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Proportionality in the BRRD: Planning, Resolvability, Early Intervention

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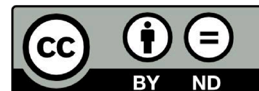

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A. Introduction: The two-sided interplay between resolution and proportionality*

Proportionality is a proper starting point that offers valuable insights on bank resolution. The reason is that the relationship between resolution and proportionality is complex, as well as closely connected with both the conception and the practical functioning of the former. Indeed, as resolution refers to actions by a public authority having a direct influence on private contracts, it is a good example of a comprehensive application of the proportionality principle in our legal system.

One way of thinking about resolution and proportionality, actually the first that comes to mind, is that resolution, administered by a public authority and typically carried out by means of administrative acts, poses a risk to proportionality. In particular, as resolution authorities interfere with the banks' conduct of their business in ways that will be examined below, and which include the power to cancel or modify private contracts concluded between banks and their equity- or debtholders, it is possible that this intervention in the workings of the banking sector becomes disproportionate.

Of course, this reference to potentially disproportionate measures raises the question of what objective is being pursued, in view of which the proportionality test will be conducted. These objectives are found in art. 31(2) of Directive 2014/59/EU (BRRD),[1] and in particular in art. 31(2)(b), which could be said to contain the fundamental objective of resolution, i.e. the protection of financial stability. Indeed, arts. 31(2)(a),(d),(e) on continuity of critical functions and the protection of covered depositors, investors and of client funds and client assets are important objectives themselves, but they could also be deemed ancillary to the main objective, which is to avoid disruptions to financial stability. Art. 31(2)(c) on minimizing reliance on extraordinary public financial support is not really an independent objective, but rather a limitation on the means available to pursue the said objective.

That resolution is a risk to proportionality is actually confirmed by art. 31(2) BRRD itself, as it compels the resolution authority to "avoid destruction of value unless necessary to achieve the resolution objectives". This suggests that there *is* destruction of value

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1 DIRECTIVE 2014/59/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council, Journal of the EU L 173/190 vom 12. Juni 2014 (BRRD), available on the Internet: <https://www.eba.europa.eu/documents/10180/966024/CELEX_32014L0059_EN_TXT.pdf/6b2ad6e8-efbb-4cc5-8354-19d1795b8473> (visited 27 August 2018).

that is necessary to achieve the resolution objective[s], which raises the issue of proportionality: Adverse effects of resolution actions should be limited to the extent suitable, necessary and *stricto sensu* proportionate.

But in the greater scheme of things there is a second, and arguably even more important, way to look at the interplay between resolution and proportionality. In particular, one should take account of the counterfactual to resolution in the context of bank failures: This counterfactual is the application of normal insolvency proceedings,[2] either on the basis of general insolvency law or of a special bank insolvency law, which for the present purposes are similarly "normal". Under such insolvency laws, the bank's business ceases, covered deposits are compensated by the deposit guarantee fund, the bank's assets are liquidated[3] and its creditors receive the proceeds. Normal insolvency proceedings are, as a methodological matter, the rule (which is why they are called normal in the first place), and resolution is the exception:[4] Namely, resolution requires an explicit decision for it to apply on the basis (in particular) of the public interest test in art. 32(1)(c) BRRD, while normal insolvency proceedings follow naturally from a "failing or likely to fail" finding without any need to examine a further condition except that the decision to apply resolution is lacking. This does not mean, however, that normal insolvency proceedings should be common as a practical rather than methodological matter too or that resolution should only be a rarely applied exception: That would probably be disproportionate!

Indeed, normal insolvency proceedings, while certainly superior to a disorderly creditors' race, are unavoidably coupled with a destruction of value at both the individual and the systemic levels. As regards the individual bank, it loses any goodwill it previously enjoyed, and it is subjected to the usually lengthy and inherently difficult process of asset liquidation and distribution to creditors, despite that its net asset value may be positive (but inadequate on the basis of prudential rules on capital). Even more importantly, as regards the financial system as a whole, a risk of contagion arises, in particular due to both the possible disruption of the interbank market's functioning and the erosion of depositors' confidence in other banks. Resolution is a method to limit these problems by protecting the smooth functioning of those contracts that are deemed to be systemically important.

In this sense, resolution reduces the destruction of value that is, to some degree, unavoidable in bank failure. While it seems to intervene in the functioning of private

[2] See also *Binder*, in: Bank of Greece's Center for Culture, Research and Documentation (ed), Commemorative Volume for L. Georgakopoulos, 37 (42-43).

