https://doi.org/10.15388/vu.thesis.121
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VILNIUS UNIVERSITY

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International Standards, the EU Bank Recovery and Resolution Legal Framework Origins, Objectives and Implementation Issues: Past, Present, Future

DOCTORAL DISSERTATION

Social science,
Law (S 001)

VILNIUS 2020

This dissertation was written between 2012 and 2019 at Vilnius University, including individual research carried out at the University of Oxford between 2018 – 2019.

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Pasauliniai standartai, ES bankų gaivinimo ir pertvarkymo teisinio reguliavimo ištakos, tikslai ir taikymo probleminiai klausimai: praeitis, dabartis, ateitis

DAKTARO DISERTACIJA

Socialiniai mokslai,
Teisė (S 001)

VILNIUS 2020

Disertacija rengta 2012 – 2019 metais Vilniaus universitete, iš jų 2018 – 2019 atliekant individualų tyrimą Oksfordo universitete.

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CONTENT

ABBREVIATIONS

AI – Artificial Intelligence
Art. – Article
BCBS – Basel Committee on Banking Supervision
BigTech – big technology firms.
BRRD – Bank Recovery and Resolution Directive
CRD – Capital Requirements Directive
CRR – Capital Requirements Regulation
DGS – Deposit Guarantee Schemes Directive
EBA – European Banking Authority
ECB – European Central Bank
EDIS – European Deposit Guarantee Scheme
EEC – European Economic Community
EMU – Economic and Monetary Union
ESMA – European Securities Market Authority
ESRB – European Systemic Risk Board
EU – European Union
FinTech – Financial Technology
FSB – Financial Stability Board
G20 – Group of Twenty
G7 – Group of Seven
GL – Guidelines
GSIB – Globally Systemically Important Bank
ITS – Implementing Technical Standards
IMF – International Monetary Fund
KA – FSB Key Attributes
MREL – Minimum Requirement for Eligible Liabilities
P. – page
RegTech – Regulatory Technology
RTS – Regulatory Technical Standards
SRB – Single Resolution Mechanism
SRM – Regulation establishing Single Resolution Mechanism
SSM – Single Supervisory Mechanism
TLAC – Total Loss Absorbing Capacity
TFEU – Treaty on the functioning of the European Union
UK – The United Kingdom of Great Britain and Northern Ireland
US – United States of America

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INTRODUCTION

Problem and relevance of the research

A growing number of empirical analyses demonstrate a strong positive link between the well-functioning financial system[1] and long-run economic growth[2] as well as financial stability[3]. The European Court of Human Rights[4] and the Court of Justice of the European Union[5] both consider financial stability as a public good. Financial law contributes to ensuring this public good through the legal regulation of banking activities.

A unique role of banks in financial markets and financial stability is defined by the fact that contrary to other commercial companies producing widgets, they produce money and credit – so-called financial widgets[6]. Banks work as intermediaries which channel savings through their financial widgets into productive activities of the society. Their activities and functions are

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[1] One of the critical functions of the financial system is maturity transformation as by enabling long-term investment projects, finance can help foster economic growth. MUELLER, D. The Oxford Handbook of Capitalism. Oxford University Press, Oxford, 2012. P. 168.

[2] LEVINE, R. Financial Development and Economic Growth: Views and Agenda. In Journal of Economic Literature, Vol. XXXV, June 1997, pp. 688 – 726, P. 720. GANGOPADHYAY, P.; CHATTERJI, M. Economics of Globalisation. Ashgate, England, 2005. P. 203; A Handbook. Financial Sector Assessment. The world Bank, International Monetary Fund, Washington, 2005. P. 50.

[3] SCHIPKE, Alfred; et all. Capital Markets and Financial Intermediation in the Baltics. International Monetary Fund, Washington DC, 2004. Appendix for an overview of the literature.

[4] The European Court of Human Rights in the context of banking has ruled that in the sensitive area of the stability of the banking system, national authorities have a wider margin of appreciation with regard to the proportionality of bank restructuring measures, and it has justified the derogation from shareholder rights on grounds of public interest on several occasions. See the European Court of Human rights decision No. 30417/96 of 7 November 2002. Olczak v. Poland, 07 11 2002; the European Court of Human rights decision No. 50357/99 of 1 April 2004. Camberrow MM5 AD v Bulgaria, 01 04 2004.

[5] The Court ruled that although there is a clear public interest in ensuring, throughout the EU, a strong and consistent protection of shareholders and creditors, that interest cannot be held to prevail in all circumstances over the public interest in ensuring the stability of the financial system established by the EU Treaties. See: Paragraph 54. Judgment of the Court (Grand Chamber) of 8 November 2016 (request for a preliminary ruling from the High Court — Ireland) — Gerard Dowling and Others v Minister for Finance. Case C-41/15. OJ C 6, 9.1.2017, p. 10–10; paragraph 91 Judgment of the Court (Grand Chamber) of 19 July 2016 (request for a preliminary ruling from the Ustavno sodišče Republike Slovenije — Slovenia) — Tadej Kotnik and Others v Državni zbor Republike Slovenije. C-526/14).

[6] GLEESON, Simon; GUYNN, Randall. Bank Resolution and Crisis Management: Law and Practice. Oxford University Press, Oxford, 2016. Paragraph. 1.01.

critical to the real economy and financial stability. However, there are also highly risky.

The increasing number of researches also shows that the financial system is not immune to financial instability and bank failures are a recurrent phenomenon since the beginning of banking in Europe[7]. Namely, when banks, the crucial development of a banking system and banking as a specialised profession (which encouraged the use of bills of exchange and written instructions as means of payment) emerged in XIII century in Renaissance Italy,[8] they faced great risks of potential failure. Most of the bank failures of the late Middle Ages and Renaissance were the result of large loans to rulers who refused or were unable to pay their debts. For example, the Peruzzi and Bardi banks failed in 1343[9] and 1345[10], respectively. These failures occurred as a result of King's Edward II of England failure to repay large loans which he borrowed from these banks to help finance the Hundred Years' War with France[11]. Later periods in Europe were not exempt from bank failures, though, reasons have been changing. In modern times, for example, the collapse of US Lehman Brothers resulted in the largest in history bankruptcy filing[12] and negatively impacted Europe's banking sector and financial market. History also shows that the Baltic banking sector and banks in the Republic of Lithuania were also not exempt from failures and difficulties.

Worth to note that banking crises could also be a distinct subset within the broader set of phenomena known as financial crises[13]. An extensive analysis performed by R. Aliber and C. P. Kindleberger[14] shows that bank failures were

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[7] See: HARTMANN, P.; BANDT, O.; PEYDRO, J. Systemic Risk in Banking after the Great Financial Crisis. In the Oxford Handbook of Banking, Second Edition (2nd ed.). Oxford University Press, Oxford, 2014. Chapter. 27.1.

[8] EAGLETON, C.; WILLIAMS, J. Money: A History. C&C Offset Printing, Co., Ltd, London, United Kingdom, 1997. P. 177. See more, HOGGSON, N.F. Banking Through the Ages: From the Romans to the Medicis – From the Dutch to the Rothschilds. Cosimo, New York, 2007. P. 63 - 81.

[9] KING, C.H.; MAY, A. J. A History of Civilisations: The Story of Our Heritage. Charles Scribner's Sons, 1969. P. 231.

[10] PERNIS, M.G.; ADAMS, L.S. Lucrezia Tornabuoni De'Medici and the Medici Family in the Fifteen Century. Peter Lang Publishing, Inc., New York, 2006. P. 11.

[11] *Ibid*.

[12] BALL, N. Laurence. The Fed and Lehman Brothers: Setting the Record Straight on a Financial Disaster. Cambridge University Press, Cambridge, June 2018. Preface ix.

[13] CALOMIRIS, C. W. The Past Mirror: Notes, Surveys, Debates. Banking crises yesterday and today. In *Financial History Review* 17.1 (2010), pp. 3-12. P. 4.

[14] See KINDLEBERGER, C. P.; ALIBER, R. Manias, Panics, and Crashes: A History of Financial Crises. Fifth Edition. John Willey & Sons, Canada, 2011.

coming in waves as well as displays, for example, the rather regular ten yearly recurrences of crises through most of the XIX century and to World War II. The post-World War II era was exceptional in its relatively calm financial markets and quietness concerning banking failures what also lasted through the early 1970s[15]. The liberalisation of banking and capital flows across borders, together with increasingly volatile macroeconomic conditions such as, for example, the weakened fiscal discipline of states, the abandonment of the Bretton Woods[16] exchange rate pegs and surges in inflation rates were followed by the return of banking crises at a frequency comparable to what had been experienced before. In sum, the IMF identifies 124 systemic crises over the period from 1970 to 2007[17]. The last systemic financial crisis we had in 2007 – 2009[18].

Empirical evidence clearly shows that despite the fact whether a bank failure is idiosyncratic or systemic, it could have a serious negative impact on human welfare. Furthermore, in particular, systemic banking crises can completely disrupt economies, and the human costs can be very real, for example, when health and education programs are significantly reduced to fund a government bailout of the failed banks. This could also substantially increase the public debt. In Europe, between October 2008 and October 2011 to maintain functions of banks that the provision of financial services for citizens and businesses would continue, governments of the Member States had injected public money into banks and issued guarantees on an unprecedented scale – the European Commission approved EUR 4.5 trillion (equivalent to 37% of the EU GDP) of state aid measures to financial institutions[19]. While academic research shows that the aided banks hardly improve their performance indicators in the years following government aid,

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[15] See. CAPRIO, Jr, G.; KLINGEBIEL, D. Bank Insolvency: Bad Luck, Bad Policy, or Bad Banking? In Annual World Bank Conference on Development Economics, 1996. P.1. <http://siteresources.worldbank.org/DEC/Resources/18701_bad_luck.pdf>

[16] See McKINNON, I.R. The Unloved Dollar Standard. From Bretton Woods to the Rise of China. Oxford University Press, Oxford, 2013.

[17] LAEVEN, L.; VALENCIA, F. Systemic Banking Crises: A New Database. IMF Working Paper, WP/08/224, 2008. P. 5. [accessed on 15 June 2019] <https://www.imf.org/external/pubs/ft/wp/2008/wp08224.pdf>.

[18] LAEVEN, L.; VALENCIA, F. Resolution of Banking Crises: The Good, the Bad, and the Ugly. Working Paper No. 10/146. IMF, 1 June 2010. P. 9.

[19] The European Commission. In *New crisis management measures to avoid future bank bail-outs*. [accessed on 8 August 2017] <http://europa.eu/rapid/press-release_IP-12-570_en.htm#footnote-1>.

indicating that bailouts, as legal instruments, are not sufficient to restore bank health[20].

Academic research and empirical analysis also show that the legal and regulatory environment matters for financial development[21] and that financial and banking sectors are better developed in countries with well-developed legal and regulatory systems[22]. Thus, the search of an appropriate legal framework and model for the supervision of financial markets and for dealing with banks facing difficulties, remains one of the most pressing financial law issues both at the global, the EU and national levels what also determines the importance of this research.

Considering the above mentioned, it would not be an exaggeration to say that banking crises are as old as banking. On the one hand, bank failures are unavoidable, like any other creations of human beings, on the other hand, to ensure an efficient, competitive banking system which supports growth, banks should be allowed to fail. Therefore, it is important to highlight that we discuss not about the legal framework which would eliminate bank failures (what is neither possible nor needed in the market economy), but about the legal framework which could ensure greater preparation and better management of bank failures in a way which allows to ensure the continuity of their critical functions[23] (in case a bank has such functions), decrease their cross-border spill-over effect, systemic magnitude and social impact.

In the European Union, global financial crisis and bank failures highlighted that the existing national *lex generalis* of standard bankruptcy procedures are

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[20] GERHARDT, M.; VENNET, R. V. Bank bailout in Europe and bank performance. In Finance Research Letters, Vol 22, August 2017, pp. 74 – 80, P. 74.

[21] LEVINE, R. Law, Finance, and Economic Growth. In Journal of Financial Intermediation Vol 8, 1999, pp. 8 – 35. P. 33.; GOLDSMITH, Raymond. Financial structure and development. Yale University Press, New Haven, 1969; HELLIWELL, J.; RAJ, Baldev. Long-Run Economic Growth. Studies in Empirical Economics. A Springer-Verlag Company, University of Wisconsin, 1996.; AGHION, Philippe; DURLAUF, Steven. Handbooks in Economics 22. Handbook of Economic Growth. Volume 1A. North-Holland, University of Wisconsin at Madison, 2005; ARNER, D. Financial Stability, Economic Growth, and the Role of Law. Cambridge University Press, Cambridge, 2007.

[22] KUNT, A.; LEVINE, R. Financial Structures and Economic Growth. A cross-country comparison of Banks, Markets, and Development. The MIT Press, Cambridge, Massachusetts, 2004. P. 3 – 5, 243 - 262; Levine, R. Law, Finance, and Economic Growth. In Journal of Financial Intermediation Vol 8, 1999, pp. 8 – 35. P. 8.

[23] For details with regard to the legal concept of critical functions see: BALČIŪNAS, L. The Legal Concept of Bank's Critical Functions, Implementation Challenges and the Role in the EU Bank Recovery and Resolution Framework. In *Teisės viršenybės link*, Vilnius University, Law Faculty, 2019. P. 30 – 54.

slow and usually unsuited[24] to the immediate need to halt a spreading panic[25]. There were also contagion concerns and fears that if bank fails, its critical functions, essential for the real economy and financial stability, would be discontinued and this might create a systemic crisis as the insolvency and bankruptcy proceedings allow legal entity to exit the market but are not aiming to ensure continuity of bank's critical functions. Therefore, in the circumstances there seemed often no alternative for resolving the crisis, apart from the use of taxpayer funds to support the financial system. The lack of relevant legal toolkit and the anxiety of the public for the use of unprecedented amounts of taxpayer's monies[26] for the banks' bailouts, encouraged the relevant bodies to act and look for new legal instruments which would allow to deal with failing banks by limiting the use of public monies and ensuring continuity of bank's critical functions.

It is said that crises bring opportunities. Indeed, the financial crisis has opened a window for the unprecedented political cooperation both at the global and the EU levels concerning the development and adoption of legal acts contributing to the development of bank recovery and resolution paradigm[27]. More specifically, an agreement on the final Bank Recovery and Resolution Directive and the regulation establishing Single Resolution Mechanism within the Banking Union was reached in record speed – within two years (from the perspective of developing and reaching an agreement on this EU regulatory framework, it is very quick – some other directives took more than ten years to be agreed). Worth to note that bank prudential supervision and bank resolution legal frameworks are mutually dependent, and they are two complementary instruments which should further contribute

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[24] See more about a fundamental difference between commercial companies and banks in GLEESON, Simon; GUYNN, Randall. Bank Resolution and Crisis Management: Law and Practice. Oxford University Press, Oxford, 2016, P.3.

[25] LASTRA, Rosa. Cross-border Bank Insolvency. Oxford: Oxford University Press, Oxford, 2011, P. V.

[26] In order to maintain essential financial services for citizens and businesses, governments have had to inject public money into banks and issue guarantees on an unprecedented scale: between October 2008 and October 2011, the European Commission approved €4.5 trillion (equivalent to 37% of the EU GDP) of state aid measures to financial institutions. The European Commission. In *New crisis management measures to avoid future bank bail-outs*. [accessed on 8 August 2017] <http://europa.eu/rapid/press-release_IP-12-570_en.htm#footnote-1>

[27] A special legal framework strengthening the legal instruments concerning the preparation and dealing with the banks facing difficulties.

to the establishment of well-functioning EU Internal Market for financial services.

However, due to rapid development and complexity of the EU bank recovery and resolution legal framework, its origins, link with other financial safety-net elements and interlink with the international standards is not always properly understood. Furthermore, the content of the legal provisions is not straightforward, and in practice, the role and content of legal resolution objectives, which are essential for consistent implementation, are neither properly understood nor researched. Moreover, we live in an age where everything seems to happen at a faster and faster speed, and the role of financial technologies (FinTech) for banking business is increasing. This also raises questions concerning opportunities and challenges for the implementation of the EU bank recovery and resolution legal framework objectives in the era of FinTech.

In summary, the relevance of this research is defined by i) the significance of legal institute being studied, it's novelty and growing perception of the importance of the EU bank recovery and resolution paradigm as an instrument to ensure the continuity of bank's critical functions; ii) implementation challenges due to lack of understanding of the EU bank recovery and resolution legal framework provisions and in particular its legal objectives; and iii) normative character of this research. These aspects substantiate the problem of this research: i) complexity of the bank recovery and resolution phenomenon due to its interlink with the international standards, company law, insolvency law, prudential supervision legal framework, state aid legal framework, deposit guarantee schemes legal framework, competition law, and interdisciplinary links, for example, with economic; ii) lack of understanding how this legal framework fits within the EU and national legal frameworks establishing other financial-safety net elements; iii) implementation challenges and issues arising when trying to determine the link between the EU bank recovery and resolution statutory framework provisions and it's legal objectives; and iv) complexity of creation of proper legal regulation due to changing banking business models, partnership with FinTech firms, and evolution of financial markets.

The object of the research and its limits

The object of this research is reflected in the title of the dissertation – research of "*International Standards, the EU bank recovery and resolution legal framework origins, objectives and implementation challenges: past, present, future*".

An understanding of the EU banking legal framework evolution, history and reasons for its development are profoundly important for getting the current situation in context and understanding how the EU arrived towards the adoption of the EU bank recovery and resolution legal framework, how it fits within the EU institutional and regulatory set-up.

Analysis of international standards and guidelines is performed considering that the development of the EU bank recovery and resolution legal framework could not be assessed without taking into the context developments at the global level and how these developments, as well as agreed international standards (in particular, in the field of bank recovery and resolution), have impacted the evolution of the EU banking legal framework and *vice versa*.

The object of this research does not cover the bank recovery and resolution legal framework developments in the United States. The Republic of Lithuania is a member of the EU. Therefore, prevailing trends in the legal regulation at the international and EU levels in the field of bank recovery and resolution are much more important. Furthermore, like any other Member State, the Republic of Lithuania is obliged either directly to apply relevant EU bank recovery and resolution legal provisions (regulations, delegated acts, regulatory technical standards, implementing technical standards) or to transpose them (directives, guidelines and recommendations) into the national law. The Republic of Lithuania had transposed the EU legal provisions into the national law[28], and the European Commission confirmed Lithuania's compliance, therefore, there is no need to perform separate analysis concerning this aspect.

The analysis of international and EU bank prudential legal provisions is performed to the extent it is needed for the achievement of defined research aim and objectives.

Aim and objectives of the research

The main aim of this research is – to research origins of the EU bank recovery and resolution legal framework and place in the EU financial safety-net, the impact of international standards for the EU bank recovery and resolution legal framework, the contents of this legal framework objectives and implementation challenges, and, to the extent permitted by the scope of

[28] Law on Financial Sustainability. *Valstybės žinios*, 2009, No XII-2053.

this research, to explore possible directions and ways of solving identified issues.

To achieve the aim, the following objectives are set:

1. To perform an in-depth analysis of the EU journey towards the adoption of the EU bank recovery and resolution legal framework, its origins and place in the EU financial safety-net.
2. To identify G20 changes to the global financial architecture focusing on the establishment of the Financial Stability Board, its international standards (in the field of bank recovery and resolution), and their impact to the EU bank recovery and resolution legal framework and its objectives.
3. To identify the EU bank recovery and resolution legal framework objectives, their contents and terms, their interlink and links with the wider EU legal framework provisions. To provide a methodological approach and to discuss theoretical and practical issues concerning the implementation of these objectives.
4. To clarify the legal definitions of financial technology and financial innovation, to check whether there is a trend and what are the drivers, if any, for collaboration between FinTech firms and banks; reactions of public authorities, if any, at the global and the EU level with regard to implications for the EU bank recovery and resolution legal framework objectives.
5. To identify potential opportunities and challenges for the EU bank recovery and resolution legal framework objectives (in particular, continuity of bank's critical functions) stemming from the collaboration between FinTech firms and banks, and to discuss relevant EU outsourcing legal framework aspects, limits and remaining misalignments.

Exploration of the research problem and practical significance of the research

It is only recently (in fact, only over the last decade) that the topic of bank recovery and resolution as an instrument for preventing and dealing with banks facing difficulties has attracted more attention. However, greater interest was shown mostly in foreign countries but not in Lithuania. More specifically, only a few scientific articles have been written and published in Lithuania.

In 2014, an article called "Financial Market Supervision Models and Trends of Legal Regulation"[29] not only focused on the bank prudential supervision legal framework but also provided a first glimpse towards the upcoming EU bank recovery and resolution legal framework. In 2019, very informative and important scientific article named "The Legal Concept of Bank's Critical Functions, Implementation Challenges and the Role in the EU bank Recovery and Resolution Framework"[30] was published by L. Balčiūnas.

However, the scope of the research in these articles is much narrower than the scope of the research in this thesis. This is because the scope of these articles is limited, and, therefore, they have limits as regards the possibility to take an integrated approach. Overall, it is possible to argue that in Lithuania no scientific research of wider scope on the topic (in particular, which would capture the EU bank recovery and resolution legal framework origins, evolution, the content of legal objectives and potential future implementation challenges) have been carried out in recent years. Therefore, this research aims to fill the mentioned gap in scientific studies that at present exist, as well as to encourage scientific discussion on this complex but important legal institute.

Over the last decade, foreign researchers have published quite a few studies on or related to the topic of bank recovery and resolution. For example, the following monographs that were published in recent years on the analysis the legal regulation of bank recovery and resolution may be mentioned: "Bank Resolution and Crisis Management: Law and Practice"[31], "Bank Resolution the European Regime"[32], "The Single Resolution Mechanism"[33].

However, all the studies of foreign researchers mentioned above differ from this research. First of all, neither of these researches provide an in-depth analysis of the EU legal framework evolution and journey towards the

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[29] BALČIŪNAS, Laurynas. Financial Market Supervision Models and Trends of Legal Regulation. In *Teisė*, 99, pp. 64 – 82, Vilnius, 2014. [interactive, accessed on 1 December 2018] <http://www.journals.vu.lt/teise/article/view/3372/2440>.

