign law, or subject to a foreign jurisdiction. This resulted in numerous subsequent acts, where the Portuguese authority (Banco de Portugal) had to *confirm* whether specific assets or liabilities had been transferred (confirmatory, non-confirmatory acts).

In the UK, this resulted in the *Goldman Sachs v Novo Banco* litigation, where the plaintiff sought to have the UK courts declare themselves competent to decide over a loan facility, because, the plaintiff alleged, the confirmatory act indicating that the loan facility had not been transferred, did not constitute an act of transfer, and thus was not subject to automatic recognition under the Winding Up Directive. The plaintiffs' view was ultimately rejected, but it took three decisions, by the High Court (which sided with the plaintiff) the Court of Appeal and the Supreme Court.

The BES resolution also gave rise to a case decided by the Court of Justice after a preliminary reference by a Spanish court, in *Banco de Portugal, Novo Banco and Fondo de Resolucion v VR*, where the Court of Justice ruled that the unconditional recognition of the *retroactive effect* of the measures regarding BES, in this case the transfer of assets, is contrary to EU law if it means that a client can no longer sue the 'bridge bank' to which the liabilities in question were previously transferred. The Court of Justice grounded its argument on fundamental rights such as judicial protection. Thus, even the strongest protection of transfer tools may have its limits.

5. THE FUNDING OF TRANSFERS

A transfer strategy may be the best option to serve resolution goals such as preventing contagion, preserving critical functions, protecting depositors or avoiding systemic risk. However, the success of this strategy depends not only on the powers of the resolution authority, but on the appetite of market actors to acquire the business, assets and liabilities of the failing bank. Funding "gaps" may deter potential acquirors from completing the transfer. This raises at least two groups of considerations.

A first consideration concerns the **adaptation of the Single Resolution Fund (SRF) to the needs of transfer strategies**. As described earlier, during an M&A process, some of the concerns of potential transferees have to do with the risk of potential liability, or hidden losses, which are normally bargained through the use of R&Ws, indemnities or conditions. These, in turn, require the transferor to be potentially responsible if some specific liability materializes. Addressing (at least some of) these concerns requires a more flexible use of the SRF. In this regard, the SRF may need to be used not for direct payments, but to **offer guarantees** to prospective purchasers, in order to adjust some of the uncertainties about the potential liabilities. This logic can be extended to other transfer scenarios. For example, if a prospective acquirer for the business is not found, and a transfer of assets is implemented, guarantees may still be needed for the acquirer. If an asset separation tool is implemented, and an SPV is used, the SRF may need to issue guarantees to the debt of the SPV. Furthermore, currently in bank resolution there is a **heavy involvement of the Commission**; first to assess the public interest leg of the resolution test, and, second, to authorise the involvement of the SRF to ensure that the state aid framework is respected. Furthermore, the assessment under state aid is still based on the 2013 Banking Communication. Both the involvement of the Commission (possibly by compressing its intervention in one single step) and the Banking Communication need to be reassessed to facilitate the success of transfer strategies.

A second consideration concerns the **coordination of the SRB and SRF with Deposit Guarantee Schemes (DGS)**.[8] DGSs are critical players in some jurisdictions, by funding transfer strategies and ensuring their success, notably in the US[9] and Japan.[10] A transfer funded by the DGS can ensure that the value obtained for the business or assets is higher than under piecemeal liquidation, and minimize the risk for financial stability, and reduce the risk for depositors, since depositors would not need to be paid out by the DGS, but would be integrated in the acquiring institution.