[3] It is conceptually possible that "normal insolvency proceedings" are not exclusively liquidation proceedings, but may also include some bank reorganization outside the context of resolution: see *Thole*, ZBB 2016, 57 (60). However, this is rather unknown to the BRRD. The Directive defines normal insolvency proceedings in art. 2(1)(47) as involving a total or partial divestment; the reference to partial divestment as well is remarkable (though not elaborated upon anywhere), but on the other hand no reference to some kind of reorganization is to be found. Moreover, the BRRD repeatedly seems to take for granted that it is winding-up/liquidation that will occur in the context of normal insolvency proceedings: see art. 4(1), 15(1), 16, 32(5), 34(1)(g), 36(8), 37(6), 41(8), 42(5)(a), 42(14), 73, 75, 109(1), 109(5), as well as Recitals 5, 14, 45-46, 50-51, 110-1. Thus, it would not be far-fetched to suggest that the BRRD might pre-empt national rules establishing reorganization proceedings for failing banks outside resolution, all the more as they would necessarily lack the BRRD method and thus would probably be less protective of financial stability.

[4] See also BRRD Recitals 45-46.

contracts, it actually does so in a pre-existing crisis situation in order to limit its repercussions. If insolvency proceedings are, in general law, an orderly way to deal with the failure of a common debtor, resolution provides (generally speaking) an even more orderly way to deal with the significantly larger difficulties of bank failure. It also follows from this analysis that resolution is the milder alternative to normal insolvency proceedings; this is further confirmed by the "no creditor worse off" principle (art. 34(1)(g) and art. 73 BRRD).[5]

Against this background, resolution is not a risk to proportionality; it is rather an *exercise in proportionality*. This also means that a call to reduce the powers of resolution authorities, either at the time of application of resolution measures or before that stage, is not necessarily entitled to use the language of proportionality. A robust resolution regime is rather *fostering* proportionality, as it enables effective solutions to potential crises. Of course, this is an observation in principle, and it remains necessary to examine that individual aspects of the resolution regime, and their practical application to particular cases, are proportional to the resolution objectives in light of the circumstances.

The analysis below will not focus on the application of resolution measures (at "wartime", as it were, for resolution authorities) because this is covered by a different speech. It will focus on the less visible, but still very important, part of the resolution authority's work: that which is happening at "peacetime", i.e. prior to the application of any measures. In any case, MREL (Minimum requirement for own funds and eligible liabilities) (art. 45 BRRD) will not be referred to, as it would by itself require a separate analysis.

B. Proportionality in resolution planning

The most continuous part of the work performed by resolution authorities is resolution planning. The two-sided interplay between resolution and proportionality is indeed at work here. On the one hand, resolution planning places an administrative burden on banks. The burden is lower than in the case of recovery planning, given that recovery plans are drawn up by banks while resolution plans are drawn up by resolution authorities; in other words, each plan is drawn up by those that may eventually be called upon to apply it.

However, the resolution authority draws up a resolution plan on the basis of information provided to it by the bank itself (which the authority may further examine on its own). Such requests for information are burdensome and themselves carry administrative costs. Indeed, one might suggest that the difference in procedure between a recovery plan that is drawn up by the institution and reviewed by the competent authority on the one hand, and a resolution plan that is drawn up by the resolution authority following an extensive dialogue with the institution on the other, is smaller than one might originally think (though certainly not negligible). An extensive exchange of views may be expected in both cases.

[5] On "no creditor worse off" as a guarantee of proportionality see explicitly *de Serière/van der Houwen*, JIBLR 31, 376 (377); *Wojcik*, in: European Central Bank (ed), From Monetary Union to Banking Union, on the way to Capital Markets Union. New opportunities for European integration, 253 (256).

It is reasonable to suggest that the administrative burden for banks stemming from resolution planning should not be disproportionate to the significance of each bank for resolution purposes. To use the terminology mentioned above, this is a view of resolution planning as a risk to proportionality. There is indeed some support for this view in the BRRD, given that art. 4 provides for simplified planning (in the context of both recovery and resolution), though only on the basis of an opt-in by the Member State as regards this provision. Simplified planning refers to both the content of planning and the frequency of planning updates: Therefore, it entails less detailed plans with longer intervals between updates. In any case, resolution authorities do retain significant discretion as to the extent of simplification, so that resolution planning may become quite "customized".[6]