[30] BALČIŪNAS, Laurynas. The Legal Concept of Bank's Critical Functions, Implementation Challenges and the Role in the EU Bank Recovery and Resolution Framework. In Teisės viršenybės link. Vilnius University, Faculty of Law. Vilnius, 2019.

[31] GLEESON, S.; GUYNN, R. Bank Resolution and Crisis Management: Law and Practice. Oxford University Press, Oxford, 2016.

[32] BINDER, J. H.; SINGH, D. Bank Resolution. The European Regime. Oxford University Press, Oxford, 2015.

[33] HOUBEN, R.; VANDENBRUWAENE, W. The Single Resolution Mechanism. Anthems Press, London, 2014.

adoption of the EU bank recovery and resolution legal framework, nor an in-depth analysis of its objectives. The academic research works, usually either limit their scope to the high-level general description of these objectives[34] or just refer to the term of resolution objectives without explaining the content and avoid going into the in-depth analysis (in particular, concerning the resolution objective – the continuity of critical functions)[35], what shows that there is a lack of relevant academic research in this field as well. Neither of these researches provide an analysis of relevant EU outsourcing legal acts and their shortcomings, relevant for the achievement of the EU bank recovery and resolution legal framework objectives in the era of FinTech.

Considering the above mentioned, it could be stated that despite the increasing importance of the bank recovery and resolution legal framework as a new paradigm and as an integral part of the financial safety-net, there is a lack of scientific research which would provide detailed analysis of this legal framework origins, legal objectives and potential opportunities and challenges for their achievement in the era of FinTech. As a result, this research not only performs legal analysis from the historical perspective and current *status quo* of the international and the EU legal framework in this field, but also looks into potential issues and challenges for the legal framework objectives stemming from the future – considering changing banking business models and increasing partnership between banks FinTech firms.

What is more, this research highlights the EU bank recovery and resolution legal framework complexity and its interlinks with the company law, insolvency law, state aid law and challenges stemming from the remaining national discretions.

This research also has practical importance not only for the EU institutions but also the Republic of Lithuania – as it's legal bank recovery and resolution legal framework is based on the transposition for the Bank Recovery and Resolution Directive into the national law. Furthermore, the Republic of Lithuania is a member of the Banking Union and therefore a member of the Single Supervisory Mechanism and the Single Resolution Mechanism. Therefore, understanding of the EU bank recovery and resolution legal framework origins, objectives and potential implementation challenges is

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[34] E.g. BINDER, J. H.; SINGH, D. Bank Resolution. The European Regime. Oxford University Press, Oxford, 2015. Paragraphs 2.28 – 2.37.

[35] E.g. GLEESON, S.; GUYNN, R. Bank Resolution and Crisis Management: Law and Practice. Oxford University Press, Oxford, 2016. P. 217, 225, 245, 246, 250, 267, 275, 292.

important for correctly applying the legal framework at the national level and performing tasks as a national resolution authority. The research is also important from the perspective of prudential supervision legal framework and for supervisory authorities as there are interlinked elements with the EU bank recovery and resolution legal framework.

The Methodology of the Research

To achieve the aim and objectives of this research logic-systemic, comparative, teleological, document analysis, historical, descriptive and linguistic methods were used. Namely:

1. **Logic-systemic Method.** A big part of the research is based on this method. The research systematically analyses the international and the EU legislation, how the EU bank recovery and resolution legal framework is linked to other elements of the financial safety-net. What is more, this method is not only used for the analysis of separate components (e.g. legal resolution objective) but also for the analysis of the role of all of them (e.g. how legal resolution objectives are linked to the legal framework provisions as well as interlined between each other). This method is also used to identify relevant links between the legal provisions of the EU bank recovery and resolution legal framework and, for example, EU prudential supervision, outsourcing, state-aid etc. legal frameworks.
2. **Comparative Method.** This method, for example, is used to identify and compare international standards and the EU legal framework linked to the concept of critical functions and relevant elements.
3. **Teleological Method.** This method is employed seeking to properly explore and assess the aim of the analysed laws and specific norms, as well as, for the analysis of legal framework objectives set by the legislator.
4. **Document Analysis Method.** This method was used to collect particular data and documents (e.g. international standards, EU legal acts, case law, preparatory materials, consultations and other documents) that is necessary to perform this research.
5. **Historic Method.** This method is mostly used in Chapter I to reveal the circumstance, origins and evolution of the EU financial law towards the adoption of the EU bank recovery and resolution legal framework and changing composition of financial safety-net elements.

6. **Descriptive Method.** This method, for example, is used to describe the background and various aspects, including an overview of the existing legal framework.
7. **Linguistic Method**. This method helps to explain the meaning of various terms (e.g. critical functions, operation continuity, continuity of access to FMIs etc.) whose understanding is necessary for the analysis of the defined aim and objectives.

Sources of the Research

To achieve the aim and objectives of this thesis, the research was based on international and the EU legal acts, scientific research papers of the Oxford, Cambridge and Harvard and other universities, available limited case law, decisions of public authorities, non-confidential meeting documents of the EU institutions as well as research papers of these institutions, and other sources.

Specifically, legal acts include the EU level one and level two legal acts which altogether set the EU bank recovery and resolution legal framework, and which were transposed into the national law of the Member States. These include Bank Recovery and Resolution Directive[36], Single Resolution Mechanism Regulation[37], Capital Requirements Regulation[38], Capital Requirements Directive[39], Deposit Guarantee Schemes Directive[40] etc. International soft law legal acts include, for example, Key Attributes[41],

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[36] 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 Text with EEA relevance. *OJ L 173, 12.6.2014, p. 190–348.*

[37] Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010. *OJ L 225, 30.7.2014, p. 1–90.*

[38] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC Text with EEA relevance. *OJ L 176, 27.6.2013, p. 338–436.*

[39] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 Text with EEA relevance. *OJ L 176, 27.6.2013, p. 1–337.*

[40] Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes Text with EEA relevance. *OJ L 173, 12.6.2014, p. 149–178.*

[41] Key Attributes of Effective Resolution Regimes for Financial Institutions. Financial Stability Board, 2014, Basel. [accessed on 8 August 2017] < http://www.fsb.org/wp-content/uploads/r_141015.pdf>.

Guidance on critical functions and critical shared services[42], Guidance on operational continuity[43], Guidance on continuity of access to FMIs[44] etc.

When trying to find answers to identified theoretical and practical issues, works of foreign scientists were analysed as well. For example, T. Huertas, E. Hupkes, R. Lastra, E. Posner, S. Gleeson, P. Craig, W. Douglas, R. Ramirez, D. Schoenmaker, Ch. Brummer, M. Carney, Ch. Goodhart and others.

The research also benefits from the analysis of relevant existing (though, a limited number due to the novelty of the legal framework) decisions of EU institutions and the European Court of Justice and the European Court of Human Rights.

What is more, for further reasoning and verification of the submitted statements, non-confidential meeting and preparatory work documents of EU institutions (Council of the European Union, European Commission, European Parliament, European Central Bank, etc.), methodological recommendations of legal acts and other sources are used as well.

Finally, the research has also made use of the author's practical experience gained when working with the legal regulation issues at the global, EU and national levels. In particular is relevant author's experience acquired from the participation in working groups at the Financial Stability Board, and from the negotiations of the EU Banking Union files at the Council of the European Union, in particular, the bank recovery and resolution directive negotiations during political and technical trilogues with the European Parliament and the European Commission. The research also benefits from the author's extensive experience gained when contributing to the development of technical advice and second level EU directly applicable legal acts[45] fulfilling the mandates set

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[42] Guidance on Identification of Critical Functions and Critical Shared Services. Financial Stability Board, Basel, 2013. [accessed on 12 July 2015] <http://www.fsb.org/wp-content/uploads/r_130716a.pdf>

[43] Guidance on Arrangements to Support Operational Continuity in Resolution. The FSB, 18 August 2016. Author contributed to the development of these guidance as an expert at the FSB working group. [accessed on 18 August 2016] <http://www.fsb.org/wp-content/uploads/Guidance-on-Arrangements-to-Support-Operational-Continuity-in-Resolution1.pdf>.

[44] Guidance on Continuity of Access to Financial Market Infrastructures for a Firm in Resolution. Author contributed to the development of these guidance as an expert at the FSB working group. The FSB, Basel, 6 July 2017 [accessed on 6 July 2017] <http://www.fsb.org/wp-content/uploads/P060717-2.pdf>.

[45] Technical advice on the delegated acts on critical functions and core business lines (Art. 2(2) of Directive 2014/59/EU); Technical advice on the delegated acts on the circumstances when exclusions from the bail-in tool are necessary (Art. 44(11) of Directive 2014/59/EU);

by the EU level one legal acts, as well as when supervising and dealing with banks restructuring transactions.

Structure of the Dissertation

The aim and objectives of this research determine the structure of the dissertation. In addition to the introduction and conclusions, the research consists of three separate but interlinked Parts.

The first Part looks into the past and focuses on the analysis of the EU journey towards the adoption of the EU bank recovery and resolution legal framework. An understanding of the EU financial law history is profoundly important for getting the present EU bank recovery and resolution legal framework and its objectives in context. Furthermore, a broader perspective is needed as it provides a better picture with regard to the role of this framework and how it forms a new element of financial safety-net. Considering that the EU bank recovery and resolution legal framework cannot be assessed in isolation from the developments at the global level, this Chapter also provides analysis of the G20 changes to the global financial architecture, establishment of the Financial Stability Board, development of the bank recovery and resolution international standards, and implications to the EU legal framework in this field.

The second Part looks into the present situation and identifies the role and importance of current legal resolution objectives, identifies theoretical and practical issues. This Chapter also provides an in-depth analysis of the EU

Recommendation on the equivalence of confidentiality regimes of Bailiwick of Guernsey, Oriental Republic of Uruguay, Republic of Korea; Technical advice on classes of arrangements to be protected in a partial property transfer[45] (Art. 76 of Directive 2014/59/EU); Technical advice on delegated acts on the deferral of extraordinary ex-post contributions to financial arrangements[45] (Art. 104(3) of Directive 2014/59/EU, Art. 71(2) of SRMR); Guidelines on the provision of information in summary or collective form for the purposes of Art. 84(3) of Directive 2014/59/EU; Implementing Technical Standards on the uniform formats, templates and definition for the identification and transmission of information by competent authorities and resolution authorities to the EBA for the purposes of Art. 4(7) of Directive 2014/59/EU; Guidelines on the application of simplified obligations under Art. 4(5) of Directive 2014/59/EU; Regulatory Technical Standards on contractual recognition of write-down and conversion powers under Art. 55(3) of Directive 2014/59/EU; Regulatory Technical Standards on a minimum set of the information on financial contracts that should be contained in the detailed records and the circumstances in which the requirement should be imposed (Art. 71(8) of Directive 2014/59/EU); Regulatory Technical Standards on independent valuers under Art. 36(14) of Directive 2014/59/EU; Comparative report on bank recovery plan options; Comparative report on the application of simplified obligations and waivers in bank recovery and resolution planning etc.

bank recovery and resolution legal framework provisions and how they are linked to those objectives and *vice versa*. More specifically, this part discusses each objective separately, defines its content, interlink with other objectives and the other provisions of the EU bank recovery and resolution legal framework.

The third Part, considering that we live in the era of FinTech which cannot be ignored, looks into potential theoretical and practical future challenges for the achievement of the EU bank recovery and resolution legal framework and its objectives. Therefore, this part clarifies the definitions and difference between the terms FinTech and financial innovation, performs analysis of drivers for collaboration between FinTech firms and banks, reactions of public authorities at the global and the EU levels. This part also identifies what kind of opportunities and challenges such collaboration could bring to the application and implementation of the EU bank recovery and resolution legal framework provisions and ensuring one of the key '*after crisis*' bank recovery and resolution legal framework objectives – to ensure the continuity of failing bank (or bank which faces difficulties) critical functions which are essential to the real economy and financial stability. Furthermore, it discusses relevant EU outsourcing legal framework provisions, their limits, shortcomings and the need to better align with the EU bank recovery and resolution legal framework and its objectives.

Finally, considering the aim, objectives and statement of the dissertation to be defended, the respective conclusions and suggestions received from the performed research are presented.

Statements of the Dissertation to be Defended

1. In the market-based economy, we cannot avoid bank failures, but up to date legal framework can help to manage them better. Therefore, dynamic not a static approach is important concerning the legal framework in the field of bank recovery and resolution, to adjust financial safety-net elements and legal instruments designed to deal with the challenges coming from the future, rather than just fixing what has not worked previously. The EU's recent reforms are the move forward, though they were made *post factum*.
2. Attempts to ensure greater harmonisation concerning the EU legal framework for dealing with failing banks or banks facing difficulties can be traced back to the creation of the EEC. However, real actions at the EU level were taken only after the financial crisis and following

the global agenda, which greatly influenced the development of the EU bank recovery and resolution legal framework as a new paradigm.

3. The EU bank recovery and resolution legal framework objectives play a vital role within the framework. Namely, the EU bank recovery and resolution legal framework lists five legal resolution objectives. However, their content is not straightforward. It is argued that the first objective – to ensure the continuity of bank's critical functions – is one of the most important and complex. Other objectives are linked to it and support this objective.
4. FinTech developments create not only opportunities but also challenges for the implementation and achievement of the EU bank recovery and resolution legal framework objectives, in particular, the continuity of bank's critical functions. The partnership between FinTech firms and banks will increase the relevance of legal provisions linked to outsourcing. This will require greater attention from regulators at the global, EU and national levels. Greater alignment between the EU prudential supervision legal framework (such elements as the legal framework for outsourcing) and the EU bank recovery and resolution legal framework and its objectives will be needed as well.

I. THE EU JOURNEY TOWARDS THE ADOPTION OF THE EU BANK RECOVERY AND RESOLUTION LEGAL FRAMEWORK, ORIGINS, AND THE IMPACT OF INTERNATIONAL STANDARDS

1.1. Introduction

Since the creation of the European Economic Community and subsequently, the EU banking legal framework was one of the key focus areas. Therefore, an understanding of the EU banking legal framework evolution, history and reasons for its development is profoundly important for getting the current situation in context and understanding how the EU arrived towards the adoption of the EU bank recovery and resolution legal framework, how it fits within the EU institutional and regulatory set-up.

The first Part consists of four Chapters. It starts from the clarification of the definition of 'bank' which is used in the context of this work. The second Subchapter provides an in-depth analysis of the EU journey towards the adoption of the EU bank recovery and resolution legal framework in a chronological sequence. Such analysis is also important, taking into account the fact that the EU banking legal framework directly impacts the evolution and development of the Republic of Lithuania legal framework in this field. Therefore, it is important to understand the context for the development of the EU legal framework, which ultimately had to be transposed into the national law.

Furthermore, the development of the EU bank recovery and resolution legal framework could not be assessed without taking into the context even a broader perspective. Namely, developments at the global level and how these developments, as well as international standards, agreed at the global level have impacted the evolution of the EU legal framework and vice versa. Therefore, the second Subchapter focuses on the in-depth analysis of G20 changes to the global financial architecture, establishment of the Financial Stability Board, development of the bank recovery and resolution international standards, and implications to the EU financial law.

Finally, key conclusions are provided at the end of Chapter I.

1.2. The journey from the creation of the European Economic Community (EEC) towards the adoption of the EU bank recovery and resolution legal framework, and creation of the Banking Union

A historical perspective and analysis are important as it provides a better understanding of the evolution of the EU banking legal framework, how and why the EU bank recovery and resolution legal framework supplements the financial safety-net elements, and how it is linked to the EU bank prudential supervision legal framework. This research is also important for the subsequent analysis of the EU bank recovery and resolution legal framework objectives and their implementation challenges in Chapters II and III.

Therefore, this Subchapter starts from the analysis of Europe's early attempts to create integrated common market in the field of financial services and banking, and first attempts to harmonise banking prudential supervision, bank reorganisation and winding-up legal frameworks, first cross border banking failures and legislative reactions, as well as, different waves of harmonisation attempts and their failures. The in-depth analysis explains how the EU legal framework setting financial safety-net elements has evolved during different stages of EU integration. It gradually moves towards the adoption of the present EU bank recovery and resolution legal framework, the EU institutional set-up changes and the creation of the Banking Union.

1.2.1. The creation of the European Economic Community and the first attempts to set a legislative agenda in banking

In 1957 six countries (Belgium, Italy, Germany, France, Luxembourg and the Netherlands) have signed the Treaty of Rome[46] (the '**EEC Treaty**') establishing the European Economic Community (the '**EEC**')[47].

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[46] See more: MEUNIER, S; McNAMARA, K. Making History – European Integration and Institutional Change at Fifty. Oxford: University of Oxford Press, 2007. P. 197.

[47] Following the advent of the European Union (EU) in 1993, the treaty that had established the EEC remained one of the EU's core documents, though the EEC itself was renamed the European Community (EC), and the EC was embedded into the EU. With the entry into force of the Lisbon Treaty in 2009, the EC was eliminated, and the Treaty of Rome that had established it was formally renamed the Treaty on the Functioning of the European Union. In Encyclopaedia Britannica. [accessed on 20 July 2017] <https://www.britannica.com/event/Treaty-of-Rome>.

At that time the UK (which already had a strong banking and financial services industry compared with continental Europe[48]) proposed a Free Trade Area around the customs union of the EEC[49] which was rejected. As a result, the UK had chosen to remain outside the EEC and to establish the European Free Trade Association with other non-EEC European States[50]. However, to the UK's surprise, the EEC made rapid economic advancement, in particular, stimulated by France and Germany what, as a result, encouraged the UK to reconsider its strategy with regard to joining the EEC. It made its first application to join in 1961. However, it was vetoed after the intervention by the French President Charles de Gaulle (as well as the second application made in 1967)[51]. The third UK application was made in 1969 when Georges Pompidou (who succeeded de Gaulle) became the French President. This time the application was accepted and the UK[52] was invited to join the EEC together

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[48] The Financial Surplus of the Private Sector 1961. Bank of England, 1961. [accessed on 15 August 2017] <https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/1962/the-financial-surplus-of-the-private-sector-1961.pdf?la=en&hash=50AAD3C3445001FDB32D5FFCDC6E62FBF19A59F9>; inflows and Outflows of Foreign Funds. Bank of England, 1962 [accessed on 15 August 2017] <https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/1962/inflows-and-outflows-of-foreign-funds.pdf?la=en&hash=9C5C0A9F35785BD9F715B8A04F5B988C12F3D224>. UK overseas portfolio investments 1959 to 1961. Bank of England, Quarterly Bulletin 1962 Q2. [accessed on 15 August 2017] <https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/1962/uk-overseas-portfolio-investments-1959-to-1961.pdf?la=en&hash=C28787103A6D8AF594B7D194E22B4F2CF232F2A8>.

[49] See: The EEC and Britain's late entry. The National Archives of the United Kingdom. [accessed on 18 November 2018] <https://www.nationalarchives.gov.uk/cabinetpapers/themes/eec-britains-late-entry.htm>.

[50] Namely, in 1959 Britain signed the Stockholm Convention with other non-EEC European states (Austria, Denmark, Norway, Portugal, Sweden and Switzerland) and created the European Free Trade Association (EFTA). However, EFTA was no competitor for the EEC and was ineffective in establishing a useful free trade area. See: The EEC and Britain's late entry. The National Archives of the United Kingdom. [accessed on 18 November 2018] <https://www.nationalarchives.gov.uk/cabinetpapers/themes/eec-britains-late-entry.htm>.

[51] The UK commonwealth ties, domestic agricultural policy, and close links to the US (fears that this could lead to an Atlantic community dominated by the US were seen as obstacles in joining the EEC; while for the UK, an argument in favour of joining the EEC was that it might eventually evolve into a full-scale Atlantic community. The French President, Charles de Gaulle who also saw the UK as a threat to his goal of using the EEC to amplify France voice in world affairs, vetoed the UK's application in 1963 and in 1967. See: The EEC and Britain's late entry. The National Archives of the United Kingdom. [accessed on 18 November 2018] <https://www.nationalarchives.gov.uk/cabinetpapers/themes/eec-britains-late-entry.htm>.

[52] Worth to note, that the subsequent UK government was unhappy with the terms of the EEC membership and held a referendum already in June 1975. Though a substantial majority voted in favour of the UK's membership in the EEC. See: The EEC and Britain's late entry. The

with Ireland and Denmark in 1973[53]. The UK's acceptance to the club is an important moment, because, as we will see from the subsequent research, it significantly increased its role in shaping Europe's legal framework, in particular, in the field of banking and financial services (though not always according to its plan) and ultimately impacted the EU journey towards the adoption of the EU bank recovery and resolution legal framework.

Worth to note that it was planned that Norway would join the same year as the UK, however, contrary to Ireland and Denmark, a referendum held in this country rejected the idea of becoming a member of the EEC. Greece joined the EEC in 1981. Subsequently, Spain and Portugal became members in 1986[54].

The EEC Treaty aimed at creating a common market and customs union among its Member States[55] as the national markets were highly segmented. It's principles, in particular, the freedom of establishment and the freedom to provide services together with the coordination of legislation were also building blocks for the development of the European banking market. Article 67 of the EEC Treaty provided that during the transitional period the Member States should gradually remove restrictions and abolish discriminatory treatment affecting capital movements between them, to the extent necessary for the proper functioning of the Common Market.

As a result, in 1962, the Council adopted the General Programme setting legislative agenda for the abolition of restrictions on freedom to provide services[56]. In the field of banking, there were two general statements: i) restrictions as regards services other than those connected with movements of capital, shall be abolished before the end of the second year of the second stage, and ii) restrictions as regards services connected with capital

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National Archives of the United Kingdom. [accessed on 18 November 2018] <https://www.nationalarchives.gov.uk/cabinetpapers/themes/eec-britains-late-entry.htm>.

[53] Read more: CRAIG, P.; BURCA, G. EU Law, Text, Cases, and Materials (Sixth Edition). Oxford University Press, Oxford, 2015. P. 6.

[54] Ibid.

[55] The treaty establishing the European Atomic Energy Community, for the purpose of developing peaceful applications of atomic energy was signed by Belgium, Italy, Germany, France, Luxembourg and the Netherlands the same day and together with the treaty establishing the European Economic Community is called as the Treaties of Rome.