In the EU, the BRRD and the SRMR treat "**resolution**" under EU rules, funded by the SRF, and "**liquidation**" under national insolvency law, and the participation of the national DGS, as **separate** domains. In practice, however, **the issue is not that simple**. The decision whether to put a bank in resolution, or which strategy to execute, may rely on the SRB's assessment of the ability of the national system to deal with parts of the bank. First, the SRB decision of whether resolution is in the public interest depends on whether "liquidation" under national insolvency law can prevent contagion and systemic risk. This, in turn, may depend on whether a DGS-funded transfer can be accomplished swiftly. In other cases, the success of a mixed strategy, involving both the use of transfer tools under resolution *and* a transfer under national insolvency law may also depend on the ability to fund both the transfer under the resolution scheme (presumably, by the SRF, if needed), and the transfer under national law

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8 See the recent Eule, Kastelein, Sala – ECB (2022).

9 Federal Deposit Insurance Corporation (FDIC) *Crisis and Response: an FDIC History, 2008-2013*, (2017). https://www.fdic.gov/bank/historical/crisis/

10 Deposit Insurance Corporation of Japan (DICJ) *A Guide to the Deposit Insurance System*, 2005. https://www.dic.go.jp/content/000010138.pdf

(presumably, by the DGS). Thus, the implementation of transfer strategies may need **coordination between national and EU authorities**.

In practice, **there are important limits to the use of DGS in funding transfers**. First, Article 109 of BRRD and Article 79 of SRMR contemplate the use of DGS for resolution funding, but this depends, in practice, of national law. Under the Directive 2014/59/EU (DGS Directive) DGS funds are primarily envisaged for deposit payouts (Article 11 DGS Directive), while its use for the funding of transfers (Article 11 (6) DGS Directive) is just a possibility. Some Member States have made use of this possibility, such as Italy,[11] United Kingdom (when still part of the EU) and Poland,[12] while others have not (e.g., Spain or the Netherlands). This may hinder the coordination of transfer strategies between national and EU levels.

Second, **the DGS funding of transfers is severely limited** by the requirement that the DGS costs do not exceed the amount that would result in a liquidation (article 11 (6) DGS Directive, article 109 BRRD, Article 79 SRMR. This "least cost principle" seeks to ensure that the DGS does not incur higher costs than needed.[13] However, "least cost" is not subject to a harmonised definition in the EU, and it is notoriously difficult to pin down.[14] Furthermore, since the least-cost is referenced to the payout in piecemeal liquidation under insolvency law, and, pursuant to Article 108 BRRD, covered deposits *and* the DGS subrogated in their position enjoy a so-called "super-priority", the net payouts would be minimal, which hinders the possibility of the DGS funding a transfer.

The Commission is currently revising the banking crisis management and deposit insurance framework,[15] and one of the aspects to revise should be the ability of DGS *in practice* to help in funding transfer strategies. In this context, it may also be possible to devise a more credible liquidity strategy for post resolution or liquidation to the benefit of the bailed-in entity or the acquiror, including the acceleration of access to central bank facilities.

6. THE LACK OF AN EU TRANSFER-BASED SYSTEM TO DEAL WITH NPLS

Finally, dealing successfully with a bank's crisis often requires having adequate tools to deal with non-performing assets (NPAs), through transfer under private sector mechanisms, or through the use of tools such as asset segregation, or asset protection schemes. In practice, however, NPAs management is largely based on national experiences, meaning that market practice has evolved along their separate lines. Meanwhile, EU institutions and bodies have dealt with non-performing loans (NPLs) largely as a problem of individual banks, and thus used a "regulatory" and "micro" approach, with guidance to individual banks for NPLs recognition, impairment measurement and write-off, as well as governance and strategy.[16] The Commission released a blueprint on the setting up of Asset

[11] In some EU Member States such as Italy, the DGS has ample powers to fund transfer strategies. See De Aldisio et al. (2019)

[12] CEPS & Milieu Consulting (2019).

[13] Mecatti, I. (2020)

[14] Costa et al. (2022).

[15] European Commission Review (2021).

[16] ECB NPLs Guidance, 2017; EBA Report (2018).

Management Companies (AMC) by national authorities,[17] but otherwise stayed out of what was perceived as an issue of national policy.