On the other hand, it should be recalled that resolution is itself proportionate when compared with normal insolvency proceedings. Moreover, resolution requires extensive planning in order to become operational. A look at art. 3 of EBA/RTS/2014/15 on the content of resolution plans confirms their importance for the application of resolution measures. Issues covered by planning are, among others, the determination of the bank's critical functions to be maintained, operational continuity, the provision of funding and liquidity at the time of crisis, as well as communication with stakeholders (which is obviously important if the goal is to preserve confidence in the banking sector). It should be added that resolution measures are always applied under significant time pressure, so that previous planning of the kind is essential. This does not mean that it is possible to prepare in advance, in the context of resolution planning, all assumptions and decisions a resolution authority must make in a crisis.[7] However, a plan is still appropriate and necessary[8] to facilitate the application of resolution tools by serving as a helpful roadmap, addressing problematic areas and containing much (though not necessarily all) information needed for an authority to deal with an eventual crisis.[9]

In this sense, "more" planning may be the *proportional* alternative to "less" planning because it allows resolution, as the proportional alternative to normal insolvency proceedings, to be applied at the time of crisis. Indeed, the very existence of resolution planning, with input from the bank itself, helps establish the proportionality of the resolution measures that may eventually be adopted. It proves that they result from a process of deliberation in which the private party affected has been involved.[10] This also means that too much emphasis on simplified planning would probably be misplaced.

[6] A similar approach is applied in the SREP Guidelines (EBA/GL/2014/13, on which see also below under 4 of the text), which categorizes institutions in four groups, while the level of "supervisory engagement" varies depending on the group that each bank is assigned to.

[7] *Koch*, ZBB 2012, 321; *Psaroudakis*, in: Hopt/Tzouganatos (eds.), Das Europäische Wirtschaftsrecht vor neuen Aufforderungen, 41 (45); *Schooner*, in: Lastra (ed.), Cross-border bank insolvency, Ch. 15, (49).

[8] On planning as a "second-generation resolution mechanism", as measures at the time of crisis are not credible on their own, see *Armour*, Making bank resolution credible, 13-14.

[9] Cf. *Binder*, Resolution planning and structural bank reform within the Banking Union, 5.

[10] In the broader (not bank-specific) discussion on proportionality see *Popelier/van De Heyning*, Eur. Const. L. Rev. 9, 230, on "procedural rationality" as a significant component of proportionality.

C. Proportionality and resolvability

Resolution authorities must assess (after consultation with the respective competent authorities) whether each bank is resolvable: art. 15 BRRD. According to art. 4(1) of the EBA/RTS/2014/15, this assessment may be said to contain two basic stages, which are a direct application of the generally known proportionality analysis. First, the resolution authority must determine whether normal insolvency proceedings are "feasible and credible" or not, in the sense that they can be applied and that they are a proper way to deal with potential bank failure; if the answer is negative, resolution becomes *necessary*. Second, the resolution authority must come up with a resolution strategy and determine whether this strategy is "feasible and credible" itself.[11] This is an examination of whether resolution is *suitable* to achieve its objectives in the particular case. Arguably, the third part of the proportionality analysis, i.e. the so-called proportionality *stricto sensu*, is then applied; however, its application occurs mostly at the time of application of measures, in order to balance them with the crisis at hand. Therefore, it is fair to say that resolvability assessment is ultimately an assessment of the resolution strategy's proportionality: In other words, it is a method for the BRRD to explicitly subject resolution to the proportionality examination.

As to the above-mentioned need to ease the administrative burden on banks as a matter of procedural proportionality, it can be derived from art. 4(4) of EBA/RTS/2014/15 that banks are first required to provide only the information upon which a resolution authority is able to orient itself to a resolution strategy. At a second stage, "additional" (in the words of the EBA Standards) information shall be requested so that a resolution authority can assess the resolution strategy that has been identified. In other words, a comprehensive request for information that would be needed to assess multiple potential strategies is avoided at the outset, and a bank must only provide the information that is clearly necessary for each part of the assessment.

Even more significant than the resolvability assessment, though related to it, is the power of the resolution authority to require from banks the removal of impediments to resolvability. This is a far-reaching power, given that, first, the measures required may be broad and intrusive and, second, its exercise is not based on the current prudential condition of the bank, as the case is with in supervisory powers or early intervention, but rather on a forward-looking analysis of the potential application of resolution measures. In particular, according to art. 17 BRRD the resolution authority may require that banks, among other things, limit exposures, divest assets, limit or cease activities, reduce complexity[12] and issue eligible liabilities. These are obviously significant intrusions in the bank's conduct of its business that should not be underappreciated.

Procedural proportionality is present in this context as well. In particular, art. 17(3),(4) BRRD grants banks an opportunity to propose measures in order to ad-

[11] To be accurate, EBA/RTS/2014/15 art. 4(1) refers to four stages, because it breaks down the part of the analysis referring to the chosen resolution strategy into three stages: strategy selection, strategy feasibility, strategy credibility. The present text emphasizes the more basic distinction between assessment of normal insolvency proceedings, which corresponds to art. 4(1)(a), and analysis related to a resolution strategy, which corresponds to art. 4(1)(b)-(d).