[56] General Programme for the abolition of restrictions on freedom to provide services. OJ 2, 15.1.1962, p. 32–35.

movements, shall be abolished concurrently with the liberalisation of such movements[57].

What is more, the Commission appointed a Group of Experts chaired by Professor Claudio Segre to examine all elements for the development of a European Capital Market (the topic which continues to be discussed in 2019[58]) and banking in Europe was an important part. In 1966, the so-called Segre report was issued[59], which also included the analysis of different banking regulations of the EEC six Member States[60]. The report stated that in most Member States "*the arrangements concerning bank supervision date from measures taken to palliate the effect of the great economic crisis of the inter-war period*"[61]. The same report also stated that competition among similar banks in the various EEC Member States would remain unequal because of disparities in the legal rules under which they operate. For example, a variety of rules concerning the collection[62] of funds (management of the bank's liabilities), and employment funds[63] (management of assets held by banks) were highlighted. This report raised early banking prudential supervision and legal framework concerns noting that differences in legal rules result in variation of banking supervisory approaches across the Member States what impedes the creation of a European Capital Market. Finally, already at that time, it was noted that "*harmonisation should be embarked upon systematically rather than be left to develop as an when local pressures make themselves felt*"[64] (as we will see it was hard to achieve this approach in practice). All these steps actuated the first wave of harmonisation in the field of banking.

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[57] Title V, C, b) of the General Programme.

[58] The Commission relaunched the ambition of creating the Capital Markets Union with the aim to deepen and further integrate the capital markets of the 28 EU Member States in 2015. See Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions Action Plan on building a capital markets union. European Commission, Brussels, 30 September 2015, COM/2015/0468 final. [accessed on 25 November 2018] <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52015DC0468>.

[59] The Development of a European Capital Market. Report of a Group experts appointed by the EEC Commission. European Economic Community, the Commission, Brussels, November 1996. (the '**Segre Report**') [accessed on 12 July 2016] < http://aei.pitt.edu/31823/1/Dev_Eur_Cap_Mkt_1966.pdf>.

[60] At that time only 6 States were members of the EEC.

[61] P. 269 of the Segre Report.

[62] P. 271 – 272 of the Segre Report.

[63] P. 272 -

[64] P. 271 of the Segre Report.

1.2.2. The first wave of harmonisation: the adoption of the first EEC legal acts in banking and the journey towards the Banking Directive

In 1972, the Commission, chaired by German Whilhelm Haferkamp, proposed a draft directive on the coordination of legislative, regulatory and administrative dispositions concerning the access to the non-stipendiary activities of credit institutions and their exercise which captured many banking legal regulation and supervision aspects[65]. Already at that time a draft directive aimed at harmonising across the Member States the legal provisions linked to authorisation procedures[66], creation of branches[67], solvency, liquidity, profitability ratios[68], deposit insurance[69], activities of foreign banks in the EEC and EEC banks abroad, credit information exchange[70], withdrawal of authorisation and winding-up procedures[71]. As it can be seen, this was an ambitious directive which aimed at harmonising many important financial safety-net elements (banking prudential supervision, deposit insurance and winding-up rules for dealing with failing banks) across the Member States. However, the Commission confronted strong opposition from the newly accepted Member State, in particular, the UK and its banks[72]. As noted by E. M. Druol this objection to the proposal was linked to the fact that even for the UK had by far the most developed banking system of the EEC, it (Denmark to a certain extent as well) did not have formal, written banking legislation and certain mechanisms foreseen in a draft directive (e.g. authorisation to access banking activities), and didn't want to change its principles-based and information supervision approach[73].

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[65] GHOSH, R. A.; QURESHI, S. M. From Great Depression to Great Recession. The Elusive Quest for International Policy Cooperation. International Monetary Fund, 2017. P. 63
[66] Section II, Articles 2 to 6 of a draft directive.
[67] Section III, Articles 7 to 9 of a draft directive.
[68] Section IV, Articles 14 to 17 of a draft directive.
[69] Art. 18 of a draft directive.
[70] Art. 20 of a draft directive.
[71] Section VIII, Articles 24 to 27 of a draft directive.
[72] SARGENT, J. Pressure Group Development in the EC: Role of BBA. In *Journal of Common Market Studies*, Blackwell, Vol 16-17, 1981. Pp. 269 – 85. P. 275.
[73] DRUOL, M.E. Banking Union in Historical Perspective: The Initiative of the European Commission P. 917. The Initiative of the European Commission in the 1960s–1970s. In JCMS 2016 Volume 54. Number 4. pp. 913–927

This was one of the first clashes between the UK and the EEC which identified different approaches to banking supervision and its legal regulation. The UK won the fight. As a result, the Commission had to change tactics by moving from the systemic approach (also highlighted in the 1966 Segre report, see above) capturing all relevant elements in one directive, to the step by step approach which, as we will see, focussed on the adoption of separate directives.

In 1973, the Council (based on Article 57(2)[74] of the EEC Treaty requiring unanimity) considering the provisions of the General Programme, adopted Directive 73/183/EEC[75] on the abolition of restrictions on freedom of establishment and freedom to provide services for self-employed activities of banks and other financial institutions. Furthermore, this Directive stated that the Commission and the representatives of the authorities responsible in the Member States for the supervision of banks should meet regularly to search for solutions which might arise from the implementation of the Directive as well as should ensure appropriate coordination among themselves within the limits of their respective powers[76]. The removal of certain restrictions aiming at opening up the domestic markets of the Member States was just the beginning of the journey as greater coordination of laws and cooperation among the supervisory authorities was needed to ensure a common playing field. This aspect is also relevant today.

In this context, it is also important mentioning that at the global level work towards greater coordination among banking supervisors was also ongoing. In 1974, the central bank governors of G-10 (currently, the G-10 is composed of European countries (Belgium, France, Germany, Italy, the Netherlands, Sweden, Switzerland and the United Kingdom), North America (Canada and the United States) and Asia (Japan), in the aftermath of serious disturbance in international currency and banking markets, failures of Bankhaus Herstatt in

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[74] Now Article 53 of the Treaty on Functioning of the European Union.

[75] Council Directive 73/183/EEC of 28 June 1973 on the abolition of restrictions on freedom of establishment and freedom to provide services in respect of self- employed activities of banks and other financial institutions Official Journal L 194, 16/07/1973 P. 0001 – 0010.

[76] Art. 7 of the Council Directive 73/183/EEC of 28 June 1973 on the abolition of restrictions on freedom of establishment and freedom to provide services in respect of self- employed activities of banks and other financial institutions Official Journal L 194, 16/07/1973 P. 0001 – 0010. [accessed on 18 November 2018] <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31973L0183&from=EN>.

West Germany and the Israeli-British Bank[77], initiated the establishment of the Basel Committee on Banking Regulations and Supervisory Practices[78] (known as the **Basel Committee** or the **BCBS**). As argued by Goodhart, the importance of the BCBS was led by so-called '*truism*[79]' – it was recognised that the financial markets have become global in scope, while the regulation and supervision remained national, subject to national legislation and jurisdiction[80]. Subsequently, this caused and continue to cause all kind of tensions about competition between financial institutions headquartered in different countries and create the 'level playing field' issue as no country could tighten financial regulation unilaterally as their banks could potentially lose their competitive edge compared with the international rivals [81]. The BCBS was designed as an instrument to reach a common regulatory basis between Europe, North America and Japan. In 1975, the BCBC issued the Concordat setting out principles for sharing supervisory responsibility for banks' foreign branches, subsidiaries and joint ventures between host and parent (home) supervisory authorities[82]. This was also a reaction to the changing landscape of global finance as banks were establishing non-branch affiliates in foreign countries of lower solvency requirements what as a result pushed to consider consolidated supervision over the solvency and capital adequacy base resulting in the rise of home country control principle in banking supervision[83]. As we will see, a so-called home country control principle was gradually also embodied in the ECC framework and still continues to play an important role in the EU.

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[77] GOODHART, C. The Basel Committee on Banking Supervision: A History of Early Years 1974 – 1997. Cambridge: Cambridge University Press, 2002. P. 77.

[78] See more: History of the Basel Committee. [accessed on 20 November 2018] <https://www.bis.org/bcbs/history.htm>.

[79] After the financial crisis, Schoenmaker formulated so called 'financial trilemma theory' stating that a stable financial system, international banking, and national financial policies for supervision and resolution are incompatible, as any two of the free objectives can be combined but not all and one has to give. SCHOENMAKER, D. Governance of International Banking: The Financial Trilemma. Oxford: Oxford University Press, 2013. P. 7.

[80] GOODHART, C. The Basel Committee on Banking Supervision: A History of Early Years 1974 – 1997. Cambridge: Cambridge University Press, 2002. P. 1.

[81] GOODHART, C. The Basel Committee on Banking Supervision: A History of Early Years 1974 – 1997. Cambridge: Cambridge University Press, 2002. P. 1 – 2.

[82] 1975 Concordat. Report to the Governors on the supervision of banks' foreign establishments. BS/75/74e. BCBS, Basel 1975. P. 2 – 4. [accessed on 15 May 2017] <https://www.bis.org/publ/bcbs00a.pdf>.

[83] PASINI-LUPP, F. The Logic of Financial Nationalism: The Challenges of Cooperation and the Role of International Law. Cambridge University Press, Cambridge, 2017. P. 67.

Whereas in 1977, the Council (on the basis of Article 57(2)[84] of the EEC[85] Treaty requiring unanimity) adopted Directive 77/780/EEC[86] (the '**First Banking Directive**') aiming to coordinate some of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions in the EEC. In particular, it focused on some of the most obstructive difference between the laws of the Member States linked to the definition of credit institution, authorisation provisions, supervision of credit institutions performing cross border activities through the established branch in different Member States, and set the basis for the principle of home country control to be further developed in the EU future legislation. This principle entrusted home supervisors with the responsibility for the supervision of banks operating within branches in the other Member States[87].

Furthermore, in order to ensure the implementation of the Directive, an Advisory Committee (known as the **Banking Advisory Committee**)[88] composed of the competent (supervisory) authorities of the Member States of the EEC was established alongside the Commission[89]. The aim was also to further 'formalise' and increase cooperation and coordination between the competent authorities and the Commission through this Committee[90]. It was also expected that the Committee would facilitate closer coordination with regard to the future legislation in banking. Worth to mention that the Banking Advisory Committee was so-called European BCBS as it usually was

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[84] Now Article 53 of the Treaty on Functioning of the European Union.

[85] Proposal for a Council Directive on the coordination of laws, regulations and administrative provisions governing the commencement and carrying on of the business of credit institutions. The Commission, Brussels, 10 December 1974, COM(74) 2010 final. [accessed on 15 May 2017] <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:51974PC2010&from=EN>.

[86] First Council Directive 77/780/EEC of 12 December 1977 on the coordination of the laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions. OJ L 322, 17.12.1977, p. 30–37.

[87] Title II of the Banking Directive.

[88] In 2003 this committee was transformed into the European Banking Committee which ultimately evolved to the European Banking Authority which was established on 1 January 2011 as part of the European System of Financial Supervision. 2004/10/EC: Commission Decision of 5 November 2003 establishing the European Banking Committee (Text with EEA relevance). Official Journal L 003, 07/01/2004 P. 0036 – 0037. Recital 5; Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC. OJ L 331, 15.12.2010, p. 12–47.

[89] Art. 11 of the First Banking Directive.

[90] Recitals 18, 19 of the First Banking Directive.

discussing identical issues simultaneously with the BCBS, however, as stated by Goodhart '*it became in practice the BCBS where the main decisions were taken, with the EC Directives transcribing the positions agreed within the BCBS*'[91].

Compared with the initial draft issues in 1972, the ambition and the level of legal harmonisation (because of the reasons mentioned above) was much lower, while the legal provisions for dealing with failing banks were completely removed from the First Banking Directive. In the recitals of the Directive, its limits were also recognised. Namely, it was noted that even though the eventual aim is to introduce uniform authorisation requirements throughout the Community for comparable types of credit institutions, the Directive is just initial stage and specifies only certain minimum requirements to be imposed by all Member States[92]. Finally, it also highlighted that the aim of integration could be achieved only if the particularly wide discretionary powers which certain national supervisory authorities have for authorising credit establishments are progressively reduced[93]. To sum up, even though the provisions of the Directive were quite general, it paved the way for subsequent measures and future harmonisation of rules in the field of banking supervision[94].

In 1983, the Council (on the basis of Article 57(2)[95] of the EEC Treaty requiring unanimity) adopted Directive 83/350/EEC[96] Directive on the supervision of banks on a consolidated basis. The adoption of this Directive was influenced by the discussions and principles agreed at the Basel Committee. Despite its vague provisions and recognition that the process of consolidation and supervision will continue to be carried out according to the national procedures, it also contributed to the harmonisation by i) introducing the principle of supervision on a consolidated bases in all Member States (which was not the case before), ii) setting general rules for the application of

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[91] GOODHART, C. The Basel Committee on Banking Supervision: A History of Early Years 1974 – 1997. Cambridge: Cambridge University Press, 2002. P. 2.
[92] Recital 7 of the First Banking Directive
[93] Recital 9 of the First Banking Directive.
[94] Subsequently adopted directives: Council Directive 83/350/EEC of 13 June 1983 on the supervision of credit institutions on a consolidated basis, OJ L 193, 18.7.1983, p. 18–20; Council Directive 86/635/EEC of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions. OJ L 372, 31.12.1986, p. 1–17, etc.
[95] Now Article 53 of the Treaty on Functioning of the European Union.
[96] Council Directive 83/350/EEC of 13 June 1983 on the supervision of credit institutions on a consolidated basis. OJ L 193, 18.7.1983, p. 18–20.

this principle and cooperation with non-member countries[97], and iii) setting obligation for the Member States to ensure that there would be no legal impediments preventing exchange of information necessary for supervision on a consolidated basis[98].

1.2.3. 1985 White Paper, 1987 Single European Act and the first steps towards the Economic and Monetary Union

The journey and integration of the single market in banking and not only was slow. Considering this, in 1985 the European Council called on the Commission to draw up a detailed programme including the timeline for achieving a Single Internal Market. As a result, A White Paper – Completing the Internal Market – which was proposed by Lord Cockfield[99] was published in 1985 (the '**1985 White Paper**')[100]. This paper dramatically recognised that '*momentum was lost partly through the onset of the recession, partly through a lack of confidence and vision*'[101] and that '*the time for talk has passed and the time for action has come*'[102]. It set an action programme of legislative proposals and measures needed in order to complete the Internal Market by 1992. Though, as noted by professor P. Craig, it would be mistaken to think that the Internal Market could have been 'completed' by 1992 or any date thereinafter, as evolution of factors (such as technological change, financial innovation), and changing patterns of risks and consumer behaviour can generate the need to reduce obstacles and develop new Internal Market measures[103].

In the field of legal regulation, on the basis of experience gained from the lengthy adoption of the first Directives[104], the paper suggested that in order to

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[97] Art. 6 of the Council Directive 83/350/EEC of 13 June 1983 on the supervision of credit institutions on a consolidated basis. OJ L 193, 18.7.1983, p. 18–20.
[98] Art. 5 of the Council Directive 83/350/EEC of 13 June 1983 on the supervision of credit institutions on a consolidated basis. OJ L 193, 18.7.1983, p. 18–20.
[99] The UK Commission for the Internal Market, Tac law and Customs.
[100] Completing the Internal Market. White Paper from the Commission to the European Council. COM(85) 310 final, Brussels, 14 June 1985.
[101] *Ibid.*, P. 4.
[102] *Ibid.*, P. 5.
[103] CRAIG, P.; BURCA, G. EU Law, Text, Cases, and Materials (Sixth Edition). Oxford University Press, Oxford, 2015. P. 10.
[104] Article 57(2) and 100 of the EEC Treaty required Council's unanimity, and it was quite complicated to agree on all technical details unanimously as any Member State could block it.

speed-up with the creation of the Internal Market (in particular, this was relevant in the fields of banking and financial services) there is a '*need to find a new approach*' which would balance between what is essential to harmonise, and what may be left to mutual recognition of national regulations and standards[105]. This also marked a change of strategy from aiming to achieve the full all-encompassing harmonisation of national rules to more flexible approach by leaving detailed technical specifications outside the Directives, relying more on mutual recognition principle[106] or using the Council's delegation powers under Article 155 of the EEC Treaty in order to '*off-load [it from] technical matters*'[107]. As we will see later, in particular, such delegation has increased after the Financial Crisis once the European Supervisory Agencies were created.

With regard to legislative proposals in the field of banking, the 1985 White Paper highlighted the need of further incorporation of two principles in the EEC legal framework, namely: i) a mutual recognition in financial services principle[108]; and ii) a home country control for supervision of financial institutions principle[109] (at the global level this principle was promoted by the Basel Committee's 1975 Concordat[110], while in the EEC it was to a certain extent included in the First Banking Directive). The Commission considered that both of these principles in the field of banking and financial services could

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[105] P. 18 of the White Paper.

[106] Completing the Internal Market. White Paper from the Commission to the European Council. COM(85) 310 final, Brussels, 14 June 1985. P. 20.

[107] *Ibid.*

[108] The mutual recognition in financial services principle was introduced following the rulings (in particular, Cassis de Dijon judgement, Rewe Zentral AG v. Bundesmonopolverwaltung fur Branntwein, 1979, ECR 649, Case 120/78) of the Court of Justices and support from the European Parliament and the Dooge Committee which have stressed the principle that goods lawfully manufactured and marketed in one Member State must be allowed free entry into other Member State. The White Paper suggested to apply this principle for financial services as well. See more: White Paper from the Commission to the European Council. COM(85) 310 final, Brussels, 14 June 1985. P. 22.

[109] The home country control principle meant attribution of the primary task of supervising the financial institution to the competent authorities of its Member State of origin, to which would have to be communicated all information necessary for supervision. The authorities of the Member State which is the destination of the service whilst not deprived of all power, would have a complimentary role.

[110] See: 1975 Concordat. Report to the Governors on the supervision of banks' foreign establishments. BS/75/74e. BCBS, Basel, 1975. [accessed on 15 September 2018] <https://www.bis.org/publ/bcbs00a.pdf>.

be implemented on the basis of minimal coordination[111] (especially on such matters as authorisation, financial supervision and reorganisation winding up, etc.) and minimum harmonisation[112] of relevant legal provisions among the Member States. Considering this, the 1985 White Paper (considering global developments at the BCBS), listed a number of bank-specific regulatory measures[113] which also included the Commission's commitment to provide a proposal for a Directive on bank reorganisation and winding-up of credit institutions and a recommendation on the establishment of a guarantee system of deposit within the Community in order to have a more harmonised approach when dealing with banks facing difficulties or failing.

Furthermore, the approach set in the 1985 White Paper and the Solemn Declaration[114] contributed to the adoption of the 1987 Single European Act[115]. Following the momentum set in the 1985 White Paper '*to achieve a genuine*'[116] Single Internal Market (an area with no internal border and in which there is free movement of goods, persons, services and capital) by the end of 1992, introduced quite fundamental changes to the EEC Treaty. Considering recommendations provided in 1985 White Paper, this Act, among other things, aimed at increasing the number of cases (including in the field of financial services) where the Council take decision by a qualified majority rather than by unanimity[117] which was hard to achieve and, therefore,

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[111] White Paper from the Commission to the European Council. COM(85) 310 final, Brussels, 14 June 1985. P. 27.
[112] Ibid., P. 28.
[113] A full list of Commission's measures in the field of banking: Proposal for a Directive on the accounts of banks by 1985; Proposal for a Directive on the accounts of foreign branches of banks by 1985; Proposal for a Directive on the freedom of establishment and the freedom to supply services in the field of mortgage credit by 1985; Proposed Recommendation on the harmonisation of the concept of own funds by 1985; Proposed Recommendation on the establishment of a guarantee system of deposit within the Community by 1986; Proposed Recommendation on the control of large exposures by credit institutions by 1986. Annex to Completing the Internal Market. White Paper from the Commission to the European Council. COM(85) 310 final, Brussels, 14 June 1985. [accessed on 15 September 2018] <http://aei.pitt.edu/1113/1/internal_market_wp_COM_85_310.pdf>.
[114] On 19 June 1983 in Stuttgart, the ten Heads of State or Government of the Member States of the European Communities, in the meeting within the European Council, signed the Solemn Declaration on European Union. [accessed on 15 November 2017] <https://www.cvce.eu/en/obj/solemn_declaration_on_european_union_stuttgart_19_june_1983-en-a2e74239-a12b-4efc-b4ce-cd3dee9cf71d.html>.
[115] Single European Act. OJ L 169, 29.6.1987, p. 1–28.
[116] VALDEZ. S.; MOLYNEUX, P. An Introduction to Global Financial Markets (Seventh Edition). Palgrave Macmillan, London, 2013. P. 357.
[117] Art. 6(7) of the Single European Act. OJ L 169, 29.6.1987, p. 1–28.

substantially delayed decision-making and the legislative process. This significant change was also supported by the UK[118].

What is more, the Act introduced another important change which allowed the Council to confer (delegate) on the Commission (in the acts which the Council adopts) power for the implementation of rules[119]. As a result, this implemented the 1985 White Paper recommendation and legally enabled the Commission itself to adopt implementing measures.

In this context, it is also worth to mention the developments at the global level. Namely, the move from the gold standard to the Bretton Woods system of fixed exchange rates[120] required the European governments to look into the future and think about the mechanism which would allow stabilising exchange rates, considering that the US became increasingly reluctant to intervene in foreign exchange markets[121]. It was argued that the proper functioning of the EEC requires exchange rate stability[122]. In the academic literature, a so-called the '*impossible trinity theory' (*supported by the Mundell-Fleming model) emerged which stated that free movement of capital, exchange rate stability and independent national monetary policies are incompatible in the long term[123].

As a result of the global developments, academic research insights, and using the momentum generated by the adoption of the Single European Act,

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[118] The UK, led by the Government of M. Thatcher, who usually was considered as anti-European, supported the adoption of the Single European Act on the grounds that without moving from unanimous voting to qualified majority voting an effective European level government would be impossible. Even though M. Thatcher did not want a European level government with extensive powers over a wide range of policy areas, but she wanted that the EEC had the power to strike down those policies of national governments that were market restricting. See: MORGAN, G. The Idea of a European Super-state. Public Justification and European Integration. Princeton University Press, Oxfordshire, 2007. P. 173.

