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Recovery and resolution of credit institutions and investment firms



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Directive 2014/59/EU of the European Parliament and of the Council, establishing a framework for the recovery and resolution of credit institutions and investment firms (BRRD) was adopted on 15 May 2014. By 31 December 2014, Member States were required to adopt and publish the laws, regulations and administrative provisions necessary to comply with it.

The BRRD is part of the second pillar of the European Union's Banking Union. It is considered to be a cornerstone in the European set of measures dealing with the failures of banking and financial institutions. Drawing conclusions from the inadequacy of existing insolvency regimes in the banking and financial sector, the BRRD provides for various resolution tools with the aim of preventing insolvency or, when insolvency occurs, to minimise negative repercussions by preserving the systemically important functions of the credit institutions and certain investment firms (collectively, Financial Institutions).

The supervisory and resolution authorities

Under the BRRD, Member States are required to designate a responsible authority that will apply the resolution tools, and exercise the resolution powers (Resolution Authority). The objective is to avoid a lengthy judicial approval of a crisis management measure while such measures may have to be taken urgently. The BRRD aims to: (i) ensure the continuity of critical functions; (ii) avoid significant adverse effect on the financial system; (iii) protect public funds; (iv) protect depositors covered by the European deposit guarantee schemes; and (v) protect clients' funds and assets (Resolution's Objectives).

In addition, the BRRD grants a significant role to the authority responsible for the prudential supervision of Financial Institutions

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(Supervisory Authority) and empowers it with the possibility of adopting a wide range of measures of early intervention, as a first step before the resolution, where a Financial Institution infringes or is likely in the near future to infringe the regulatory requirements such as capital adequacy. Among these measures the Supervisory Authority may require the management body of a Financial Institution to: (i) implement one or more of the arrangements or measures set out in the Recovery Plan (as defined below); (ii) draw up an action programme to overcome the problems identified; (iii) convene a meeting of shareholders; (iv) remove or replace one or more of its members; (v) draw up a plan for negotiation on restructuring of debt with some or all of the creditors of the Financial Institution; (vi) change the Financial Institution's business strategy; or (vii) change the legal or operational structures of the Financial Institution.

It is worth noting that following the entry into force of the Regulation (EU) No 1024/2013, conferring specific tasks on the European Central Bank (ECB) concerning policies relating to the prudential supervision of credit institutions, the ECB became the Supervisory Authority for Financial Institutions or groups of Financial Institutions which are considered as significant. Regulation (EU) No 806/2014, establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms, sets up a Single Resolution Board that will act as Resolution Authority for such significant Financial Institutions.

The recovery and resolution planning

According to the BRRD, Financial Institutions shall draw up, maintain, and update, at least annually, a recovery plan providing for measures to be taken by the Financial Institution to restore its financial position following a significant deterioration of its financial situation (Recovery Plan). Information that must be contained in a Recovery Plan is listed in Section A of the BRRD's Annex. On 6 May 2015 the European Banking Authority (EBA) published its Guidelines on the minimum list of qualitative and quantitative Recovery Plan indicators, setting out specific indicators that should be included for each category of the Recovery Plan's indicators. The Resolution Authority shall draw up and update, at least annually, a resolution plan which provides for the resolution actions to be taken by the Resolution Authority where a Financial Institution meets the conditions for resolution (Resolution Plan).

Financial support at group-level

The BRRD introduces the possibility for those Financial Institutions which are part of a group to enter into agreements to provide financial support to another group entity, under certain conditions. The financial support may take the form of a loan or a guarantee and can only be granted to a group entity that meets the condition for an early intervention (even when located in another Member State or a third-country), in order to prevent any financial instability within the group.

The resolution of a financial institution

Conditions for resolution. The competent Resolution Authority may take a resolution action (Resolution Procedure) in relation to a Financial Institution when it considers that three cumulative conditions are met. First, the Financial Institution is failing or is likely



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to fail according to the Supervisory Authority. Second, there is no reasonable prospect that any alternative private sector measure taken in respect of the Financial Institution would prevent its failure within a reasonable timeframe. Finally, the Resolution Procedure is necessary in the public interest (i.e., proportionate and necessary for the achievement of at least one of the Resolution's Objectives).

Resolution tools. The Resolution Authority may apply one or more of the four main resolution 'tools' contained in the BRRD. On the one hand, several tools allow the Resolution Authority to transfer all or a part of the shares, rights, assets or liabilities of a Financial Institution, without obtaining any consent from its shareholders, to: (i) a third party purchaser (the sale of business tool); (ii) a special purpose vehicle controlled by the Resolution Authority in order to continue providing some or all of the services and activities of the Financial Institution (the bridge financial institution tool); or (iii) to a special purpose vehicle controlled by the Resolution Authority in order to raise the value of the instruments transferred before selling them (the asset separation tool).

On the other hand, the bail-in tool allows the Resolution Authority to, among others, write down or convert capital instruments into shares, bail-in creditors by reducing the outstanding or principal amount due in respect of certain liabilities, cancel certain debt instruments, or convert certain liabilities into equity. The bail-in is considered to be the key resolution tool of the BRRD. For the purpose of the bail-in, Financial Institutions are required by the BRRD to hold a minimum of eligible liabilities and own capital (MREL). The MREL for each Financial Institution is to be determined by the Resolution Authority based on criteria which need to be published by the EBA in the form of technical regulatory standards by 3 July 2015.

The implementation of the BRRD in Luxembourg

On 28 May 2015, the European Commission urged Luxembourg, as well as several other Member States, to fully implement the BRRD. The Luxembourg Financial Authority (CSSF) published, on 7 April, the Circular 15/610 on *ad hoc* data collection within the context of the BRRD. The latter stresses that the CSSF will act as the Resolution Authority in Luxembourg. The implementation process of the BRRD in Luxembourg is still ongoing.

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