[12] On which in banking see more generally *Hu*, Tex. L. Rev. 90, 1601.

dress and remove such impediments that have been identified by the resolution authority before the latter makes its related decision.[13] This also suggests that the starting point for the exercise of this power is the proposal by the bank itself, and that the resolution authority carries the burden of argumentation as to its potential refusal of such proposal and insistence on (presumably more intrusive) measures.

However, this procedural safeguard for proportionality may not end the related discussion. Resolution authorities also need substantive criteria in order to determine the appropriate level of interference with the business workings of the banks. It is on the basis of such criteria that resolution authorities will also assess the above-mentioned proposals by banks themselves.

Here follows a look[14] at three potential criteria[15] for such decisions to be made by banking-related public authorities in general, which is followed by an analysis of their comparative relevance for resolution authorities, as opposed to prudential supervisors. The second part of the analysis is informed by the idea that resolution is an orderly process to reduce the cost of bank failure.[16] In the area of impediments to resolvability, this is mostly about reducing the negative externalities created by the manner that a bank conducts its business, as a bank may impose on third parties a part of the costs that derive from the risks it assumes. This happens when failure influences the rest of the financial system because of the interbank market or because of the erosion of depositor confidence. The cost of potential bank failure to the stakeholders (in particular, the creditors and the resolution fund that may intervene in lieu of loss absorption by some creditors) of the individual bank themselves is also relevant.

As regards this last point, the fundamental objective of resolution in art. 31(2)(b) BRRD is, admittedly, oriented towards the financial system as a whole,[17] and classic creditor protection is somewhat "negative" in nature, as evidenced in the "no creditor worse off" principle. Still, averting, as much as possible, damages to the bank's creditors (in particular depositors, as the quintessential bank creditors) is precisely the most significant method to avoid disturbances in the functioning of the whole system.

[13] See *Cappiello*, in: European Central Bank, From Monetary Union to Banking Union, on the way to Capital Markets Union. New opportunities for European integration, 192 (193).

[14] Which draws on *Psaroudakis*, in: European Central Bank (ed), From Monetary Union to Banking Union, on the way to Capital Markets Union. New opportunities for European integration, 174 (184-190).

[15] In the sense of a set of indicators that may be combined with varying weight for each, or one of which may be so telling in one particular case that it compensates for the lack of others or overrules others. This is a *bewegliches System* in the sense of the classic analysis by *Wilburg*, Entwicklung eines beweglichen Systems im bürgerlichen Recht, 22-23.

[16] See *Cappiello*, in: European Central Bank, From Monetary Union to Banking Union, on the way to Capital Markets Union. New opportunities for European integration, 192.

[17] *Hadjiemmanuil*, in: European Central Bank, From Monetary Union to Banking Union, on the way to Capital Markets Union. New opportunities for European integration, 225 (232), as well as *Coleton*, JIBLR 27, 63 (78-79), refer to this as a significant difference between normal insolvency proceedings and resolution. See also *Haentjens/Wessels*, JIBLR 31, 396 (397-398). For a more radical formulation of the same point see *Hellwig*, in: Kenadjan (ed.), Too Big To Fail – Brauchen wir ein Sonderinsolvenzrecht für Banken?, 35 (50), who refers to the "straightjacket of the analogy to insolvency law" resulting from the creditor protection objective.

In this sense, there is a different emphasis in resolution but not a fundamentally different method.[18] Indeed, normal insolvency proceedings are not at all unrelated to the public interest themselves, as the orderly procedure for creditor protection is thought of as a means to restrict the wider (possibly market-wide) consequences of a merchant's insolvency.[19] However, this objective is more urgent, and harder to achieve in the case of banks, who are "more systemic" than other merchants,[20] and thus call for much faster[21] and more sophisticated proceedings,[22] but this is a (large, indeed) difference in degree rather than a difference in kind.[23] Lastly, normal insolvency proceedings are generally driven by creditors themselves, who make the crucial decisions required, while resolution is driven by the resolution authority.[24] This is a remarkable difference, but it should not be overestimated, as it does not necessarily result from a divergence between the interest of creditors and the public; instead, it can be attributed to the existence of numerous and disorganized creditors in the case of banks.

Given the analysis above, references to "public interest" as a peculiarity of resolution capture the particular significance of bank failure and the more sophisticated attempt to protect the public interest in cases of resolution. But they should not obscure the fundamental similarity of the methods used in normal insolvency proceedings and resolution, in which protection of individual creditors and public interest are connected with each other. Now it is time to examine, against this background, the individual criteria to be employed in order to determine the appropriate degree of intervention by administrative action.