[119] Art. 10 of the Single European Act. OJ L 169, 29.6.1987, p. 1–28.

[120] The Bretton Woods Agreement was reached in 1944 by all World War II allied nations and was aimed at setting and planning the post-war financial order. For details see: LAMOREAUX, N.; SHAPIRO, I. The Bretton Woods Agreements. Yale University Press, the US, 2019.

[121] CHANG, M. Economic and Monetary Union. Palgrave, London, 2016. P. 10.

[122] Ibid.

[123] A theory was firstly proposed by R. Mundell and M. Fleming. See: MUNDEL, R. A Theory of Optimum Currency Areas. In *the American Economic Review*, 51(4), 1961, pp. 657–65; FLEMING, M. Domestic Financial Policies under Fixed and Floating Exchange Rates. In IMF Staff Papers 9, 1962, pp. 369 – 377. MUNDEL, R. On the History of the Mundell-Fleming Model. In IMF Staff Papers, Vol. 47, Special Issue, 2001, pp. 215 – 228. This model continues to be quoted in the latest literature, e.g.: FORREST, J.; YING, Y.; GONG, Z. Currency Wars. Offense and Defence Through Systemic Thinking. Springer, 2008. P. 391

in 1989 the Commission issued Delors Report[124] which set out a three-stage plan for reaching Economic and Monetary Union (the '**EMU**'). The creation of the EMU was considered necessary to maintain the sustainability of the single market in financial services. On the basis of the impossible trinity theory, the report stated that the completion of the single market would link national economies much more closely what will bring considerable opportunities but could only be achieved if the regulatory policy at national and Community levels will respond adequately to the structural change[125]. Therefore, it suggested establishing (in a federal form) European System of Central Banks, composed of a new independent institution (now known as the European Central Bank) and national central banks which together would be responsible for the Community monetary policy[126].

The report also indicated three stages towards the creation of the EMU. The first stage aimed at ensuring the free movement of capital between the Member States (the period from 1 July 1990 to 31 December 1993)[127]. The second stage aimed at convergence of Member States' economic policies and strengthening of cooperation between Member States' national central banks[128]. The third stage aimed at the gradual introduction of the euro as the single currency and the implementation of a common monetary through the European System of Central Banks composed of national central banks and the ECB[129]. Worth to mention, the United Kingdom and Denmark gave notification of their intention not to participate in the third stage of EMU and, therefore, not to adopt the euro. These two Member States, therefore, have exemptional arrangements with regard to their participation in the EMU, which are detailed in the protocols relating to these two countries annexed to the founding Treaties of the EU[130]. Finally, the report noted that the final stage

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[124] Report on economic and monetary union in the European Community. Committee for the Study of Economic and Monetary Union. 17 April 1989. (**the 1989 Delors Report**) [accessed on 15 October 2017] < http://aei.pitt.edu/1007/1/monetary_delors.pdf>.
[125] P. 10 of the 1989 Delors Report.
[126] P. 21 of the 1989 Delors Report.
[127] P. 30 of the 1989 Delors Report.
[128] P. 33 of the 1989 Delors Report.
[129] P. 35 of the 1989 Delors Report.
[130] See the Protocol on certain provisions relating to the United Kingdom of Great Britain and Northern Ireland and the Protocol on certain provisions relating to Denmark to the Treaty on European union, signed at Maastricht on 7 February 1992. Official Journal of the European Communities, C 191, 29 July 1992 [accessed on 15 November 2016] <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:C:1992:191:FULL&from=EN>.

of the EMU would imply complete freedom of movement for persons, goods, services (including financial services), and capital, as well as, irrevocably fixes exchange rates between national currencies and a single currency[131]. This stage still continues.

Altogether, the above-mentioned measures aimed at ensuring not only greater and speedier common market integration, but also integration and harmonisation of legal rules in banking as it was understood that this is an essential element for the functioning of the integrated common market in the field of financial services. Furthermore, as noted by certain authors[132], it was also acknowledged that actual financial market integration is more developed than financial market legal regulation at the Union level.

1.2.4. The second wave of harmonisation: adoption of the Second Banking Directive, and failed attempts to harmonise bank reorganisation, winding-up and deposit insurance legal framework

In 1989, following the ambitious banking legal regulation agenda set in the 1985 White Paper, the Council adopted (under new qualifying majority voting rules) the Directive on the coordination of laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of credit institutions and amending Directive 77/780/EEC (the '**Second Banking Directive**')[133]. It entered into force on 1 January 1993.

The Second Banking Directive reinforced the home country control principle set in the Banking Directive and introduced the so-called '*European passporting regime*' which was further developed by the future EU legal acts. This principle means that bank authorised in any home Member State should be free to establish branches and to provide cross-border services (either traditional banking and payment services or investment-related services)

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[131] P. 13 of the 1989 Delors Report.

[132] GALANOPOULOU, V. The FSA as an Institutional Model for the Emergence of a Single (Unified) European Financial Services Regulator. In *European Business Law Review*, 14, 2003, Issue 3, pp. 277–323, P. 295.

[133] Second Council Directive 89/646/EEC of 15 December 1989 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions and amending Directive 77/780/EEC. *OJ L 386, 30.12.1989, p. 1–13*. < https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A31989L0646>. In 1997, the European Commission also issued Commission Interpretative Communication – Freedom to provide services and the interest of the general good in the Second Banking Directive. 97/C 209/04, JOC_1997_209_R_0006_0.

through the Community in host Member State without a separate authorisation[134], on the basis of the fundamental principle of home country supervision.

With regard to the level of harmonisation worth to mention the preamble of this Directive which stated that the approach which has been adopted is to achieve only the essential harmonisation necessary and sufficient to secure the mutual recognition of authorisation and of prudential supervision systems, making possible the granting of a single licence recognised throughout the Community and the application of the principle of home Member State prudential supervision[135]. As a result, in the Directive, it was already acknowledged that it could be implemented only simultaneously with specific Community legislation[136] dealing with the additional harmonisation of technical prudential supervision matters such as own funds and solvency ratios[137].

To sum up, the approach adopted in this Directive further encouraged to move towards the common market in banking and indicated the future direction for harmonisation of banking prudential supervision legal framework across the Member States. The subsequent EU prudential supervision legal framework (together with already enacted Directives) focused on four key areas: i) consolidated supervision[138]; ii) own funds[139]; iii) solvency ratio[140]; and iv) large exposure[141]. All the Directives falling under

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[134] Art. 61) of the Second Banking Directive.
[135] Recital 8 of the Second Banking Directive.
[136] Recital 9 of the Second Banking Directive. Council Directive 83/350/EEC of 13 June 1983 on the supervision of credit institutions on a consolidated basis, OJ L 193, 18.7.1983, p. 18–20; Council Directive 86/524/EEC of 27 October 1986 amending Directive 77/780/EEC in respect of the list of permanent exclusions of certain credit institutions. OJ L 372, 31.12.1986, p. 1–17. Council Directive 86/635/EEC of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions. OJ L 372, 31.12.1986, p. 1–17; Council Directive 89/299/EEC of 17 April 1989 on the own funds of credit institutions OJNoL124,5.5.1989, p.16.
[137] Recital 9 of the Second Banking Directive.
[138] Council Directive 83/350/EEC of 13 June 1983 on the supervision of credit institutions on a consolidated basis. OJ L 193, 18.7.1983, p. 18–20; Council Directive 92/30/EEC of 6 April 1992 on the supervision of credit institutions on a consolidated basis. OJ L 110, 28.4.1992, p. 52–58.
[139] Council Directive 89/299/EEC of 17 April 1989 on the own funds of credit institutions. OJ L 124, 5.5.1989, p. 16–20.
[140] Council Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit institutions. OJ L 386, 30.12.1989, p. 14–22.
[141] 87/62/EEC: Commission Recommendation of 22 December 1986 on monitoring and controlling large exposures of credit institutions. OJ L 33, 4.2.1987, p. 10–15.

these categories were codified in the Banking Directive of 2000/12/EC[142] before the introduction of the Euro.

However, even though the bank prudential supervisions, as one of the elements of the financial safety-net, got a lot of attention from the legislator and the Member States (what to a certain extent was derived by the adoption of international principles and standards by the BCBS at the global level), progress with the development of the EU common regulatory framework for other financial safety-net element, in particular, harmonisation of rules for the bank reorganisation, winding-up and deposit guarantee schemes was slow.

The Commission, following ambitious regulatory agenda set in the White Paper, already in 1985, put forward the proposal for a Council Directive on the reorganisation and the winding-up of credit institutions[143] (the '**draft Directive on bank reorganisation and winding-up**'). The Commission noted that there is a tendency in the laws and practice which are in force in the Member States[144] to apply reorganisation measures, aimed at preventing credit institutions from becoming insolvent, as soon as financial difficulties become apparent, so as to maintain saver's confidence in the banking system usually this was done with the government support). At the same time, the Commission acknowledged that it would be too difficult to attempt to unify those laws and practices without firstly securing mutual recognition and introducing the home country control principle with regard to these proceedings across borders. Therefore, the Directive did not aim to harmonise national legal frameworks regarding reorganisation measures and winding-up proceedings but rather to ensure mutual recognition (i.e. automatic recognition and relief across all EU Member States) and coordination of these procedures by the Member States, based upon further incorporation of home country control principle (i.e. that action taken by the home country where the parent bank is established should be automatically recognised by the host authority where, for example, the branch of that parent bank is established) in this area.

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[142] Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions. OJ L 125, 5.5.2001, p. 15–23.

[143] Proposal for a Council Directive on the coordination of laws, regulations and administrative provisions relating to the re-organization and the winding-up of credit institutions. COM/85/788FINAL-SYN46. OJ C 356, 31.12.1985, p. 55–63. [accessed on 12 September 2016] <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:51985PC0788&from=EN>.

[144] See Annex to the draft Directive on reorganisation and winding-up.

In this context, it is also worth noting how the reorganisation measures were defined in the Directive, as the term might be a bit confusing. For the purpose of this Directive '*reorganisation measures*' meant measures which are intended to safeguard or restore the financial situation of a credit institution, however, only if they satisfy the following conditions[145]. Firstly, those measures should be included in the list set out in the Annex of the Directive. This list separately listed measures provided in each Member State and included[146], for example, the power to perform inspections, appointment of special administrator or auditor, the power to appoint one or more competent persons to investigate and report on conduct of the business of an authorised institution etc. (now these measures are widely known as supervisory or early intervention measures). The other two conditions included the requirement that such measures should be designed to avoid the opening of a winding-up procedure[147] and they were decided on before any declaration that the credit institution was insolvent[148].

However, the adoption of this Directive failed at that time. The Commission came back to this Directive in light of the Bank of Credit and Commerce International collapse in 1991 which had direct implications for the amendments to the Basel Concordat at the global level[149], and which also highlighted issues with regard to mutual recognition of taken measures across the EU in the field of bank reorganisation and winding-up. The failure of the Bank of Credit and Commerce International resulted in winding-up proceedings that commenced in both Luxembourg and England led to a complex conflict of laws issues with far-reaching legal and practical consequences. The Commission used this case as the opportunity to highlight that there is the need for a more coherent system for handling the liquidation of an international banking group in a way which would provide for equitable treatment of depositors and other creditors in all Member States[150]. However, this was not sufficient to achieve significant progress at that time. As we will

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[145] Art. 2(1) of the draft Directive on reorganisation and winding-up.
[146] Art. 2(1)(a) of the draft Directive on reorganisation and winding-up.
[147] Art. 2(1)(b) of the draft Directive on reorganisation and winding-up.
[148] Art. 2(1)(c) of the draft Directive on reorganisation and winding-up.
[149] GOODHART, Ch. Basel Committee on Banking Supervision. A History of the Early years 1974 - 1997. Cambridge University Press, Cambridge, 2011. P. 107 - 110.
[150] The Commission Press Release on the progress with the regulatory agenda, Brussels, 1992. [accessed on 15 October 2016] < https://europa.eu/rapid/press-release_IP-92-1058_en.htm>.

see later, a revised version of the Directive was adopted only in 2001[151] (more than 10 years after its initial proposal).

In the field of another financial safety-net element – deposit guarantee schemes and depositor protection – the situation was a bit better. Prudential oversight in banking provides a measured alternative to the disruptive discipline of bank runs and is often accompanied by government provision of deposit guarantees[152]. In 1987, the Commission issued a recommendation concerning the introduction of deposit guarantee schemes[153]. This recommendation recognised that not all Member States had in their jurisdiction a deposit guarantee scheme - a financial safety-net element, which would guarantee compensation for depositors to a certain amount in the event of winding-up of a credit institution with insufficient assets. Among other things, this recommendation encouraged the Member States to ensure that such schemes cover the depositors of all authorised credit institutions, including the depositors of branches of credit institutions that have their head offices in the other Member States[154]. Furthermore, it noted, that the Member States which had plans for introducing such schemes should do this by 31 December 1988[155]. Though, it took quite some time to agree on the first Deposit Guarantee Schemes Directive which was adopted only after the creation of the European Union.

In particular, the first Deposit Guarantee Schemes Directive[156] was adopted only in 1994. It required the Member States to ensure that within its territory, one or more deposit-guarantee schemes were introduced[157]. It also introduced the home country control principle of compulsory membership by credit institutions of a guarantee scheme in their home Member State (the home state in which supervisory authority had granted the banking license) and required that this would capture the cover of the depositors at credit institution's branch

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[151] Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions. OJ L 125, 5.5.2001, p. 15–23.
[152] ARNER, W.D. Economic Growth, Financial Stability and the Role of Law. Cambridge University Press, Cambridge, 2009. P. 199.
[153] Commission recommendation 87/63/EEC concerning the introduction of deposit guarantee schemes. OJ NoL33,4.2.1987, p.16.
[154] Article 1(b) of the Recommendation.
[155] Article 2 of the Recommendation.
[156] Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes. OJ L 135, 31.5.1994, p. 5–14.
[157] Art. 3 of the first Deposit Guarantee Schemes Directive.

in another Member State[158]. The rationale behind such requirement was that the jurisdiction the supervisory authority of which is responsible for the supervision of the head credit institutions and its branches in the other Member States should also be responsible for the cover of deposits of those branches in case the credit institution fails[159]. The adoption of this Directive also more clearly indicated the need for mutual recognition of reorganisation measures and winding-up proceedings across the Member States.

However, even though the first Deposit Guarantee Schemes Directive was an important move forward, from the perspective of the Internal Market it only required a minimum level of harmonisation between domestic guarantee schemes in the EU (i.e. it only harmonised a minimum level (up to ECU 20 000) to which deposits should be covered in the event of deposits being unavailable, leaving a discretion to the Member States to set a maximum level, Member States retained wide discretion to include or exclude from the covered deposits and the deposit definition itself was broad and varied greatly across the Member States[160] etc.). Such approach set in the legal framework, as we will see later, proved to be inefficient element of the EU financial safety-net and proved to be disruptive for financial stability and the internal market, especially during the financial crisis of 2007 – 2009, what, as a result, encouraged the Member States to look for rapid individual solutions and subsequently for the solutions at the EU level.

1.2.5. From the creation of the European Union to the adoption of the Financial Services Action Plan and endorsement of the Lamfalussy Report

Following the momentum set by the Single European Act, Delors Report, and after two Intergovernmental Conferences[161], the Treaty on European

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[158] Art. 4 of the first Deposit Guarantee Schemes Directive.
[159] Ibid.
[160] CARIBONI, V.; et all. Deposit protection in the EU: State of play and future prospects. In Journal of Banking Regulation Vol. 9, No. 2, pp. 82–101, 2008, P.91.
[161] The first Intergovernmental Conference was dedicated to the Economic and Monetary Union (APEL, E. European Monetary Integration 1958 – 2002. Routledge, New York, 2005. P. 12) the second Intergovernmental Conference was held on Political Union (for details see LAURSEN, F.; VANHOONACKER, S. The Intergovernmental Conference on Political union. Institutional Reforms, New Policies and International Identity of the European Community. European Institute of Public Administration, Maastricht, the Netherlands, 1992).

Union (the 'TEU') was signed by the Member States in Maastricht in 1992, which entered into force[162] in 1993. This Treaty made a number of changes, including significant institutional changes, which also included legal provisions necessary for establishing a European System of Central Banks and a European Central Bank to oversee economic and monetary union[163]. Furthermore, there were new legal provisions[164] on economic and monetary union, which laid the foundations for the introduction of the single currency – the euro. The creation of the EU was also marked by its extension as Austria, Finland and Sweden were accepted to the club in 1995[165].

In the field of banking supervision and financial services, the harmonisation continued, though the EU financial regulation was criticised, as it included a series of exemptions and derogations to the harmonised rules, and often resulted in inconsistent and delayed implementation[166]. Confronted with the changing financial landscape and recognising the inadequacy of the European regulatory framework, the Member States invited the Commission at the Cardiff European Council of June 1998 to draft a framework for action to improve the single market in financial services. In response to this mandate, the Commission published a Communication which identified a range of issues for urgent action to secure the full benefits of the single currency and an optimally functioning European financial market[167]. The Communication

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[162] In Germany, this Treaty was challenged before the German Federal Constitutional Court, though, the court cleared the way for its ratification. See: HERDEN, Matthias. Maastricht and the German Constitutional Court: Constitutional Restraints for an "Ever Closer Union" and Document "Extracts from: Brunner v. The European Union Treaty (Bundesverfassungsgericht). In *31 Common Market Law Review*, 1994, Issue 2, pp. 235–262

[163] Protocol (No 4) on the statute of the European System of Central Banks and of the European Central Bank. Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union - Consolidated version of the Treaty on European Union - Protocols - Declarations annexed to the Final Act of the Intergovernmental Conference which adopted the Treaty of Lisbon, signed on 13 December 2007 - Tables of equivalences. OJ C 326, 26.10.2012, p. 13–390.

[164] Art. 98 – 124. Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union - Consolidated version of the Treaty on European Union - Protocols - Declarations annexed to the Final Act of the Intergovernmental Conference which adopted the Treaty of Lisbon, signed on 13 December 2007 - Tables of equivalences. OJ C 326, 26.10.2012, p. 13–390.

[165] TATHAM, A. European Law Collection. Enlargement of the European Union. Kluwer Law International, the Netherlands, 2009. P. 57.

[166] MOLONEY, N. New Frontiers in EC Capital Markets Law: From Market Construction to Market Regulation. In 40 Common Market Law Review, 809, 2003. P. 810.

[167] Commission communication of 28 October 1998 entitled Financial services: building a framework for action. The Commission, Brussels, COM (1998) 625. 28.10.98.

highlighted a need for developing structured cooperation between national supervisory authorities, and, therefore, suggested to draw up a "supervisors cooperation charter" which would assign responsibilities for different tasks and establish machinery for coordination between the different authorities responsible for prudential supervision across borders[168]. What is more, the Communication also called for international cooperation on regulatory and supervisory matters, as well as review and updating of the existing rules on prudential supervision[169]. It also noted that the integration of financial markets in the EU had progressed much further and faster in wholesale than in retail financial services, with the latter still segmented largely on national lines.

The Vienna European Council, in December 1998, considered it vital to translate the clear consensus on the challenges and opportunities that confront EU financial markets into a concrete and urgent work programme also stressing the importance of the financial services sector as a motor for growth and job creation and the need to confront the new challenges posed by the introduction of the single currency[170]. As a result, in 1999 the Commission, assisted by Economic and Finance Council (the '**ECOFIN**') Ministers and the European Central Bank, prepared the Financial Services Action Plan (the '**FSAP**'). The FSAP was approved by the ECOFIN and submitted for adoption to the European Council in 1999 (the same year as the euro was introduced as the single currency of eleven EU countries[171]). Subsequent European Council meetings continuously called for the full implementation of the FSAP by 2005 what clearly showed that there was a political commitment and willingness to proceed with the regulatory agenda and reforms. What is more, the 2002 London Economics Report for the Commission provided empirical support for the FSAP agenda implementation[172].

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[168] *Ibid.*
[169] *Ibid.*
[170] Communication from the Commission – Implementing the Framework for Financial Markets: Action Plan. The Commission, Brussels, COM(l999) 232 final. P. 1. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:51999DC0232&from=EN>.
[171] Physical Euro banknotes and coins began to be used in everyday payments after three years – in 2002. SABBATINI, R.; GIOVANE, P. The Euro, Inflation and Consumers' Perceptions. Lessons from Italy. Springer, Rome. 2018. Foreword.
[172] Quantification of the Macro-Economic Impact of Integration of EU Financial Markets. Final Report to the European Commission - Directorate-General for the Internal Market. London Economics in association with PricewaterhouseCoopers and Oxford Economic Forecasting, 2012. [accessed on 12 September 2017] <http://londoneconomics.co.uk/wp-content/uploads/2011/09/103-Quantification-of-the-Macro-economic-Impact-of-Integration-of-EU-Financial-Markets.pdf>.

Furthermore, worth to note that in 2001 the Committee of Wise Men, chaired by Baron A. Lamfalussy issued the Final Report[173] (also known as a Lamfalussy Report) which recommended the adoption of a new four-level structure (see Scheme 4) of regulatory measures as summarised in the scheme below. The suggested process was important as it captured an entire regulatory mechanism – the adoption, implementation and enforcement of legal rules in the EU. The report was endorsed by Heads of State in the Stockholm European Council in 2001[174].

The Lamfalussy Report was concerned only with the securities markets. However, its recommendations were subsequently adopted in relation to banking and insurance[175]. In its Resolutions of 5 February and 21 November 2002, the European Parliament endorsed the four-level approach advocated in the Final Report of the Committee of Wise Men on the regulation of European securities markets and called for certain aspects of that approach to be extended to the banking and insurance sectors subject to a clear Council commitment to reform to guarantee a proper institutional balance[176]. As a result, the Commission suggested establishing not only the Level 3 Committee of European Securities Regulators (the '**CERS**')[177] but also the Level 3 Committee of European Banking Supervisors (the '**CEBS**')[178] and the Level 3 Committee of European Insurance and Occupational Pension Supervisors (the '**CEIOPS**')[179]. Worth to the Banking Advisory Committee which was

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[173] Final Report of the Committee of Wise Men on the Regulation of European Securities Markets. Brussels, 15 February 2011. [accessed on 15 September 2018] <https://www.spk.gov.tr/Sayfa/Dosya/114>.