And yet, as we have said elsewhere, the **use of securitization in the NPLs market** provided an excellent opportunity for the expansion of the Capital Markets Union (CMU), and for exploiting synergies between public goals and private interest. NPLs can be dealt with by means of bulk transfer, but also through securitization.[18] While being aware that securitization, used in an aberrant way, can distort incentives, and build up systemic risk, it is an essential mechanism to ensure liquidity in the secondary credit market. Furthermore, its basic mechanics emphasize the ideas of diversification and "tranching" to cater to investors with different risk appetites. In some circumstances, the transfer to the SPV may be organized via demerger and a junior tranche of the SPV assigned to the shareholders of the transferor whose shares are cancelled or written down may, also in this context, help defusing the controversy on the fair value of the transferred NPLs, preserving in this way a chance for an upside in the future for shareholders otherwise cancelled in their ownership. These mechanisms could function with an EU-wide market as they function within national boundaries. We have argued that **EU-wide AMCs, or a network of national AMCs** could provide the institutional foundations for such step.[19] However, EU-wide NPLs securitization can also evolve without AMCs, and benefit both bank crisis management and the development of the CMU. Yet, there have been no decisive efforts to interact with market players, to identify what are the practical barriers, or to find the best strategies to accomplish that goal.

7. CONCLUSIONS

From a legal perspective, there is possibly no greater risk for the EU banking system than the obstacles to implement transfer strategies in bank crisis management. Simply put: the resilience of the EU banking system may depend not only on exogenous shocks but also on its ability to deal with them; yet the EU can do less to prevent exogenous shocks than to make it easier to deal with them. This will depend on the availability of strategies that allow banking groups, national authorities or the SRB to swiftly execute transfers of funds, assets, liabilities or shares (hereby called "transfer strategies").

The EU's single-minded focus on (i) dealing with the largest banks, and (ii) minimizing taxpayer losses has resulted in a bank crisis management system that is skewed towards resolution and bail-in, to the neglect of transfer strategies. Yet, national practice in different Member States, and the SRB's own experience in cases like Banco Popular or Sberbank shows that successful bank crisis management requires transfer strategies more often than bail-in. It is necessary to acknowledge the relevance of transfer strategies, and address the current limitations to give them effect.

First, current rules lack sufficient clarity as to when intra-group transfers of resources, or repayment of liabilities can take place, both in going concern and gone concern scenarios, to avert the crisis of a subsidiary, or maximize its transfer value, even in a situation where the parent itself may be in financial distress. National contract, corporate or insolvency law can present obstacles, and lack certainty about how to execute the transfers. Whilst any attempt to remove such obstacles via general corporate or insolvency law reforms through EU harmonization would clearly be bound to fail, a bespoke and well targeted legal regime only for banks and banking group is easier to devise and would perfectly fit into the Banking Union rulebook.

[17] Commission AMC Blueprint (2018).

[18] Lamandini; Lusignani; Ramos (2017).

[19] Ramos; Lamandini (2021).

Second, the current resolution framework is primarily "regulatory", while successful transfer strategies require a more M&A-oriented approach. Once the authorities visualize the M&A process, some limitations of the current framework become evident, including cross-border recognition, the treatment of SPVs, the coordination between authorities, or the potential liability of the transferee, or the parent company.

Third, successful transfers often need funding and liquidity support, and the current framework makes it difficult for the Single Resolution Fund (SRF) to adequately fulfil that role, and for national deposit Guarantee Schemes (DGS) to offer additional funding in coordination with the SRF.

Fourth, currently there seems to be no intention to explore the idea of an EU-wide market of Non-Performing Loans (NPLs) using mechanisms like securitisation, which straddle across banking and capital markets. Such mechanisms could make NPL management more efficient, improve both crisis management and the liquidity of secondary loan markets, and deepen the Capital Markets Union.

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This paper shows that to successfully deal with bank crises, the EU framework needs to facilitate the smooth transfer of funds, assets and liabilities from financially troubled entities to other entities. Currently, the EU framework does not guarantee that. The reasons are identifiable, and can be remedied.
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