First, interfering with the bank's corporate structure and governance is arguably less intrusive, and thus inherently "more proportional", than interfering with its substantive business strategy. The idea here is that a proper (i.e.. effective and transparent) structure

[18] *Binder*, in: Bank of Greece's Center for Culture, Research and Documentation (ed), Commemororative Volume for L. Georgakopoulos, 37 (44), makes the point that liquidation under normal insolvency proceedings might be beneficial to certain groups of creditors, so that there may indeed be a divergence between public and private interests here. While this is not impossible in one or the other particular case, it is hard to see how fire sales would be comparatively advantageous to creditors as a general matter, while creditor control over the proceedings is also of doubtful value to individual creditors of a universal bank, given the size of its liabilities and thus of its creditor classes. Whatever (unlikely) potential for such divergence there is, it is anyway adequately addressed by the "no creditor worse off" principle.

[19] See generally, on insolvency law as a "peace order", *Häsemeyer*, Insolvenzrecht, 22, and more specifically on the relevance of this point for bank resolution *Psaroudakis* in: Hopt/Tzouganatos (eds.), Das Europäische Wirtschaftsrecht vor neuen Aufforderungen, 41 (63-64).

[20] In the words of *Anderson*, JBL 2016, 670 (692): "… the potential contagion is of a different order when the debtor is a financial institution."

[21] See eg *Armour*, Making Bank Resolution credible, 6-7.

[22] As nicely put in the U.S. context by *Jackson/Skeel*, Harv. Bus. L. Rev. 2, 435 (449): "Bankruptcy judges do not ignore systemic issues. But neither they nor the parties can take control as fully and effectively at the outset of a case as regulators can under the Dodd-Frank resolution rules."

[23] On bank resolution as the "special insolvency law" for banks see *Psaroudakis* in: Hopt/Tzouganatos (eds.), Das Europäische Wirtschaftsrecht vor neuen Aufforderungen, 41 (62-65). Cf. also *Baird/Morrison*, Dodd-Frank for Bankruptcy Lawyers; *Marotzke*, JZ 2009, 763 (766); *Thole*, in: Kenadjan (ed.), Too Big To Fail – Brauchen wir ein Sonderinsolvenzrecht für Banken?, 219 (221-222), who makes the different, but not unrelated, point that it is not advisable to replace creditors' interest with systemic considerations.

[24] Cf. *Binder* in: Bank of Greece's Center for Culture, Research and Documentation (ed), Commemororative Volume for L. Georgakopoulos, 37 (44). See also n 17.

and governance[25] should generally be trusted to produce proper results and allow for the necessary measures to be more easily implemented in a crisis.[26] It is telling that the modern prudential regime deals quite extensively with compliance, financial and operational control systems, as well as with the composition and functioning (including remuneration) of senior management. From the point of view of resolution authorities, the more important issue is probably the reduction of unnecessary complexities in corporate structure, which may pose difficulties in the application of resolution measures, e.g. because this structure becomes too opaque as business activities and legal entities within the group are organized in a complex way, or because it involves foreign jurisdictions that create obstacles to the recognition and enforcement of resolution measures, or because it does not allow for practical division of the entity to be resolved into appropriate parts (e.g. because IT support has been organized at the group level by means of complex intra-group arrangements).

Second, the closer to failure a bank is, the more justified it seems for public authorities to exercise their powers. Generally speaking, this stems from a conception of these powers as a form of debt governance for banks, in the public interest. In particular, as known from general corporate law, in the "vicinity of insolvency" the corporation is no longer to be run in the interest of shareholders, or at least not solely on the orthodox "shareholder value" basis.[27] Shareholders have mostly lost their investment, and it is now the creditors' position that is at stake; management has to take account of this and to increasingly make decisions that are in the interest of creditors. In the case of banks,[28] it should be recalled that creditors, in particular depositors, are numerous, weak and disorganized, and the intervention of public authorities in the business workings of banks may correspondingly be conceived of as a method of creditor (in particular depositor) protection when the bank comes close to failure. The "vicinity of insolvency" would become "vicinity of failing or likely to fail" in the case of banks, as this is the triggering event for normal insolvency proceedings (or, alternatively, resolution) in which shareholders lose any control over the management of the bank's assets and liabilities.

This intervention by public authorities substitutes for the lacking ability of depositors to protect themselves, e.g. by means of covenants. It is not necessary for it to be regarded as a means of protection of each creditor's individual interest; it is, rather, arguable that the smooth functioning of the contracts with creditors contributes to the

25 An area of interest is preventing shareholder influence from going beyond the appropriate measure: cf. *Binder*, ZGR 2013, 760; *Binder*, SAFE Working Paper 96 (2015), 20 = EBOR 16 (2015) 469. It should be noted though that this is rather a matter of interest to the prudential supervisor than a resolvability issue.