[174] Resolution of the European Council on More Effective Securities Market Regulation in the European Union. Stockholm, 23 March 2001. [accessed on 14 September 2016] <https://www.esma.europa.eu/sites/default/files/library/2015/11/resolutionstockholm.pdf>.

[175] WALKER, G; PURVES, R. Financial Services Law. Fourth Edition. Oxford University Press, Oxford, 2018. Paragraph 3.32.

[176] Recital 2 of the 2004/5/EC: Commission Decision of 5 November 2003 establishing the Committee of European Banking Supervisors (Text with EEA relevance). Official Journal L 003, 07/01/2004 P. 0028 – 0029.

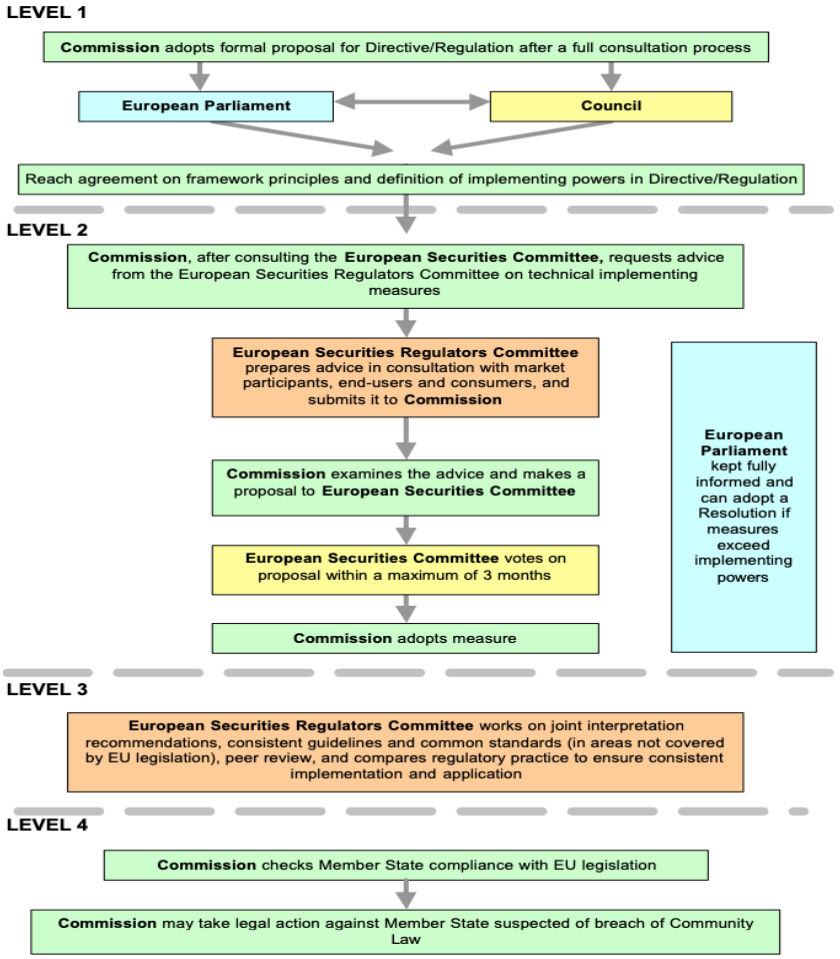
[177] 2001/527/EC: Commission Decision of 6 June 2001 establishing the Committee of European Securities Regulators (Text with EEA relevance) (notified under document number C(2001) 1501).

[178] 2004/5/EC: Commission Decision of 5 November 2003 establishing the Committee of European Banking Supervisors (Text with EEA relevance). Official Journal L 003, 07/01/2004 P. 0028 – 0029.

[179] 2004/6/EC: Commission Decision of 5 November 2003 establishing the Committee of European Insurance and Occupational Pensions Supervisors (Text with EEA relevance). OJ L 3, 7.1.2004, p. 30–31.

established under the First Banking Directive in 1977 (see Subchapter 1.3.2.) was replaced by the European Banking Committee[180] responsible for the Level 2 and the CEBS responsible for the Level 3 in the field of banking.

Scheme 1. The Four-Level Approach Recommended by the Lamfalussy Report[181]



The adopted FSAP was one more attempt to set an ambitious agenda and proceed with the harmonisation of rules using the momentum brought by the introduction of the euro. An ambitious regulatory agenda was followed by the

[180] 2004/10/EC: Commission Decision of 5 November 2003 establishing the European Banking Committee (Text with EEA relevance). OJ L 3, 7.1.2004, p. 36–37.
[181] *Ibid*, P. 6.

amendments to the EU legislative process in order to make financial regulation more flexible by using different levels of regulation so that the legal rules could be adapted to deal with innovation and technological change and to improve implementation and enforcement of the rules in the Member States. Finally, as a result of the endorsement of the FSAP and Lamfalussy Report, the EU institutions proceeded with the adoption of a number of new measures more expeditiously than had been the case with earlier banking regulation legal framework.

It is also worth to note that during the period of the FSAP implementation, the EU faced one of its biggest extensions as Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia joined the club and project of European integration on 1 May 2014. As a result, the EU grew from 15 to 25 Member States[182].

1.2.6. The third wave of harmonisation: the final attempt to adopt bank reorganisation and winding-up Directive and new initiatives in the field of banking prudential supervision

The FSAP marked the first significant intensification of the regulatory agenda in the field of banking supervision and financial services after the creation of the EU, in support to market liberalisation as well as reflecting vibrant market conditions. The FSAP related to a Single Market across the EU as a whole and consisted of a set of measures intended by 2005 to fill gaps and remove remaining barriers so as to provide a legal and regulatory environment that supports the integration of EU financial markets. The FSAP set three key objectives linked to i) a single wholesale market; ii) an open and secure retail market; and iii) sound prudential rules and supervision[183].

The FSAP also reminded about certain legislative proposals which were of significant relevance to the functioning of EU financial markets but were

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[182] The EU extension by accepting Eastern Member States was quite strongly supported by the UK who believed that this could be used as an opportunity to get additional support in the decision making and to push its own agenda as well as to use this to avoid Franco-German dominance. To a certain extent it was true and worked in practice. On the other hand, immigration from the new EU MS to the UK was quite a strong argument for leaving the EU during Brexit referendum.

[183] Communication from the Commission – Implementing the Framework for Financial Markets: Action Plan. The Commission, Brussels, COM(l999) 232 final. P. 3, 8, 10. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:51999DC0232&from=EN>.

'victims' to protracted political deadlocks. For example, this was the case with the draft Directive on bank reorganisation and winding-up, which was initially proposed by the Commission in 1985. It was noted that with the adoption of the First DGS Directive in 1994 (which introduced the principle of compulsory membership by credit institutions of a guarantee scheme in their home Member State), the need for mutual recognition of reorganisation measures and winding-up proceedings became even more clear[184]. Finally, a revised version of the Directive was finally adopted only in 2001[185] (more than 10 years after its initial proposal). The final Directive was based on the same principles and mainly aimed to introduce mutual recognition and the home country control principle rather than focus on harmonisation of actual tools, measures or procedures.

More specifically, it was acknowledged that to harmonise national laws and practices in this field is too challenging. Therefore, the aim was (considering the approach used in other Directives linked to bank prudential supervisions) at least to establish a requirement for the mutual recognition by the Member States of the measures taken by each of them to restore the viability of the credit institutions which it has authorised[186].

As regards the definition of reorganisation measures they were broadly defined by stating that it includes "*measures which are intended to preserve or restore the financial situation of a credit institution and which could affect third parties' pre-existing rights, including measures involving the possibility of a suspension of payments, suspension of enforcement measures or reduction of claim*s" [187]. The 'winding-up proceedings' were broadly defined as "*collective proceedings opened and monitored by the administrative or judicial authorities of a Member State with the aim of realising assets under the supervision of those authorities, including where the proceedings are terminated by a composition or other, similar measure*" [188].

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[184] Recital 5 of the Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions. OJ L 125, 5.5.2001, p. 15–23.
[185] Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions. OJ L 125, 5.5.2001, p. 15–23.
[186] Recital 6 of the Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions. OJ L 125, 5.5.2001, p. 15–23.
[187] Art. 2 of the Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions. OJ L 125, 5.5.2001, p. 15–23.
[188] *Ibid.*

Even though being quite general and with no ambition to harmonise relevant national rules and proceedings, this Directive was a step forward for establishing minimum mutual recognition rules based on home country control principle for dealing with the banking issues across borders. Before this Directive, at the EU level, it was not guaranteed that the reorganisation measures adopted by the administrative or judicial authorities of the home Member State and the measures adopted by persons or bodies appointed by those authorities to administer those reorganisation measures, including measures involving the possibility of a suspension of payments, suspension of enforcement measures or reduction of claims and any other measure which could affect third parties' existing rights, will be effective in all Member States. This was evident in practice when the Bank of Credit and Commerce International failed in 1991 and winding-up proceedings initiated both in Luxembourg and England led to a complex conflict of laws (see Subchapter 1.3.4.).

However, it should also be noted that this was the only and limited legislative measure which was explicitly dedicated for dealing across borders with banks facing difficulties while other measures in the field of banking supervision focused on strengthening the bank prudential supervision legal framework and trying to strengthen the regulatory framework linked to the supervisions of financial conglomerates.

Namely, in 2002 Directive on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate[189] was adopted. It noted that new developments in financial markets led to the creation of financial groups which provide services and products in different sectors of the financial markets, while at the EU level there was no form of prudential supervision on a group-wide basis of credit institutions, insurance undertakings and investment firms which are part of such a conglomerate, in particular as regards the solvency position and risk concentration at the level of the conglomerate, the intra-group transactions, the internal risk management processes at conglomerate level, and the fit and

[189] Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and Directives 98/78/EC and 2000/12/EC of the European Parliament and of the Council. Official Journal L 035, 11/02/2003 P. 0001 – 0027.

proper character of the management[190]. It was also noted that some of these conglomerates are among the biggest financial groups which are active in the financial markets and provide services on a global basis, and therefore is such conglomerates, and in particular credit institutions, insurance undertakings and investment firms which are part of such a conglomerate, were to face financial difficulties, these could seriously destabilise the financial system and affect individual depositors, insurance policyholders and investors[191].

What is more, amendments to other critical elements of the bank prudential supervision legal framework – capital adequacy – where initiated. Worth to note that they were resulted by the revision of the Basel I and subsequent adoption (at the global level) of the new capital framework in June 2014 (known as Basel II)[192]. Already in July 2004, the Commission presented its proposals[193] transposing the Basel II requirements into the EU law. These proposals in the form of Directives[194], subject to some amendments, where adopted by the European Council and the Council relatively quickly – within 2 years.

Finally, at the end of 2005, the Commission issued the White Paper for Financial Services Policy (2005-2010)[195] Annex of which stated that "*almost all measures of the FSAP have been completed on time. It has put in place*

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[190] Recital 2 of the Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and Directives 98/78/EC and 2000/12/EC of the European Parliament and of the Council. Official Journal L 035, 11/02/2003 P. 0001 – 0027.

[191] *Ibid.*

[192] International Convergences of Capital Measurement and Capital Standards. A Revised Framework. Basel Committee on Banking Supervision, Basel, June 2014. [accessed on 16 October 2017] <https://www.bis.org/publ/bcbs107.pdf>.

[193] Proposal for Directive of the European Parliament of the Council Re-casting Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions and Council Directive 93/6/EEC of 15 March 1993 on the capital adequacy of investment firms and credit institutions (COM/2004/0486 final)

[194] Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) (Text with EEA relevance). OJ L 177, 30.6.2006, p. 1–200 and Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (recast). OJ L 177, 30.6.2006, p. 201–255.

[195] White Paper – Financial Services Policy 2005-2010. SEC(2005) 1574. COM/2005/0629 final.

necessary policy initiatives of legislative and non-legislative character"[196]. However, this paper also highlighted the risk of legal uncertainty and continued fragmentation which were resulted from diversity in the transposition of adopted legal measures, as the FSAP Directives were being transposed by the Member States into national law at a different pace and considerable delays[197]. It also highlighted risks emerging from the inconsistency and overregulation in the new regulatory framework, noting that the FSAP can't be reached if measures are not effectively and consistently transposed in all EU Member States within the agreed time period[198]. These concerns were not something completely new, and as we have seen, it was a common issue during different stages of EU integration. Furthermore, even though the paper indicated future policy lines (during 2005 – 2010) none of foreseen legislative measures focused on further harmonisation bank crisis management legal framework.

1.2.7. The eruption of the financial crisis – reactions of the Member States and an evident need to act at the EU level

History shows that financial crises and bank failures usually trigger amendments to the financial safety-net elements, post-factum regulatory reforms, which, because of the high costs involved, are usually harder to promote as preventative measures during the 'piece' time but easier to justify once losses can be ascribed to regulatory failures[199]. The last financial crisis is not an exception[200]. With its unprecedented amplitude, high impact on the real economy and trillions of ascertained losses, a political momentum was created that allowed for substantial changes at the international and domestic levels not only in traditional financial safety-net components such as banking regulation and prudential supervision, deposit insurance[201], but also stimulated

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[196] Commission staff working document - Annex to the White Paper Financial Services Policy (2005-2010) - Impact assessment. COM(2005) 629 final. SEC/2005/1574.
[197] Ibid.
[198] Ibid.
[199] BALČIŪNAS, Laurynas. Financial Market Supervision Models and Trends of Legal Regulation. In *Teisė*, 99, pp. 64 – 82, Vilnius, 2014. P. 78.
[200] *Ibid*.
[201] See, for example: Finalising post-crisis reforms: an update. A report to G20 Leaders. The Basel Committee on Banking Supervision, Basel, November 2015. [accessed on 18 July 2018] <https://www.bis.org/bcbs/publ/d344.pdf>; MENON, R. Financial Regulation – 20 years after the Global Financial Crisis. the Symposium on Asian Banking and Finance, Federal Reserve

a reform to set-up a special legal framework for banking crisis management, recovery and resolution as well as an expansion of macro-prudential supervision.

In particular, the financial crisis and following bank failures once again highlighted that the *lex generalis* of standard bankruptcy procedures are slow and usually unsuited[202] to the immediate need to halt a spreading panic[203]. There were also contagion concerns and fears that if bank fails, it's critical functions, essential for the real economy and financial stability, would be discontinued and this might create systemic crisis as the insolvency and bankruptcy proceedings allow legal entity to exit the market but are not aiming to ensure continuity of bank's critical functions. The lack of relevant toolkit and the anxiety of the public for the use of unprecedented amounts of taxpayer's money[204] for the banks' bailouts, encouraged to act and look for new legal instruments for public authorities which would allow to deal with failing banks by limiting the use of public money and ensuring continuity of bank's critical functions[205]. The high-profile EU banking failures (such as Fortis, Icelandic banks, Anglo Irish Bank, Dexia) have also demonstrated that government support for banks which are 'too big to fail' with squeezed public finances is becoming increasingly unsustainable[206].

Bank of San Francisco, San Francisco, 25 June 2018. [accessed on 25 June 2018] <https://www.bis.org/review/r180727a.pdf>.

[202] See more about a fundamental difference between commercial companies and banks in GLEESON, Simon; GUYNN, Randall. Bank Resolution and Crisis Management: Law and Practice. Oxford University Press, Oxford, 2016, P.3.

[203] LASTRA, Rosa. Cross-border Bank Insolvency. Oxford: Oxford University Press, Oxford, 2011, P. V.

[204] In order to maintain essential financial services for citizens and businesses, governments have had to inject public money into banks and issue guarantees on an unprecedented scale: between October 2008 and October 2011, the European Commission approved €4.5 trillion (equivalent to 37% of the EU GDP) of state aid measures to financial institutions. The European Commission. In *New crisis management measures to avoid future bank bail-outs*. [accessed on 8 August 2017] <http://europa.eu/rapid/press-release_IP-12-570_en.htm#footnote-1>

[205] BALČIŪNAS, L. The Legal Concept of Bank's Critical Functions, Implementation Challenges and the Role in the EU Bank Recovery and Resolution Framework. In *Teisės viršenybės link*, Vilnius University, Law Faculty, 2019. P. 30.

[206] Bank recovery and resolution proposal: frequently asked questions. European Commission, Brussels, 6 June 2012. [accessed on 7 June 2012] <https://ec.europa.eu/commission/presscorner/detail/da/MEMO_12_416>.

As a result, in the EU, many Member States (e.g. the UK, 2009[207]; Germany, 2011[208]; Denmark, 2009[209]; Ireland, 2011[210]; Italy[211], Spain, 2012[212], Lithuania etc. some on their own, some because of the recommendations made by the IMF after the Financial Sector Assessment Programme) adopted relevant legal acts contributing to the development of bank crisis management, recovery and resolution legal framework and the new paradigm of resolution. As regards the Republic of Lithuania, bank resolution legal institute and certain types of bank resolution tools (e.g. sale of business, bridge bank) were introduced into the Lithuanian law already in 2011[213], following insolvency of AB bankas SNORAS[214], and were applied in practice during the resolution of AB Ūkio bankas[215]. As it will be seen from the subsequent analysis, these tools as well as other recovery and resolution legal instruments were further harmonised across the EU and in Lithuania with the transposition of the BRRD into national laws.

The amendments to the national legal frameworks in the field of banking supervision and crisis management also resulted in the change of financial safety-net elements. More specifically, before the financial crisis it was widely agreed that the financial safety-net is composed of the following elements:

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[207] United Kingdom: Crisis Management and Bank Resolution Technical Note. IMF Country Report No. 11/228. IMF, July 2011. P. 5. [accessed on 5 June 2019] <https://www.imf.org/external/pubs/ft/scr/2011/cr11228.pdf>.

[208] Germany: Technical Note on Crisis Management Arrangements. Country Report No. 11/368. IMF, 23 December 2011. P. 13.

[209] Denmark: Crisis Management, Bank Resolution, and Financial Sector Safety Nets: Technical Note. IMF, 18 December 2014. P. 24.

[210] Central Bank and Credit Institutions (Resolution) Act 2011. [accessed on 5 June 2019] <http://www.irishstatutebook.ie/eli/2011/act/27/enacted/en/html>

[211] Italy: Technical Note on Safety Nets, Bank Resolution, and Crisis Management Framework. Country Report No. 13/350. IMF, 6 December 2013.

[212] Spain: Safety Net, Bank Resolution, and Crisis Management Framework: Technical Note. Country Report No. 12/145. IMF, 11 June 2012.

[213] The Republic of Lithuania Law on the Bank of Lithuania. Valstybės žinios, 2004, No. 54-1832 (as in force at that time).

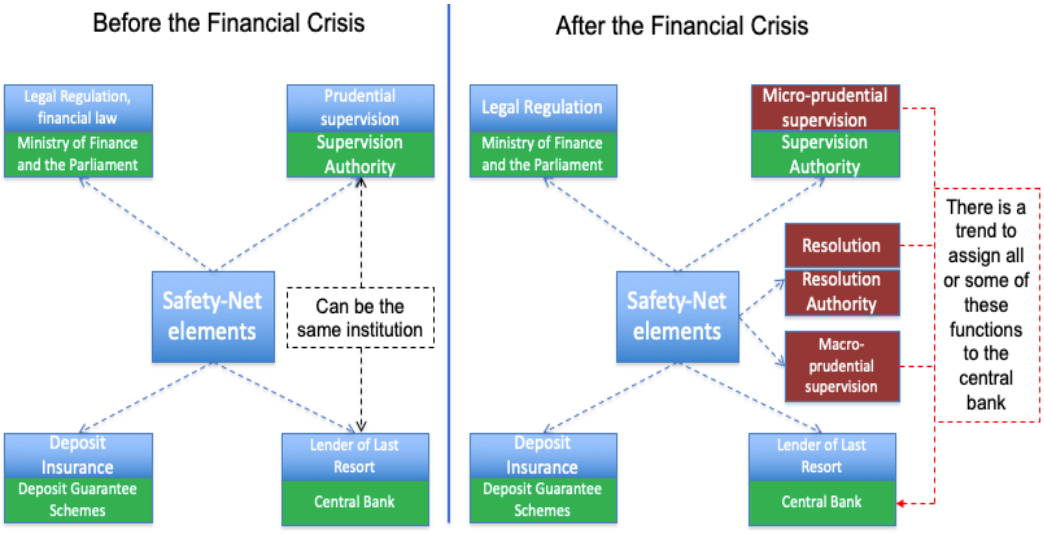
[214] Lietuvos bankas atšaukė AB banko SNORAS veiklos licenciją ir paskelbė, kreiptis į teismą dėl bankroto. [accessed on 5 December 2019] <https://www.lb.lt/lt/naujienos/lietuvos-bankas-atsauke-ab-banko-snoras-veiklos-licencija-kreipsis-i-teisma-del-bankroto>.

[215] Lietuvos bankas pritarė nemokaus Ūkio banko įsipareigojimų ir turto perkėlimui į kitą banką. [accessed on 9 December 2019] <https://www.lb.lt/lt/naujienos/lietuvos-bankas-pritare-nemokaus-ukio-banko-isipareigojimu-ir-turto-perkelimui-i-kita-banka>.

financial laws, prudential supervision, deposit insurance and the lender of last resort[216] (see Scheme 2).

The strength of the financial safety net is determined by the strength of its weakest element. The financial crisis and bank failures have identified weak spots of national financial safety-nets. As a result of many regulatory reforms, the composition of the financial safety-net has also changed. Namely, after the financial crisis, Member States have the same four elements at the national level. Furthermore, additional ones have also emerged. Namely, prudential supervision is divided into micro-prudential and macro-prudential supervision (which gradually is receiving much more attention), and we have a new separate element aimed at preparation, prevention and management of banks' crisis – the resolution, for which newly established resolution authorities are responsible. Also, there is a clear trend of the increasing role of central banks in the field of prudential supervision (both micro and macro) and bank crisis management and resolution[217].

Scheme 2. Evolution of financial safety-net elements



[216] A function performed by central banks that lends money to banks in difficult financial periods when they cannot borrow from anywhere else. The term 'lender of last resort' owes its origins to Sir Francis Barings, who in 1797 referred to the Bank of England as the 'dernier resort' from which all banks could obtain liquidity in times of crisis. LASTRA, M.R. Lender of Last Resort, and International Perspective. In *International and Comparative Law Quarterly, 48*(2), 340-361. P. 340. Also see: Working Group on Deposit Insurance Progress Report. Note for FSF meeting. The Financial Stability Forum, 22-23 March 2001.

[217] See: BALČIŪNAS, Laurynas. Financial Market Supervision Models and Trends of Legal Regulation. In *Teisė*, 99, pp. 64 – 82, Vilnius, 2014.

Though the strengthening of the financial safety net elements at the national level is important, however, may not be sufficient, in particular, taking into account that in the past few decades international linkages between the states have increased dramatically[218]. As a result, this increased cross border spill-over risk as increased financial linkage leads to the faster and more powerful transmission of shocks across countries[219]. The globalisation of financial systems has also made banks more interdependent and thus more exposed to systemic risk that can arise from bank failures at the national level and to volatility in cash flows[220]. This required adequate legal regulation at the domestic and international level which, as many agree, unfortunately, did not accompany following the liberalisation of financial markets, the globalisation of financial services and capital flows[221].

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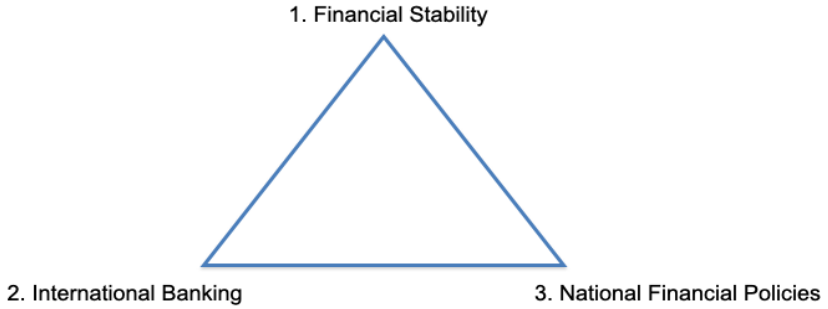
[218] World trade as a share of global GDP has doubled since 1970. Over the past two decades, 80% of the increase in total trade has come from intermediates goods trade, driving up the value added of imports as a share from 10% of exports in 1990 to around 20% in 2015. Cross holding of countries' assets and liabilities increased almost fourfold since 1990, and measures of stock market integration are at their highest ever see BASIDON, C; et all. Towards an Unstable Hook: The Evolution of Stock Market Integration Since 1913. In *NBER Working Paper* No. 26166, 2019 as quoted in a speech given by Mark Carney Governor of the Bank of England. The Growing Challenges for Monetary Policy in the current International Monetary and Financial System. 23 August 2019. P.6. [accessed on 24 Augusts 2019] <https://www.bankofengland.co.uk/-/media/boe/files/speech/2019/the-growing-challenges-for-monetary-policy-speech-by-mark-carney.pdf?la=en&hash=01A18270247C456901D4043F59D4B79F09B6BFBC>.

[219] The Growing Challenges for Monetary Policy in the current International Monetary and Financial System. The speech was given by Mark Carney Governor of the Bank of England, Jackson Hole Symposium, 23 August 2019. P.6. [accessed on 24 Augusts 2019] <https://www.bankofengland.co.uk/-/media/boe/files/speech/2019/the-growing-challenges-for-monetary-policy-speech-by-mark-carney.pdf?la=en&hash=01A18270247C456901D4043F59D4B79F09B6BFBC>.

[220] ALEXANDER, Kern; DHUMALE, Rahul; EATWELL, John. Global Governance of Financial Systems: The International Regulation of Systemic Risk. Oxford University Press, Oxford, 2006. P.14.

[221] Ibid., P. 3, 14..

Scheme 3. Financial Trilemma Theory



(*Dirk Schoenmaker, 2013*)

Professor D. Schoenmaker argues that the financial trilemma[222] (scheme 3) i) a stable financial system; ii) international banking; and iii) financial policies for supervision and resolution just at national level – are incompatible. Any two of the three objectives can be combined but not all three – one has to give, as the financial stability implications of international banking implies that just national financial policies are no longer adequate[223], and therefore greater alignment of the legal framework should be ensured both at the EU and at the global levels.

More specifically, the professor argues that the financial trilemma will develop as financial integration increases, both at the global level and in the EU. The key insight is that "*national governments do not incorporate cross-border externalities of the failure of an international bank[,] they only care about the domestic effects, as they are accountable to their national parliament. Moreover, some banks are too large relative to the economy for a country to save. The financial crisis has subsequently confirmed that national financial supervision and resolution can indeed not cope with*

[222] D. Schoenmaker's financial trilemma theory got inspiration from the monetary trilemma formulated by M. Fleming and R. Mundell. It states that i) a fixed exchange rate, ii) international capital mobility, and iii) national independence in monetary policy cannot be achieved at the same time and one policy objective has to give. See FLEMING, M. Domestic Financial Policies under Fixed and Floating Exchange Rates. In *IMF Staff Papers* 9, 1962. P. 369 – 377.; MUNDELL, R. Capital Mobility and Stabilisation Policy under Fixed and Flexible Exchange Rates. In *Canadian Journal of Economics* 29, 1963. P. 475 – 485.

[223] SCHOENMAKER Dirk. Governance of International Banking. The Financial Trilemma. Oxford University Press, Oxford, 2013. P. 7.

international banks"[224]. Here also the words of Mervyn King, the former governor of the Bank of England, can be quoted that "*global banking institution are global in life, but national in death*", indicating the need to tackle faulty lines in the global regulation and supervision of cross border banks through the appropriate future approach set in the legal framework to be better prepared for future bank failures[225].

So-called financial trilemma issue was recognised at the EU level, what triggered thinking and discussions on how the above mentioned emerging national financial safety-net elements could be reflected in the EU legal framework and institutional structure. In the famous J. de Larosiere report it was highlighted that in spite of some progress, too much of the EU's framework remains seriously fragmented, namely, the regulatory rule book itself, the EU's supervisory structure, crisis management mechanisms[226]. It was also recognised to a certain extent that increasing integration within the Single Market (in particular, in the euro area) also deepens the issue of the financial trilemma.

1.2.8. The fourth wave of harmonisation – EU institutional and regulatory reforms in the field of banking supervision, recovery and resolution legal frameworks

During the fourth wave of harmonisation and deeper integration attempts, the EU reactions in the field of banking supervision and crisis management could broadly be split into two steps and trying to fix two different but interlinked elements: a) the EU tried to '*upgrade*' its institutional set-up for banking supervision and crisis management; b) the EU focused on the transposition of international standards into the EU financial law and further harmonisation of the legal framework linked to the financial safety-net elements across the EU.

The EU actions concerning the institutional set-up to deal with the banking supervision and crisis management issues could be broadly split into two

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[224] SCHOENMAKER, D. Governance of International Banking. The Financial Trilemma. Oxford University Press, Oxford, 2013. P. 6.
[225] TURNER, A. The Turner Review: A Regulatory Response to the Global Banking Crisis. London: Financial Services Authority, London, 2009. P. 36.
[226] The High-Level Group of Financial Supervision in the EU. Chaired by Jacques de Larosiere. The Report, Brussels, 25 February 2009. P. 3. [accessed on 25 February 2009] <https://ec.europa.eu/info/system/files/de_larosiere_report_en.pdf>.

different waves and periods: i) 2008 – 2011 – set-up of the European System of Financial Supervisors; and ii) 2012 – 2014 creation of the Banking Union.

The first wave of reforms (which lasts from 2008 – 2011) started when the crisis built-up in the US and subsequently came to Europe[227]. As noted in the J. de Larosiere report, a regular response to the worsening situation was weakened by an inadequate crisis management infrastructure in the EU, both in terms of the cooperation between national supervisors and between public authorities[228]. In the absence of a common framework, Member States were faced with a difficult situation (especially for the larger financial institutions) as they had to react quickly and pragmatically to avoid a banking failure. However, the taken actions were not fully coordinated and led sometimes to negative spill-over effects on the other Member States[229].

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[227] The financial crisis eventually erupted when inflation pressures in the US economy required tightening of monetary policy because of the sub-prime housing bubble. Starting in July 2007, accumulating losses on US sub-prime mortgages triggered widespread disruption of credit markets, as uncertainty about the ultimate size and location of credit losses undermined investor confidence. As a result, financial institutions tried to dispose of assets as they realised that they had overstretched their leverage, thus lowering market prices for these assets. Already excessively leveraged, financial institutions were required to either sell further assets to maintain capital levels, or to reduce their loan volume. So-called 'fire sales' made by one financial institution, in turn, forced all other financial institutions holding similar assets to mark the value of these assets down to the market. Many hedge funds acted similarly, and margin calls intensified liquidity problems. Once credit rating agencies started to revise their credit ratings for CDOs downwards, banks were required to adjust their risk-weighted capital requirements upwards. Already highly leveraged, and faced with increasing difficulties in raising equity, a range of financial institutions hastened to dispose of assets, putting further pressure on asset prices. When, despite the fear of possible negative signalling effects, banks tried to raise fresh capital, more or less at the same time, they were faced by weakening equity markets. This obliged them to look for funding from sovereign wealth funds and, in due course, from heavy state intervention. What was initially a liquidity problem rapidly, for a number of institutions, turned into a solvency problem. Finally, the lack of market transparency, combined with the sudden downgrade of credit ratings, and the US Government's decision not to save Lehman Brothers led to a wide-spread breakdown of trust and a crisis of confidence that, in autumn 2008, practically shut down inter-bank money markets, thus creating a large-scale liquidity crisis, which subsequently weighed heavily on financial markets in the EU and beyond. The regulatory response to this worsening situation was weakened by an inadequate crisis management infrastructure in the EU. See: The High-Level Group of Financial Supervision in the EU. Chaired by Jacques de Larosiere. The Report, Brussels, 25 February 2009. Paragraphs 32 – 37. [accessed on 25 February 2009] <https://ec.europa.eu/info/system/files/de_larosiere_report_en.pdf>.

[228] The High-Level Group of Financial Supervision in the EU. Chaired by Jacques de Larosiere. The Report, Brussels, 25 February 2009. Paragraph 37. [accessed on 25 February 2009] <https://ec.europa.eu/info/system/files/de_larosiere_report_en.pdf>.

[229] *Ibid.*

As a result, the European Commission, taking into account the recommendations of the de Larosière report, set out an action plan for reforming the way financial markets are regulated and supervised with a focus on the architecture for a new European financial supervisory framework. More specifically, it was suggested that an enhanced European financial supervisory framework should be composed of i) a European Systemic Risk Board[230] (the '**ESRB**') which will monitor and assess potential threats to financial stability that arise from macro-economic developments and from developments within the financial system as a whole[231] (so-called 'macro-prudential supervision'); and ii) a European System of Financial Supervisors (the '**ESFS**') consisting of a robust network of national financial supervisors working in tandem with new European Supervisory Authorities (the European Banking Authority (the '**EBA**')[232], the European Securities Market Authority (the '**ESMA**')[233] and the European Insurance and Occupational Pensions Authority (the '**EIOPA**')[234]) to safeguard financial soundness at the level of individual financial firms and protect consumers of financial services (so-called 'micro-prudential supervision')[235] (see Scheme 4). The ESRB and the European Supervisory Authorities[236] started their activities in January 2011.

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[230] Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board. OJ L 331, 15.12.2010, p. 1–11. (the '**ESRB Regulation**').

[231] Risks to the financial system can in principle arise from the failure of one financial institution alone if it is large enough in relation to the country concerned and/or with multiple subsidiaries, branches in other countries. However, the financial crisis clearly showed that much more important global systemic risk arises from common exposure of many financial institutions to the same risk factors.

[232] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC. OJ L 331, 15.12.2010, p. 12–47. (the '**EBA Regulation**').

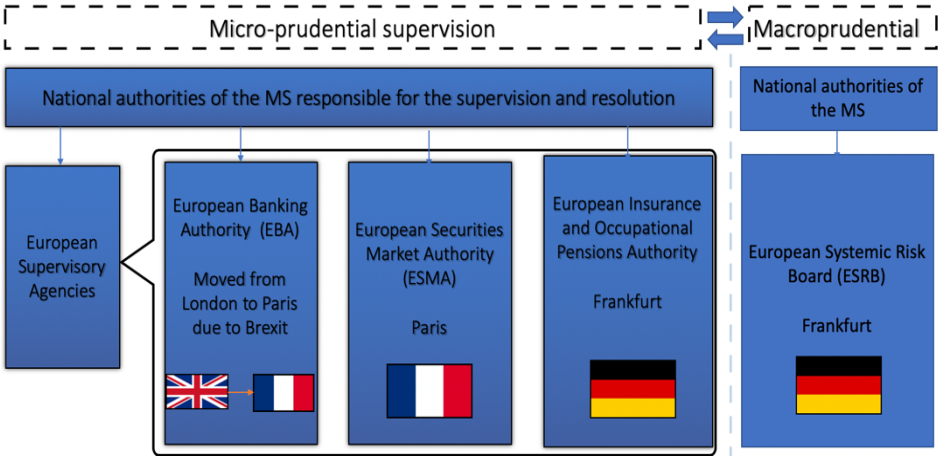
[233] Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC. OJ L 331, 15.12.2010, p. 84–119. (the '**ESMA Regulation'**).

[234] Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC. OJ L 331, 15.12.2010, p. 48–83.

[235] Communication from the Commission - European financial supervision. SEC(2009) 715, SEC(2009) 716. COM/2009/0252 final. P. 3.

[236] These authorities replace, respectively, the Committee of European Banking Supervisors (replaced by the EBA), the Committee of European Securities Regulators (replaced by the

Scheme 4. The European System of Financial Supervision



However, it is important to note that in practice the European Supervisory Authorities remained mostly regulatory agencies, rather than bodies performing actual direct supervision of financial institutions (only the ESMA has received direct supervisory powers with regard to credit rating agencies and trade repositories[237]). Therefore, on the one hand, the national authorities retained their actual supervision power, on the other hand, by entrusting the European Supervisory Authorities with the regulatory powers (in particular, in the field of developing the second level regulatory and implementing binding technical standards), Member States showed their willingness to move from the minimum harmonisation of the legal framework at the EU level towards much more harmonised (or maximum harmonisation) legal framework by establishing a European Single Rule Book applicable to all financial institutions in the internal market[238].

Separate attention should be given to macro-prudential supervision and the ESRB. Contrary to the micro-prudential supervision, before the crisis, the macro-prudential supervision was not identified as a separate element of the financial safety-net neither at the national level nor the EU level. However,

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ESMA), and the Committee of European Insurance and Occupational Pensions Supervisors (replaced by the EIOPA).

[237] See Recital 5 of the ESMA Regulation and Art. 4(3)(b) of the Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (Text with EEA relevance). OJ L 302, 17.11.2009, p. 1–31.

[238] Recital 5 of the EBA Regulation, the ESMA Regulation, the EIOPA Regulation.

even though the terms "*macro-prudential supervision*" and "*macro-prudential policy*" began to be used widely in the aftermath of the financial crisis, they are not recent inventions. As noted by the Bank of England, "*an idea of macroprudential policy was vintage wine in a new bottle*" because the term was used as far back as 1979 and the approach was set out in some depth in 2000 by Andrew Crockett, General Manager of the Bank for International Settlements and previously an Executive Director at the Bank of England[239]. On the other hand, it is also true that the macroprudential supervision as a clear separate element of the financial safety-net emerged at the national and the EU levels only after the financial crisis which encouraged to put more emphasis on the analysis of determinants of systemic risks[240]. Though, at the EU the ESRB's macro-prudential supervision is established more to act as a network by bringing together the actors of financial supervision at a national level[241] and at the level of the Union[242] rather than a body with its strong institutional bases. More specifically, even though the ESRB is responsible for conducting macro-prudential oversight at the level of the EU, it does not have legal personality[243]. The ECB and the national central banks have a leading role in macro-prudential oversight because of their expertise and their existing responsibilities in the area of financial stability[244]. It is expected that with the greater integration of the EU, understanding of common risks

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[239] BRAZIER, Alex. Financial Resilience and Economic Earthquakes. Speech. Bank of England, University of Warwick, 13 June 2019. P.2.

[240] At the global level the IMF, the FSB and the BIS, as a response to a request made by the G20 Leaders in April 2009, issued guidance to ensure greater common understanding of the notion 'systemic risk' and to help national authorities to assess the systemic importance of financial institutions, markets and instruments. Report to G20 Finance Ministers and Governors. Guidance to Assess the Systemic Importance of Financial Institutions, Markets and Instruments: Initial Considerations. IMF, BIS, FSB, Washington, October 2009. [accessed on 16 November 2013] <https://www.imf.org/external/np/g20/pdf/100109.pdf>.

[241] Member States were recommended to designate in the national legislation an authority entrusted with the conduct of macroprudential policy, generally either as a single institution or as a board composed of the authorities whose actions have a material impact on financial stability. The national legislation should specify the decision-making process of the governing body of the macro-prudential authority. In any case, Member States were recommended to ensure that the central bank plays a leading role in the macroprudential policy and that macroprudential policy does not undermine its independence in accordance with Article 130 of the Treaty. See: Recommendation B1 of the Recommendation of the European Systemic Risk Board of 22 December 2011 on the macroprudential mandate of national authorities (ESRB/2011/3).

[242] Recital 14 of the ESRB Regulation.

[243] Recital 15 of the ESRB Regulation.

[244] Recital 24 of the ESRB Regulation.

exposure of many financial institutions to the same risk factors will make the macro-prudential supervision at the EU level more and more important. While the micro-prudential supervision cannot effectively safeguard financial stability without adequately taking into account of macro-level developments[245]. However, in order to become a stronger element of the EU financial safety-net, the ESRB (considering its current set-up) will require further institutional strengthening at the EU level in the future.

The second wave of reforms (which lasts from 2012 to 2014) was triggered when the EU was suffering from the Euro area sovereign debt crisis[246] which emerged due to the loop between national banking sectors and their sovereigns (what is also known in the literature as the '*doom loop*')[247]. Eventually, with the Bankia failure case in Spain in 2012 (sometimes called as the bank that broke Spain[248]), regulators and policymakers acknowledged that the spill-over effects among different Member States are so high that mutualisation of risks among the countries is happening. After a historic Euro Area Summit on 29 June 2013, not only the financial support to Spain for the recapitalisation of its banking sector was agreed, but Euro Area Member States also issued a statement which declared *"[w]e affirm that it is imperative to break the vicious circle between banks and sovereigns. The Commission will present Proposals on the basis of Article 127(6) for a single supervisory mechanism shortly. We ask the Council to consider these Proposals as a matter of urgency by the end of 2012*"[249]. A right political moment emerged for subsequent regulatory reform at the EU level.

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[245] The High-Level Group of Financial Supervision in the EU. Chaired by Jacques de Larosiere. Report, Brussels, 25 February 2009. Paragraph 148. [accessed on 25 February 2009] <https://ec.europa.eu/info/system/files/de_larosiere_report_en.pdf>.

[246] Some figures, Greece's sovereign debt spread over the related benchmark was more than 1500 basis points in June 2011, while those of Portugal and Ireland were around 700 bp. As you know, the crisis hit Spain head on a year later in July 2012, with the market demanding more than 7% for 10 years bonds. Informational breakfast The European Banking Union. Club Dialogos para la Democracia. Margarita Delgado, Deputy Governor, Banco De Espana, 2020. P. 5. [accessed on 14 January 2020] < https://www.bis.org/review/r200115d.pdf>.

[247] See: ALOGOSKOUFIS, S.; LANGFIELD, S. Regulating the doom loop. Working Paper Series. No 74 / May 2018. European Systemic Risk Board, May 2018. P. 3. [accessed on 6 June 2019] <https://www.esrb.europa.eu/pub/pdf/wp/esrb.wp74.en.pdf>.

[248] The bank that broke Spain. Financial Times, London, 21 June 2012. [accessed on 5 June 2019] <https://www.ft.com/content/d8411cf6-bb89-11e1-90e4-00144feabdc0>.

[249] Euro Area Summit Statement, 29 June 2012. P. 1. [accessed on 2 July 2012] <https://www.consilium.europa.eu/media/21400/20120629-euro-area-summit-statement-en.pdf>.

As a result, the Commission used the opportunity to highlight that further steps are needed to tackle the specific risks within the Euro Area, as pooled monetary responsibilities have spurred close economic and financial integration and increased the possibility of cross-border spill-over effects in the event of bank crises, and to break the link between sovereign debt and bank debt[250]. The EC suggested creating a Banking Union. A key objective of which would be to reverse the fragmentation of financial markets since the euro crisis, by weakening the link between banks and their national sovereigns (whereby bank failures can imperil public finances, and sovereign stress can destabilise banks)[251]. The Commission also expected that centralisation of decision making, common bank supervision and resolution across the Euro Area applied consistently to all banks would ultimately build the necessary trust between the Member States, which is a precondition for the introduction of any common financial arrangements to protect depositors and support orderly resolution of failing banks[252].

The result of the second wave reforms was the creation of the Banking Union (see scheme 5) composed, firstly, of the Single Supervisory Mechanism (the '**SSM**')[253] (the ECB) and, secondly, of the Single Resolution Mechanism (the '**SRM**')[254] (responsible EU authority is the Single Resolution Board). This was the biggest step towards the greater integration within the EU after the creation of the Monetary and Economic Union and the introduction of

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[250] A Roadmap towards a Banking Union. Communication from the Commission to the European Parliament and the Council. The European Commission, Brussels, 12 September 2012. COM (2012) 510 final P.3. [accessed on 13 September 2012] < https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012DC0510&from=EN>.

[251] Towards the completion of the Banking Union. Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions. The European Commission, Strasbourg, 24 October 2015. P.3. [accessed on 25 October 2015] <https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX%3A52015DC0587>.