26 Cf. more generally *Binder*, ZGR 2007, 745.

27 See in particular the classic analysis by Chancellor *Allen* in *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*, 1991 WL 277613 at 33-34 (Del.Ch.). See also *West Marcia Safetywear Ltd v Dodd* [1988] BCLC 250 (CA); *Davies*, Introduction to Company Law, 265; *Keay*, JBL 2002, 379 (385). For a radical criticism of this "shift of duty" doctrine cf. *Hu/Westbrook*, Col. L. Rev. 107, 1321 (1364 *et seq.*).

28 On the relevance of these thoughts regarding the pre-insolvency protection of creditors in the particular case of banks see *Psaroudakis* in: European Central Bank (ed), From Monetary Union to Banking Union, on the way to Capital Markets Union. New opportunities for European integration, 174 (181-183). This is consistent with a "contractarian approach" to banking regulation proposed by *Sepe*, Emory L.J. 327 (384). See also *Garten*, Fordham L. Rev. 57, 501 (543); *van der Weide/Kini,* B.C.L. Rev. 41, 195 (208).

public interest in the proper functioning of the financial system. Thus, the worse the prudential condition of a bank and the closer the bank is to failure, the "more proportional" the intervention by public authorities becomes.

This criterion is certainly significant for prudential supervisors, as evidenced in the connection between supervisory powers in art. 104 CRD IV and a failure or likely failure to comply with the CRR/CRD IV requirements (art. 97, 102 CRD IV), which brings closer the "failing or likely to fail" of art. 32 BRRD. The same could be remarked with respect to the triggers for early intervention according to art. 27(1) BRRD, which are clearly meant to capture circumstances leading up to a crisis that would call for irreversible measures.

The criterion is less significant for resolution authorities than for prudential supervisors. Resolution authorities' work is not directed at preventing bank failure (as this lies in the competence of the prudential supervisor) but at limiting the cost of a potential bank failure.[29] Correspondingly, art. 17 BRRD, unlike the above-mentioned art. 104 CRD IV, does not offer support for the use of this criterion. On the other hand, a higher probability of failure of a particular bank is leads, obviously, to a higher probability that the costs of failure will emerge. Therefore, measures to limit such potential costs are more justified as the chance of failure increases. In other words, and given that the cost of potential failure of an individual bank is never extinguished, the decision of the resolution authority on the acceptable level of cost may be influenced by the probability of failure. It is true that a prudential supervisor is competent to deal with this issue and take measures to reduce such probability; however, supervisory measures are no panacea and should not be thought to pre-empt any related consideration on the part of the resolution authority. Moreover, it has been explained above that the resolution authority is not indifferent to creditor protection at the individual bank. To conclude on this second criterion, it is less important here than from the point of view of prudential supervisors, but it is still relevant.

Third, the more systemically significant a bank is, the more cost its failure will bring about. It is reasonable that larger, more interconnected, and in other words more systemically significant, banks are subjected to a closer control of resolvability. It is not the probability of failure that causes closer scrutiny but rather the magnitude of the consequences that failure would cause. In simpler terms, this is where the "too big to fail" problem and the corresponding moral hazard arise. Indeed, there are some instances of additional regulatory burden on banks of particular systemic significance. Beyond the capital buffers in art. 131 CRD IV, that are only indirectly relevance here, one should take note of the risk-adjusted calculation to the resolution fund as per art. 103(7) BRRD. In the same vein, it is "more proportional" for resolution authorities to exercise their power related to resolvability impediments on such banks because of the greater risk involved. As a matter of public policy, intrusive regulation is also a counter-incentive for banks to become "too big to fail" and then externalize the risks stemming from their business to the resolution fund (and possibly even the budget). In other words, such intrusive regulation is still "more proportional" than other proposals that have been made in order to deal with such banks, such as the concept of preventive break-up. Clearly, this criterion is very closely linked with the area of competence of

[29] Cf. *Cappiello*, in: European Central Bank, From Monetary Union to Banking Union, on the way to Capital Markets Union. New opportunities for European integration, 192 (194).

resolution authorities, indeed more so than the case is with prudential authorities; therefore, it is reasonable to expect that it will be the most relevant one in the context of resolvability.