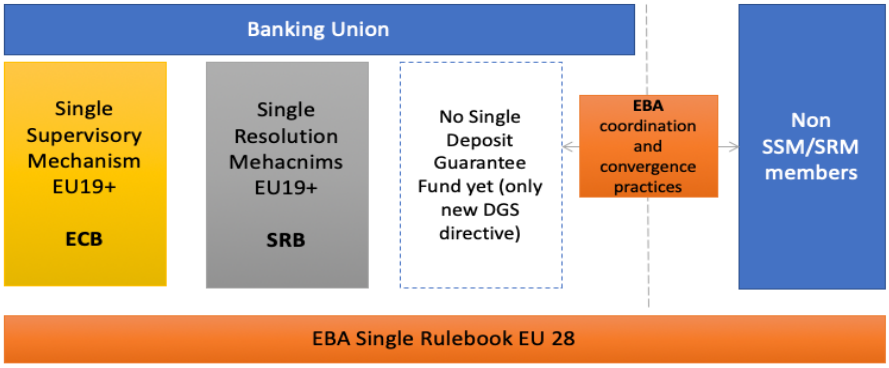
[252] A Roadmap towards a Banking Union. Communication from the Commission to the European Parliament and the Council. The European Commission, Brussels, 12 September 2012. COM(2012) 510 final P. 4. [accessed on 13 September 2012] < https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012DC0510&from=EN>.

[253] Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions. OJ L 287, 29.10.2013, p. 63–89.

[254] Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010. OJ L 225, 30.7.2014, p. 1–90.

Euro currency. This moment is also important not only from the perspective of the evolution of the EU institutional set-up in the field of banking supervision and crisis management but also highlights the moment when the mindset of the policymakers and the Member States have changed significantly encouraging greater integration which was hard to imagine before the financial crisis. Namely, it was understood (at least temporarily) that within a well-integrated market (as it is the case, for example, in the US) with integrated financial safety-net elements at the EU level you could have a more resilient financial system.

Scheme 5. The Outcome of the Banking Union



The EU institutional reform has shifted certain national financial safety-net elements towards the EU level, however, only to a certain level. Within the Single Market, the European Supervisory Authorities got more powers in the development of the European Single Rulebook applicable to all financial institutions and monitoring of its consistent implementation across the EU. While actual bank supervision and resolution were shifted towards the EU level only in the Euro Area. It is already recognised that the third pillar of the Banking Union, the Single Deposit Guarantee Scheme, which is an important element of the financial safety-net element[255], is missing and exists only at national levels. The EC regularly reminds about the issue[256]. In 2015 the so-

[255] The 2015 Five Presidents' Report also identified a European Deposit Insurance Scheme as an essential step to complete the Banking Union. JUNCKER, J.C. Completing Europe's Economic and Monetary Union. Brussels, 2015. P. 11. [accessed on 2 January 2019] < https://ec.europa.eu/commission/sites/beta-political/files/5-presidents-report_en.pdf >.

[256] Communication to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions on completing

called five presidents report highlighted that a single banking system is the mirror image of a single money, as the vast majority of money is bank deposits, money can only be truly single if confidence in the safety of bank deposits is the same irrespective of the Member State in which a bank operates what as a result requires single bank supervision, single bank resolution and single deposit insurance[257]. However, the progress is vague as there is no sufficient political will among the Member States to move forwards towards greater integration. As a result, the creation of the EU financial safety-net elements in the Euro area remains unfinished. Hopefully, not until the actual banking crisis will force to do this.

Furthermore, worth to note that the current EU allocation of powers and interplay between the newly established EU bodies and national competent authorities has already created some legal tensions within the Banking Union. For example, the Court of Justice of the European Union (the '**CJEU**')[258] in one of its ruling noted that it is wrong to argue that the national authorities retain, under Article 6(4) of the SSM Regulation, their competence for the purposes of performing the tasks listed in Article 4(1)(b) and (d) to (i) thereof, in relation to those entities classified as 'less significant'[259]. The court also noted the scope of the ECB's competence for the direct prudential supervision of credit institutions, noting that it should be recalled that Article 4 of the SSM Regulation, headed 'Tasks conferred on the ECB', provides in paragraph 1 that, within the framework of Article 6 of that regulation, the ECB is 'exclusively competent' to carry out, for prudential supervisory purposes, the tasks listed in Article 4(1) in relation to 'all' credit institutions established in the participating Member States, without drawing a distinction between significant institutions and less significant institutions. Thus, it follows from the wording of Article 4(1) of Regulation No 1024/2013 that the ECB is exclusively competent to carry out the tasks stated in that provision in relation to all those institutions[260]. Furthermore, under Article 6(1) of Regulation

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the Banking Union. The European Commission, Brussels, 11 October 2017. COM(2017) 592 final. P. 9.

[257] JUNCKER, J. C.; et all. Completing Europe's Economic and Monetary Union. European Commission, Brussels, 2015. P. 11. [accessed on 4 January 2016] <https://ec.europa.eu/commission/sites/beta-political/files/5-presidents-report_en.pdf>.

[258] Landeskreditbank Baden-Württemberg – Förderbank v. ECB, EC. Case C-450/17 P, 8 May 2019.

[259] *Ibid.*, Paragraph 36.

[260] *Ibid*., Paragraph 38.

No 1024/2013, the ECB is to carry out its tasks within an SSM composed of the ECB and national competent authorities and is to be responsible for the effective and consistent functioning of the SSM. It is in that context that, in accordance with Article 6(6) of Regulation No 1024/2013, national competent authorities are to carry out and be responsible for the tasks referred to in Article 4(1)(b), (d) to (g) and (i) of that regulation and are authorised to adopt all relevant supervisory decisions in relation to the credit institutions referred to in the first subparagraph of Article 6(4), that is, those which, in accordance with the criteria stated in that latter provision, are 'less significant'[261]. Finally, the Court concluded that "*[t]he national competent authorities thus assist the ECB in carrying out the tasks conferred on it by Regulation No 1024/2013, by a decentralised implementation of some of those tasks in relation to less significant credit institutions, within the meaning of the first subparagraph of Article 6(4) of that regulation*"[262]. The SRM is built on a similar concept and, therefore, this CJEU could be relevant for the interpretation of the SRB powers with regard to less significant institutions as well.

The current EU allocation of powers and interplay between the newly established EU bodies and national competent authorities and resolution authorities were assessed by national courts as well. The Federal Constitutional Court for the Federal Republic of Germany (the '**German Federal Constitutional Court**') has assessed the claim that the EU has exceeded the competences when establishing the Banking Union and conferring additional powers from national authorities to the ECB and the SRB. In July 2019, the German Federal Constitutional Court[263] ruled that the EU did not exceed the competences conferred on it by the Treaties when adopting the legislative framework regarding the Banking Union, including the SSM and the SRM only if those competencies "*are interpreted strictly*". More specifically, the German Federal Constitutional Court has held that the SSM Regulation does not manifestly exceed the authorisation under Art. 127(6) of the TFEU, given that it does not fully confer on the ECB the supervision of all credit institutions in the euro area. It also noted that the

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[261] *Ibid.,* Paragraph 40.
[262] *Ibid.,* Paragraph 41.
[263] Leitsätze zum Urteil des Zweiten Senats vom 30. Juli 2019. 2 BvR 1685/14. [accessed on 15 November 2019]
<https://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/DE/2019/07/rs20190730_2bvr168514.html;jsessionid=167F5A6571F7D28FB9EF0886DBCE8396.2_cid383>.

establishment of and competences assigned to the SRB by the SRM Regulation raise concerns with regard to the principle of conferral, but "*they do not amount to a manifest exceeding of competences if the Board acts strictly within the limits of the tasks and powers assigned to it*". Where the establishment of independent agencies is limited to exceptional circumstances, it does not encroach on the constitutional identity of the Basic Law. However, the diminished level of democratic legitimation that results from the independence of supervisory and resolution authorities at the European Union and national level is not permissible without limits and requires justification. In the domain of banking supervision and resolution, this diminished level of legitimation is acceptable in the end because it is compensated by specific safeguards allowing for democratic accountability[264].

As we can see, allocation of powers between the EU bodies and national authorities were already assessed both by the CJEU and national courts (e.g. the German Federal Constitutional Court). Considering the complexity of the legal regime, it could be expected that we will see more similar kind tensions with regard to the interplay between the newly established EU bodies and national authorities.

When the creation of the ESFS and the Banking Union was in progress, the Commission was working on the ambitious new directives and regulation in the field of banking. More specifically, the EU was transposing agreed international standards into the EU financial law, developing the EU bank prudential supervision, recovery, resolution and deposit insurance directives. Furthermore, a number of level 2 mandates for the newly established European Supervisory Agencies to further harmonise technical rules across the EU through the development of regulatory[265], implementing[266] technical

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[264] Leitsätze zum Urteil des Zweiten Senats vom 30. Juli 2019. 2 BvR 1685/14. [accessed on 15 November 2019] <https://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/DE/2019/07/rs20190730_2bvr168514.html;jsessionid=167F5A6571F7D28FB9EF0886DBCE8396.2_cid383>.

[265] Art. 8(2)(a), Art. 10 of the EBA Regulation, the ESMA Regulation, the EIOPA Regulation.

[266] Art. 8(2)(b), Art. 15 of the EBA Regulation, the ESMA Regulation, the EIOPA Regulation.

standards[267], guidelines and recommendations[268] were set in those directives. This was one of the most significant regulatory ambitions in the EU history (which could be compared with the first Commission's systematic attempts (which failed at that time) to harmonise legal rules linked to different financial safety-net elements in 1972, see Subchapter 1.3.2) with the aim at the same time to significantly harmonise legal rules linked to different financial safety-net element across the Member States.

In the field of bank prudential supervision, the EU adopted the Capital Requirements Directive[269] (the '**CRD IV**') and the Capital Requirements Regulation (the '**CRR'**). They transposed international standards (i.e. Basel III agreement[270], enhancing requirements for the quality and quantity of capital, a basis for new liquidity and leverage requirements, new rules for counterparty risk, new macroprudential standards including a countercyclical capital buffer and capital buffers for systemically important institutions etc.) into the EU law, as well as, made changes to rules on bank governance, including remuneration, as well as, introduced standardised EU regulatory reporting (referred to as COREP and FINREP[271]). This part of the EU regulatory framework aimed to further harmonise bank prudential supervision requirements across the EU to reduce the probability of bank failures.

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[267] Draft regulatory and implementing technical standards developed, for example, by the EBA, become acts with binding legal effect only when they are endorsed by the European Commission, by means of delegated acts pursuant to Article 290 TFEU or Article 291 of TFEU, respectively. They are subject to amendment only in very restricted and extraordinary circumstances, since the European Supervisory Authorities are the actors in close contact with and knowing best the daily functioning of financial markets. Draft technical standards are subject to amendment if they are incompatible with Union law, do not respect the principle of proportionality or ran counter to the fundamental principles of the internal market for financial services as reflected in the acquis of Union financial services legislation. The European Commission is also obliged not to change the content of the draft technical standards prepared by the Authorities without prior coordination with the Authorities. See, for example, Recital 23, Art. 10 – 15 of the EBA Regulation.

[268] Art. 8(2)(c), Art. 16 of the EBA Regulation, the ESMA Regulation, the EIOPA Regulation.

[269] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (Text with EEA relevance). OJ L 176, 27.6.2013, p. 338–436.

[270] See: Basel III: International Regulatory Framework for Banks. Basel. [accessed on 15 May 2018] <https://www.bis.org/bcbs/basel3.htm>.

[271] The EBA was mandated to specify all reporting data required from banks and national supervisory authorities via COREP and FINREP. For details see: EBA reporting framework. The European Banking Authority, London, 2019. [accessed on 7 June 2019] <https://eba.europa.eu/risk-analysis-and-data/reporting-frameworks>.

In the field of depositors' protection, the EU adopted a maximum harmonisation Deposit Protection Directive (the '**DGSD**')[272]. As a result, it harmonised rules concerning deposit coverage, the level of deposit protection by all recognised DGSs, pay-out conditions, contributions to the deposit guarantee schemes etc. This was a substantial step forward in ensuring common rules across the EU compared with the first DGSD[273] which was only a minimum harmonisation directive what allowed the Member States, for example, to set different coverage levels, while during the crisis uncoordinated increases in coverage across the EU have in some cases led to depositors transferring money to banks in countries where deposit guarantees were higher and drained liquidity from banks in times of stress.

The most substantial work has been done in the field of harmonisation of legal rules linked to bank crisis prevention and management. As it was discussed, since the creation of the EEC and subsequently the EU, there were a number of attempts to harmonise further legal rules and instruments for dealing with failing banks which usually failed. Significantly watered-down bank reorganisation and a winding-down directive was adopted only in 2002 and lacked actual harmonisation of instruments across the Member States. What is more, the financial crisis clearly showed that there is a lack of legal instruments which would allow imposing losses on bank's creditors without placing it into insolvency, while the insolvency of a systemic bank, providing critical functions, could result even in a greater loss to the wider economy. The Commission also acknowledged and highlighted that there were not only the considerable substantial and procedural differences between the laws, regulations and administrative provisions which govern the insolvency of institutions in the Member States, but also the fact that general corporate insolvency procedures may not always be appropriate for banks as they may not always ensure sufficient speed of intervention, the continuation of the critical functions of banks and the preservation of financial stability[274].

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[272] Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes Text with EEA relevance. OJ L 173, 12.6.2014, p. 149–178.
[273] Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes. OJ L 135, 31.5.1994, p. 5–14.
[274] Recital 4 of 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

Therefore, the question was how to rescue a bank providing critical functions without economic disruption of insolvency and with minimal recourse to public funds. Such a situation and, in particular, developments at the global level (for details see Subchapter 2) created momentum for unprecedented progress in this area and the creation of the EU bank recovery and resolution legal framework.

As a reaction to the report of the High-Level Group on Financial Supervision in the EU chaired by Jacques de Larosière[275], globally agreed Key Attributes, the Commission came with the legislative initiative – directive establishing a framework for the recovery and resolution of credit institutions and investment firms (the '**BRRD**') which also amended the EU bank reorganisation and winding-up directive[276]) and later with the Regulation[277] establishing the Single Resolution Mechanism (the '**SRM**'). The BRRD file was closed by the Lithuanian Presidency of the Council of the European Union which within a short period of time (six months) performed extensive negotiations in political and technical trialogues between the Parliament, the Council and the Commission. The agreement reached in trilogues was approved by the European Parliament and the European Council and the BRRD, setting the EU bank recovery and resolution legal framework across 28 EU Member States, was adopted in spring 2014.

Furthermore, on the basis of the BRRD, the SRM, establishing the Single Resolution Board (the '**SRB**') and the second pillar of the EU Banking Union, was adopted in summer 2014. Contrary to the BRRD, the SRM applies only to the Member States which participate in the Banking Union – by default Member States whose currency is euro (see scheme 6). The SRM sets procedural rules for the functioning of the SRB, which acts together with the

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Parliament and of the Council (Text with EEA relevance)Text with EEA relevance. OJ L 173, 12.6.2014, p. 190–348.

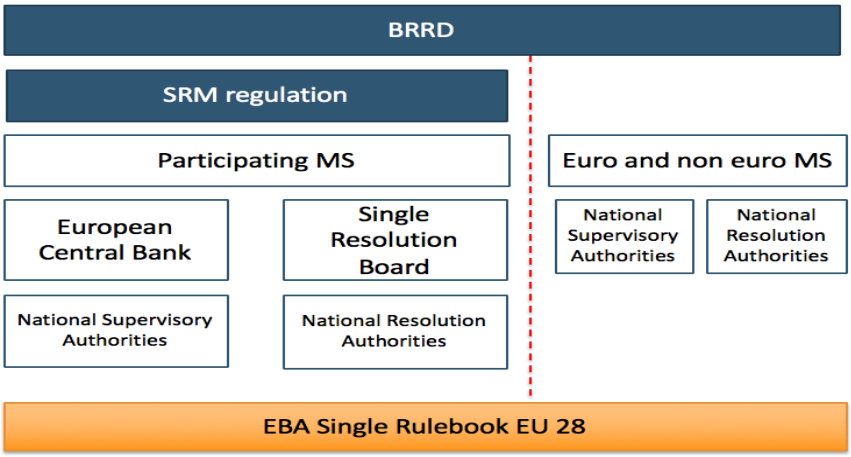
[275] In the report, among other things, it was observed that "*The lack of consistent crisis management and resolution tools across the Single Market places Europe at a disadvantage vis-à-vis the US and these issues should be addressed by the adoption at EU level of adequate measures.*" The high-level group on financial supervision in the EU. Report. European Parliament, Brussels, 25 February 2009. [accessed on 6 June 2015] <http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf>.

[276] Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions. OJ L 125, 5.5.2001, p. 15–23.

[277] Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010. *OJ L 225, 30.7.2014, p. 1–90.*

participating national resolution authorities as a centralized decision-making body in the field of resolution[278].

Scheme 6. The BRRD and the SRM interaction



By adopting the Bank Recovery and Resolution Directive[279] (the '**BRRD**') which together with the SRM in the Euro area, set (in-line with the international standards of the Financial Stability Board, see detailed analysis in Subchapter II) a new resolution paradigm was created with the aim strengthen this financial safety-net element across the Member States at the EU level. Though, further harmonisation of bankruptcy and winding-up rules remained out of the scope.

Management and planning have always been the so-called key 'ingredients' of organisational life. However, the way planning was done has changed significantly over the years in response to societal change in the business environment.[280] Banks were pushed to focus on planning as well. By introducing a number of preparatory and early intervention measures, new tools and powers both for supervisory and newly established resolution

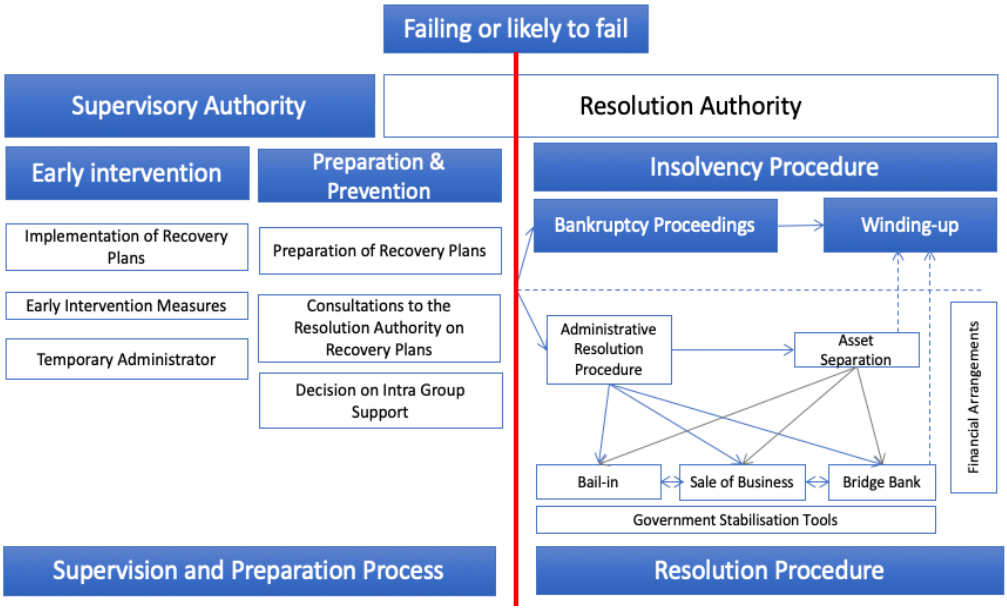
[278] Recitals 10 and 11 of the SRM.

[279] 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 (Text with EEA relevance)Text with EEA relevance. OJ L 173, 12.6.2014, p. 190–348.

[280] RAMIREZ, R.; WILKINSON, A. Strategic Reframing. The Oxford Scenario Planning Approach. Oxford University Press, Oxford, Oxford 2016. Foreword.

authorities (see Scheme 8), as well as, obligations for banks, the BRRD aims to further strengthen and harmonise across the Member States the preparation, prevention and management of bank failures by aiming to ensuring the continuity of the bank's critical functions which are essential to the real economy and financial stability when the bank faces difficulties. However, worth to note that the BRRD acknowledges that in order to avoid moral hazard, banks should be allowed to fail and that the winding up of a failing bank through normal insolvency proceedings should always be considered before the resolution tools are applied[281].

Scheme 7. The EU bank recovery and resolution legal framework Elements



What is more, the EU legal framework has introduced a public interest test for the determination of whether the resolution action would be in the public interest. More specifically, there are three main conditions set in the legal framework which have to be met by the institution that resolution authority could take resolution actions, namely: i) determination that the institution is failing or likely to fail[282]; ii) there is no reasonable prospect that any alternative

[281] Recitals 44 – 45 of the BRRD.

[282] An institution shall be deemed to be failing or likely to fail in one or more of the following circumstances: (a) the institution infringes or there are objective elements to support a determination that the institution will, in the near future, infringe the requirements for

private sector measures or supervisory actions would prevent the failure of the institution; iii) a resolution action is necessary in the public interest. While the first two conditions are more 'traditional' and were usually assessed by supervisory authorities when considering whether to put the bank under insolvency, the third condition – *public interest test* – is more specific and has introduced a new angle for the resolution paradigm. The BRRD further specifies that a resolution action should be treated as in the public interest if it is necessary for the achievement of and is proportionate to one or more of the resolution objectives (which are extensively discussed in Part II) and winding up of the institution under normal insolvency proceedings would not meet those resolution objectives to the same extent[283]. While the continuity of critical functions is one of the resolution objectives[284], therefore, forms an important part of the public interest test.

In the Banking Union, the SRB (the EU resolution authority) applied public interest test and, therefore, assessed whether the resolution objectives, including the continuity of critical functions, would be met for the first time in respect of Banco Popular Espanol, S.A (the '**Bank**'). On 7 June 2017, the SRB decided that the conditions for resolution action of Article 18(1)(a) (failing or likely to fail), (b) (alternative private measures and supervisory

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continuing authorisation in a way that would justify the withdrawal of the authorisation by the competent authority including but not limited to because the institution has incurred or is likely to incur losses that will deplete all or a significant amount of its own funds; (b) the assets of the institution are or there are objective elements to support a determination that the assets of the institution will, in the near future, be less than its liabilities; (c) the institution is or there are objective elements to support a determination that the institution will, in the near future, be unable to pay its debts or other liabilities as they fall due; (d) extraordinary public financial support is required except when, in order to remedy a serious disturbance in the economy of a Member State and preserve financial stability, the extraordinary public financial support takes any of the following forms: (i) a State guarantee to back liquidity facilities provided by central banks according to the central banks' conditions; (ii) a State guarantee of newly issued liabilities; or (iii) an injection of own funds or purchase of capital instruments at prices and on terms that do not confer an advantage upon the institution, where neither the circumstances referred to in point (a), (b) or (c) of this paragraph nor the circumstances referred to in Article 59(3) of the BRRD are present at the time the public support is granted. See Article 32 (1)(a)(4) of the BRRD.