To conclude, requirements to remove resolvability impediments, indeed after receiving proposals by the bank on this process, should be regarded as a part of the dialogue between banks and resolution authorities. This dialogue and its outcome may seem burdensome at the time, but it helps avoid even more heavy-handed, and thus "less proportional", measures (such as the application of normal insolvency proceedings as resolution would not be feasible) when a crisis occurs.[30]

D. Proportionality and early intervention

Early intervention could be thought to be misplaced in this analysis, as it could be viewed as a matter for competent rather than resolution authorities. And yet, both the formal argument that it is found within the BRRD and, more importantly, its functional connection with bank failure, which early intervention is meant to prevent, establish its relevance in the present context.

Early intervention encompasses three stages of measures: Moving from the milder to the more intrusive, these are the following:

a) the general early intervention powers in art. 27 BRRD, such as requirements that a bank apply its recovery plan, a debt restructuring plan or change its business strategy (among other things);
b) the (full or partial) removal of senior management or the management body as per art. 28 BRRD, in which case it is still the bank that appoints replacements (though with approval or consent of the competent authority);
c) the appointment of a temporary administrator as per art. 29 BRRD, which is really the ultimate supervisory power and the most intrusive measure taken regarding a still-functioning bank.

Issues worth addressing with regard to early intervention include the justification in principle for such intervention, the trigger for early intervention and the choice among the available instruments of early intervention. As a preliminary remark, there is some overlap between art. 27 BRRD and the supervisory powers of art. 104 CRD IV; even if the wording of the powers is not the same in both cases, it often leads to the same result. For instance, changes in business strategy in the sense of art. 27(1)(f) BRRD could also be required on the basis of art. 104(1)(e) CRD IV. That the law refers to a measure as an instance of early intervention is redundant to the extent that the measure could be adopted on the basis of the abovementioned provision in the CRD IV. This redundancy does not make much practical sense and a change here would be appropriate.

The justification for early intervention has actually been presented above in the discussion on proximity to "failing or likely to fail" as a justification for intervention by

[30] Cf. more generally *Psaroudakis*, in: European Central Bank (ed), From Monetary Union to Banking Union, on the way to Capital Markets Union. New opportunities for European integration, 174 (175).

public authorities. Indeed, the shift from corporate governance to insolvency governance (i.e., the adoption of measures disempowering shareholders and protecting creditors) is gradual and characterized by an increasingly significant role played by public authorities as failure of a bank becomes a more likely possibility. This enhanced role is meant to prevent (preferably), but also prepare for, the shift to full insolvency governance if failure does occur.

This function (and justification) of early intervention also means that the two-sided relationship between proportionality and the BRRD is relevant here as well. Early intervention may comprise the most intrusive acts of public authority into the activities of a still functioning bank (in particular, the appointment of a temporary administrator, taking away from shareholders their fundamental competence to appoint management – though not their other competences), but it is also "more proportional" than triggering normal insolvency proceedings or resolution.[31]

As regards the trigger for early intervention itself, it becomes important precisely due to its intrusive nature. It is remarkable that mostly quantitative, "bright-line" approach has been adopted, though certainly not in pure form. In particular, EBA/GL/2015/03 par. 7(a) refers to the bank's score in the supervisory review and evaluation procedure (SREP), as per art. 97 CRD IV, as a basis for deciding on early intervention.[32] The process leading to this score is detailed in EBA/GL/2014/13.[33] In a nutshell, early intervention is triggered by an overall score of a "4" on the SREP, which indicates high risk.

The approach is, however, less "bright-line" than it looks at first sight. To begin with, SREP assessment itself necessarily involves some exercise of discretion by the competent authority, if within a well-built framework. Moreover, the competent authority has significant discretion regarding the use of the SREP score as an early intervention trigger. First, while an overall score of "4" is a trigger, the competent authority also has to *consider* applying early intervention in case of an overall score of "3" (which stands for medium risk) but when a "4" is given for a key indicator, in other words on one of the following four areas: internal governance and institution-wide controls, business model and strategy, capital adequacy, liquidity adequacy. Thus, there is in such cases some leeway for the competent authority to activate early intervention or not.

Second, the SREP score is not the only trigger, but is rather named in par. 7 of EBA/GL/2015/03 alongside "material changes and anomalies" and "significant events". It is fair to say that the guidelines adopt a mixed approach, with quantitative and qualitative variations of the test applied, in par. 7(a) and par. 7(b-c) accordingly. The former will be used first, as it is based on a more elaborate analysis for which the parameters have already been set by the SREP Guidelines. However, the latter remains available

[31] See *Psaroudakis*, in: Hopt/Tzouganatos (eds.), Das Europäische Wirtschaftsrecht vor neuen Aufforderungen, 41 (45).

[32] The same tendency towards a somewhat quantitative approach is found in art. 27(1) BRRD itself, which refers to "the institution's own funds requirement plus 1,5 percentage points" as an (optional) trigger for early intervention. On the other hand, that this formulation of the trigger is not imposed on Member States, is indicative for an unwillingness to impose an unqualified quantitative approach.

[33] The function of early intervention as a middle ground between ongoing supervision and proceedings related to bank failure is confirmed by the Guideline, which refers (at p 7) to itself as a link between the two areas (and thus between CRD IV and BRRD).

(probably as an exception rather than a tool of common application) in order to deal with harder cases. Third, the precise significance of the "trigger" is noteworthy. According to EBA/GL/2015/03 par. 8, the (so-called[34]) breach of the triggers does not automatically lead to the application of early intervention but rather initiates a further stage of decision-making by the competent authority as to whether to apply early intervention considering "the urgency of the situation and the magnitude of the breach". These are, again, open-ended terms that allow for discretionary decisions.

The overall method determined by the European Banking Authority (EBA), i.e. a quantitative approach as the main part of the exercise, complemented by more open-ended qualifiers, seems to strike the right balance here. Of course, the choice between rules and standards or, depending on how the terms are defined, between more concrete or abstract rules, is a broadly discussed matter. While the major advantage of concrete rules, established in advance, is predictability, such rules are often unable to capture all the relevant aspects so that they lead to over- and under-inclusion. Indeed, it has been suggested that concrete rules have to be very elaborate in order to minimize the risks, and that they are only worth formulating if the behaviour to be regulated occurs frequently and is homogeneous (and thus easier to capture effectively).[35] Early intervention is indeed a significant, and not terribly extraordinary, field of regulatory activity. Moreover, precisely because banking is a regulated business, it likely that the conduct of business and the problems therein present significant common features across banks. In this sense, this is an area in which it is advisable to develop gradually quite concrete rules. That open-ended criteria (in other words, standards or at least less concrete rules) are used to complement this approach is also reasonable, in particular given that early intervention is a rather recent field and related experience is still to be gathered.

Turning now to the internal structure of early intervention, which becomes important once the decision to initiate it has been made, it is remarkable that proportionality is written into the BRRD in so clear a manner. The second stage of early intervention (art. 28 BRRD), i.e. the removal of senior management or the management body, explicitly presupposes that the first stage of early intervention (art. 27 BRRD) is not adequate. The third stage (temporary administrator) similarly presupposes that the removal of managers, while leaving it to the bank to decide (subject to the competent authority's approval) who the successors will be, is not adequate. Given that each stage is more intrusive than the former, application of proportionality would be required anyway. However, the explicit reference to it has some procedural importance as it seems to impose on the competent authority a particular burden to justify the necessity of its decisions, i.e. the necessity of the chosen measure. It is a different matter, however, that the public authority retains some discretion in determining the proportionate response to the circumstances.

Lastly, proportionality does not apply only between stages of early intervention, but also within each stage. In the context of art. 27 BRRD, there are a variety of measures,

[34] As a matter of wording, the reference to a "breach" is unfortunate, as the triggers are not quite prohibitions, but rather descriptions of objective conditions, and early intervention itself is not a sanction (but rather a administrative measure of regulatory and preventive nature).

[35] On this discussion generally see *Diver*, Yale L. J. 93, 65 (75); *Ehrlich/R. Posner*, J. Legal Studies 3, 257 (273); *Kaplow*, Duke L. J. 42, 557 (573 *et seq.*); *E. Posner*, Harv. J. L. Pub. Pol'y 21, 101 (102, 112); *Psaroudakis*, Acting in concert in börsennotierten Gesellschaften, 456-457.

out of which the competent authority has to choose the most suitable. In art. 28 BRRD, the scope of removal of managers has to be determined. In art. 29 BRRD, a number of decisions regarding the appointment of a temporary administrator have to be made, depending on which measure may be more or less intrusive: The most significant decision is whether the administrator will replace the management body (which is then removed) or work with it (in which case the appointment comes down to a more or less comprehensive requirement that the administrator consents to management decisions). The competent authority also needs to determine the duration of the appointment and the functions that the temporary administrator will be assigned. While one is tempted to think that proportionality will almost always require limitations on the powers of the temporary administrator, things may be more nuanced. Third parties dealing with the bank, and on which the stability of the bank thus depends, may be interested in clarity or even a (somewhat) "fresh start". Therefore, it is possible to regard a *limited* appointment as unsuitable and disproportionate because it ultimately fails to achieve its target, while an appointment with more comprehensive mandate would be suitable and proportionate.

This last remark might even be summarized into a general principle. While the importance of proportionality in the present area, and in the broader banking regulation, is clear, it would be simplistic to overlook the need for regulation that can be more intrusive in the banking sector than elsewhere. In this sense too, "banks are special".

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