[283] Article 32(5) of the BRRD.

[284] Article 31(2)(a) of the BRRD. Other objectives: ii) to avoid a significant adverse effect on the financial system, in particular by preventing contagion, including to market infrastructures, and by maintaining market discipline; iii) to protect public funds by minimising reliance on extraordinary public financial support; iv) to protect depositors covered by Directive 2014/49/EU and investors covered by Directive 97/9/EC; and v) to protect client funds and client assets. Article 31(2)(b)(c)(d)(e) of the BRRD.

actions) and (c) (public interest test) were satisfied[285]. The resolution plan of this bank identified the following functions as critical: deposit-taking, lending to small and medium enterprises, payment and cash services[286]. During the public interest test assessment, the SRB concluded that resolution action would be necessary to ensure the continuity of critical functions (as identified in the resolution plan) and to avoid adverse effects on financial stability. It was assessed that the winding up of the institution under normal insolvency proceedings would not meet those resolution objectives to the same extent.

However, other cases showed that in practice, the application of this test, including the legal concept of critical functions, may not be straightforward, and there are still potential gaps in the EU legal framework. For example, on 23 June 2017, the SRB decided not to take resolution action in respect of Banca Popolare di Vicenza S.p.A and Veneto Banca S.p.A. (the Banks). The SRB assessed that, while the conditions for resolution action of Article 18(1)(a) (failing or likely to fail) and (b) (alternative private measures and supervisory actions) of the SRM were met, the condition of Article 18(1)(c) (public interest) was not satisfied. In particular, the SRB highlighted that i) the functions performed by the Banks, e.g. deposit-taking, lending activities and payment services, are not critical since they are provided to a limited number of third parties and can be replaced in an acceptable manner and within a reasonable timeframe; ii) the failure of the Bank is not likely to result in significant adverse effects on financial stability taking into account, in particular, the low financial and operational interconnections with other financial institutions; and, iii) normal Italian insolvency proceedings would achieve the resolution objectives to the same extent as resolution since such proceedings would also ensure a comparable degree of protection for depositors, investors, other customers, clients' funds and assets[287]. Therefore,

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[285] Decision of the Single Resolution Board in its Executive Session of 7 June 2017, concerning the adoption of a resolution scheme in respect of Banco Popular Espanol, S.A. with the Legal Entity Identifier: 80H66LPTVDLM0P28XF25, Addressed to FROB. SRB/EEs/2017/08. [accessed on 20 August 2017] <https://srb.europa.eu/sites/srbsite/files/resolution_decision_updated_on_30_10_2018.pdf>.

[286] *Ibid,* paragraph 20.

[287] Public summary of the SRB's decision in respect of Banca Popolare di Vicenza S.p.A, 23 June 2017. [accessed on 26 June 2017] <https://srb.europa.eu/sites/srbsite/files/23.6.2017_summary_notice_banca_popolare_di_vicenza_s.p.a._20.00.pdf>; Public summary of the SRB's decision in respect to Veneto Banca, 23 June 2017. [accessed on 26 June 2017] <https://srb.europa.eu/sites/srbsite/files/23.6.2017_summary_notice_veneto_banca_s.p.a_20.0

these two banks were put into liquidation in order to be wound-up under national insolvency proceedings under the responsibility of the Bank of Italy, in its capacity as the national resolution authority. However, the Italian government argued that to avoid an economic disturbance in the region as a result of the liquidation, state aid is necessary for these banks to exit the market. Finally, the European Commission applied the provisions of its communication[288] approved state aid for the market exit of these banks, involving the sale of some parts to Intesa Sanpaolo[289]. This has raised concerns whether special national insolvency frameworks will not be used to overcome the EU bank recovery and resolution legal framework. Potential divergent approaches at the EU and national level, in particular, given that there is the EU bank recovery and resolution framework, but insolvency remains a national prerogative, already caught the European Parliament's attention[290] which started discussions on the need for further harmonisation of the legal framework to ensure a common approach.

The bank recovery and resolution legal framework is a complex matter as, on the one hand, it is situated at the intersection of bank prudential regulation and supervision legal framework, and on the other, resolution and national insolvency legal framework – spilling over into both areas'[291]. More

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0.pdf>). For details with regard to the assessment of criticality of the functions see: Decision of the SRB in its Executive Session of 23 June 2017 concerning the assessment of the conditions for resolution in respect of Veneto Banca S.p.A with the Legal Entity Identifier 549300W9STRUCJ2DLU64, addressed to Banca d'Italia in its capacity as National Resolution Authority, SRB/EES/2017/11. [accessed on 20 June 2018] < https://srb.europa.eu/sites/srbsite/files/srb-ees-2017-11_non-confidential.pdf>; Decision of the SRB in its Executive Session of 23 June 2017 concerning the assessment of the conditions for resolution in respect of Banca Popolare di Vicenza S.p.A. (the "Institution"), with the Legal Entity Identifier V3AFM0G2D3A6E0QWDG59, addressed to Banca d'Italia in its capacity as National Resolution Authority , SRB/EES/2017/12. [accessed on 20 June 2018] <https://srb.europa.eu/sites/srbsite/files/srb-ees-2017-12_non-confidential.pdf>.

[288] Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis (Banking Communication), 2013/C 216/01.

[289] See public summary: Commission approves aid for the market exit of Banca Popolare di Vicenza and Veneto Banca under Italian insolvency law, involving sale of some parts to Intesa Sanpaolo, Brussels, 25 June 2017. [accessed 25 June 2017] <http://europa.eu/rapid/press-release_IP-17-1791_en.htm>

[290] See: Critical functions and public interest in banking services: Need for clarification? European Parliament, Brussels, November 2017.

[291] See for example, HAENTJENS, Mathias; WESSELS, Bob. Research Handbook on Crisis Management in the Banking Sector. Edward Elgar Publishing Limited, UK, 2015. P. 84.

specifically, the BRRD is reliant and refers to the national insolvency[292] and corporate laws[293], the areas which are harmonised to a very limited extent at the EU level[294]. This, as it was discussed, already caused some concerns in practice (this aspect will be further discussed in Chapter II).

What is more, the recovery and resolution planning constitute an integral part of an enhanced and strengthened framework for bank prudential supervision with a focus on planning and resolvability. More specifically, where the CRD and CRR (transposing the global Basel standards into the EU law) seek to prevent financial distress[295] in the first place, the EU bank recovery and resolution legal framework (transposing the FSB international standards into the EU law) by setting legal provisions linked to the preparation, prevention and early intervention go further and seek to ensure that if things go wrong the[296] bank resolution could be initiated or, if the conditions for resolution are not met, could be orderly wound-up via normal insolvency proceedings.

Furthermore, the application of the resolution tools[297] and powers may also lead to concentration of banking activities and, therefore, require considering national legal provisions and the provisions of Regulation (EC) No 139/2004 (the **Regulation on the control of concentrations**[298]), unless the application

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[292] E.g. Art. 32(1)(c), 32b, 33a(5), 44(2)(h) of the BRRD.
[293] E.g. Art. 29(8), 40(12) of the BRRD.
[294] For the analysis of variation of national insolvency regimes across jurisdictions see: BAUDINO, P.; et all. Why do we need bank-specific insolvency regimes? A review of country practices. In FSI Insights on Policy Implementation, No 10, October 2018.
[295] Even though it was declared that the CRR and CRD are maximum harmonisation legal acts, they contain over 150 national options and discretions. As a result, this provides the Member States with an option to choose how they transpose those elements into the national law or to adjust to practices which existed before the adoption of the legal norm at the EU level. See: Public consultation on a draft Regulation and Guide of the European Central Bank on the exercise of options and discretions available in Union law. Explanatory memorandum. European Central Bank, Frankfurt, 11 November 2015. P. 3. [accessed on 10 July 2019] <https://www.bankingsupervision.europa.eu/legalframework/publiccons/pdf/reporting/pub_con_explanatory_memorandum_options_discretions.en.pdf?bf95087a9a34cd3d654446e5bb462c8a>.
[296] Ibid.
[297] For example, such a situation may occur when the sale of business tool is applied and all or a significant part of the critical functions, assets, liabilities or shares are transferred to an acquiring bank.
[298] Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation) (Text with EEA relevance). OJ L 24, 29.1.2004, p. 1–22.

of resolution tools and powers does not have a Union dimension[299]. Such analysis, for example, was required in Banco Popular resolution case[300] when the sale of business tool was applied, and the Banco Santander S.A. acquired the Banco Popular within the meaning of Article 3(1)(b) of the Regulation on the control of concentrations[301].

To sum up, it is evident that by '*upgrading*' the EU institutional set-up and regulatory framework in the field of banking supervision, crisis prevention and management, the EU has taken a big step in improving financial safety-net elements and building bank crisis management architecture, ensuring greater harmonisation across the Member States as well as cooperation among supervisory and resolution authorities when dealing with bank recovery and resolution issues. However, the institutional set-up and the regulatory framework is nothing without its actual and consistent implementation in the single market, what is a challenge. On the one hand, this challenge arises from the remaining national options and discretions allowed by directives, on the other hand, because of complexity and interlinks of the EU bank recovery and resolution legal framework with other parts of the EU and national legal frameworks (which are also either harmonised to a limited extent or exists only at the national level). To ensure greater consistency, understanding of international standards which have impacted the development of the EU bank recovery and resolution legal framework, as well as, its legal resolution

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[299] Art. 1(1) of the Regulation on the control of concentration defining the application scope of the Regulation states that it should apply to all concentrations with a Union dimension as defined in that Article.

[300] See Decision of the Single Resolution concerning the adoption of a resolution scheme in respect of Banco Popular Espanol, S.A, addressed to FROB. The Single Resolution Board, Brussels, 7 June 2017. [accessed on 8 20 June 2019] <https://srb.europa.eu/sites/srbsite/files/resolution_decision_updated_on_30_10_2018.pdf>.

[301] Worth to note that in order to implement the measures necessary for the financial stability of the Banco Popular before the adoption of the final decision of the Commission under the Regulation on the Regulation on the control of concentrations the Banco Santander requested the Commission for the derogation from the standstill obligation provided for in Article 7(1) of the Regulation. The Commission, taking into account that the measures would be limited to what is necessary to avoid a further deterioration of the Banco Popular solvency and other regulatory ratios and would not lead to the operational integration of the Banco Popular within Santander, on the same day adopted a decision granting the derogation from the standstill obligation subject to certain conditions and to the extent necessary for the financial stability. See: Case M.8553 – Banco Santander S.A. / Banco Popular Group S.A. The European Commission, Brussels, 7 June 2017. [accessed on 8 June 2018] <https://ec.europa.eu/competition/mergers/cases/decisions/m8553_222_3.pdf>

objectives is important as well and therefore will be captured in the following Chapters.

1.3. G20 changes to the global financial architecture, establishment of the Financial Stability Board, development of the bank recovery and resolution international standards, and implications to the EU legal framework in this field

Bank failures can disrupt the continuity of their critical functions (in case they do perform a function which is considered as critical)[302] and therefore threaten systemic stability as i) many banks play an important role in the payment and clearing systems; ii) banks are credit institutions that generally hold illiquid assets and liquid liabilities, the latter of which are usually cash deposits that may be recalled on demand, with a potential of bank run; and iii) the interconnections between banks in their wholesale operations make them vulnerable to contagion, in which one bank's failure can have a domino effect other banks[303]. In order to manage systemic risk, national authorities have relied on various *ex-ante* and *ex-post* regulatory measures. With regard to *ex-ante* measures such examples as authorisation requirements, capital adequacy requirements, large exposures limits, and limitations on lending could be mentioned (e.g. the CRD and the CRR in the EU). With regard to *ex-post* measures, deposit insurance could be mentioned as an example. As it was discussed in the first Subchapter, a lot of efforts were put to harmonise the legal provisions linked to those elements since the creation of the EEC and subsequently the EU.

However, integration has been increasing not only in the EU. As it was already discussed, international linkages around the globe have increased dramatically[304] over the past few decades as well. This increased cross border

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[302] A detailed research of the critical functions concept, methodology for the identification whether certain function is critical or not, interlinked elements etc. is provided in Chapter II.

[303] ALEXANDER, Kern; DHUMALE, Rahul; EATWELL, John. Global Governance of Financial Systems: The International Regulation of Systemic Risk. Oxford University Press, Oxford, 2006. P.24.

[304] World trade as a share of global GDP has doubled since 1970. Over the past two decades, 80% of the increase in total trade has come from intermediates goods trade, driving up the value added of imports as a share from 10% of exports in 1990 to around 20% in 2015. Crossholding

spill overs risk as increased financial linkage lead to faster and more powerful transmission of shocks across countries[305]. The globalisation of financial systems has also made banks more interdependent and thus more exposed to systemic risk that can arise from bank failures at the national level and to volatility in cash flows[306]. This required adequate legal regulation at the domestic and international level which, as many agree, unfortunately, did not accompany following the liberalisation of financial markets, the globalisation of financial services and capital flows[307].

History shows that financial and banking crises usually trigger regulatory reforms, which, because of the high costs involved, are usually harder to promote as preventative measures during the 'piece' time but easier to justify once losses can be ascribed to regulatory failures. The last financial crisis is not an exception[308]. With its unprecedented amplitude, high impact on the real economy and trillions of ascertained losses, a political momentum was created that allowed for substantial changes at the international and domestic levels not only in traditional financial safety-net components such as banking regulation and prudential supervision (for example, at the global level the Basel Committee of the Bank for International Settlements focused on capital requirements) deposit insurance[309]but also stimulated a reform to re-setup a

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of countries' assets and liabilities increased almost fourfold since 1990, and measures of stock market integration are at their highest ever see BASILDON, C; et all. Towards an Unstable Hook: The Evolution of Stock Market Integration Since 1913. In *NBER Working Paper* No. 26166, 2019 as quoted in speech given by Mark Carney Governor of the Bank of England. The Growing Challenges for Monetary Policy in the current International Monetary and Financial System. 23 August 2019. P.6. [accessed on 24 Augusts 2019] <https://www.bankofengland.co.uk/-/media/boe/files/speech/2019/the-growing-challenges-for-monetary-policy-speech-by-mark-carney.pdf?la=en&hash=01A18270247C456901D4043F59D4B79F09B6BFBC>.

[305] The Growing Challenges for Monetary Policy in the current International Monetary and Financial System. Speech given by Mark Carney Governor of the Bank of England, Jackson Hole Symposium, 23 August 2019. P.6. [accessed on 24 Augusts 2019] <https://www.bankofengland.co.uk/-/media/boe/files/speech/2019/the-growing-challenges-for-monetary-policy-speech-by-mark-carney.pdf?la=en&hash=01A18270247C456901D4043F59D4B79F09B6BFBC>.

[306] ALEXANDER, Kern; DHUMALE, Rahul; EATWELL, John. Global Governance of Financial Systems: The International Regulation of Systemic Risk. Oxford University Press, Oxford, 2006. P.14.

[307] *Ibid.*, P. 3, 14.

[308] BALČIŪNAS, Laurynas. Financial Market Supervision Models and Trends of Legal Regulation. In *Teisė*, 99, pp. 64 – 82, Vilnius, 2014. P. 78.

[309] See, for example: Finalising post-crisis reforms: an update. A report to G20 Leaders. The Basel Committee on Banking Supervision, Basel, November 2015. [accessed on 18 July 2018] <https://www.bis.org/bcbs/publ/d344.pdf>; MENON, R. Financial Regulation – 20 years after

global international standard-setter in the field of banking crisis management, resolution and financial stability. While the G20, as we will see, emerged as a key forum for the development of an internationally coordinated regulatory response, and significantly gained influence of political control over the standard-setting bodies. These reforms also do have implications for the EU.

Considering the above mentioned, this section will discuss: i) how the global financial architecture has changed and who is a key player in developing international standards in the field of bank crisis management, recovery and resolution; ii) what kind of legal status it has; iii) what are those international standards and what is their legal power; and, finally, iv) what is the role of the EU and implications to the EU financial law, and, in particular, the EU bank recovery and resolution legal framework.

1.3.1. Changes to the global financial architecture and (re)establishment of the Financial Stability Board (FSB) and the EU participation

The G20 which is considered to be a premier forum for international economic cooperation is a group of 20 finance ministers and central bank governors[310] established by the G7 in 1999 in the wake of the Asian financial crisis to bring together systemically important industrialized and developing economies to discuss key issues in the global economy. It has a broader membership than the traditional Western-dominated groups (i.e. G7[311]) as it was created as an attempt to involve developing nations more in international policy discussions[312]. It does not have any kind of law-making power, and

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the Global Financial Crisis. the Symposium on Asian Banking and Finance, Federal Reserve Bank of San Francisco, San Francisco, 25 June 2018. [accessed on 25 June 2018] <https://www.bis.org/review/r180727a.pdf>.

[310] The Members of the G20 are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, United Kingdom, United States, European Union, IMF, and World Bank. See: The G20. Australian Government. Department of Foreign Affairs and Trade. [accessed on 6 June 2019] <https://dfat.gov.au/trade/organisations/g20/Pages/g20.aspx>.

[311] G7 stands for the Group of 7. The Members of the G7 are Canada, France, Germany, Italy, Japan, the United Kingdom and the United States. The European Union has been involved in G7 work since 1977. Together, the G7 countries represent 40% of global GDP and 10% of the world's population. See: G7 Presidency, France. [accessed on 6 June 2019] < https://www.elysee.fr/en/g7/2019/01/01/what-is-the-g7>.

[312] The impact of G20 decisions is considerable as it represents 85% of the global GDP, and accounts for two thirds of the world's population. See: G7 Presidency, France. [accessed on 6 June 2019] < https://www.elysee.fr/en/g7/2019/01/01/what-is-the-g7>.

rather it is a forum for discussion, though, given its membership and composition, it is of course very influential[313].

The G20 Leaders at the Washington Summit in 2008, amid a serious challenge to the world economy and financial markets, agreed to undergo significant financial system reform, including review of the global financial architecture[314]. Already in 2009 at the meeting in London, the G20 Leaders agreed to re-establish the Financial Stability Board (the '**FSB**') with a stronger institutional basis and broadened mandate, as a successor to the Financial Stability Forum (the '**FSF**') established in the wake of the Asian financial crisis (though, it had no mandate to generate standards)[315], to play a key role in promoting the reform of international financial regulation and supervision, in particular with regard to banking crisis management, resolution and financial stability[316]. The FSB is politically accountable to the G20. Considering the UK lead and expertise in the field of financial markets, Mark Carney, Governor of the Bank of England, was appointed as the first Chair of the FSB[317].

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[313] McCORMICK, R; STEARS. C. Legal and Conduct Risk in the Financial Markets. University Oxford Press, Oxford, United Kingdom, 2018. Paragraph 9.11.

[314] Declaration of the Summit on Financial Markets and the World Economy. The Leaders of the G20, Washington DC, 15 November 2008. [accessed on 20 November 2008] <http://www.g20.utoronto.ca/2008/2008declaration1115.html#principles>.

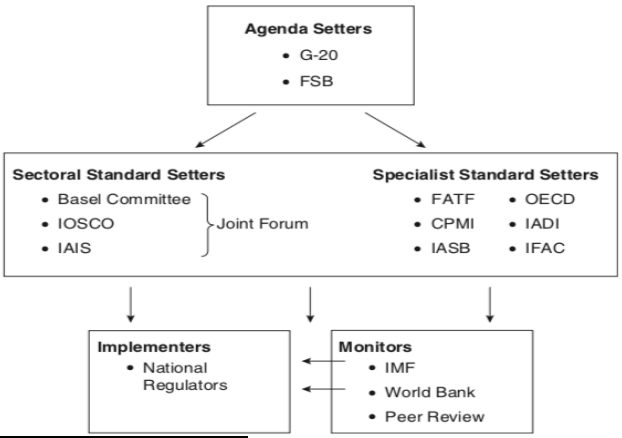
[315] As the **G20** (see the above footnote) the **Financial Stability Forum** (the 'FSF') was founded by G7 Ministers and Central Bank Governors in 1999 in the wake of the Asian financial crisis. The aim of the FSF was to assess issues and vulnerabilities affecting the global financial system and identify and oversee the actions needed to address them, including encouraging, where necessary, the development or strengthening of international best practices and standards and defining priorities for addressing and implementing them. It was composed of the FSF members, representatives of national authorities responsible for financial stability, the relevant international financial institutions and organisations as well as the relevant international supervisory bodies and expert groupings. The FSF was based at the Bank for International Settlements in Basel, Switzerland. Communiqué of G-7 Finance Ministers and Central Bank Governors. Petersburg, Bonn, 20 February 1999. Paragraph 15. [accessed on 20 April 2018] <https://web.archive.org/web/20061001083016/http://www.fsforum.org/attachments/g7pressrelease_on_establishment_ofFSF.pdf>.

[316] G20 London Summit – Leaders' Statement. The Leaders of the Group of Twenty, London, 2 April 2019. Paragraph 15. [accessed on 20 July 2018] <http://www.g20.utoronto.ca/2009/2009communique0402.pdf> and Declaration on the Strengthening the Financial System – London Summit. The Leaders of the G20, London, 2 April 2009. P. 1. [accessed on 20 July 2018] <http://www.g20.utoronto.ca/2009/2009ifi.pdf>.

[317] Former Chair of FSB (2011 – 2018). The FSB, 2019. [accessed on 2 April 2019] <https://www.fsb.org/profile/mark-carney/>.

The FSB is now composed of Members (including all G20 countries, FSF members, Spain and the European Union)[318], international financial institutions[319], international standard setters and other bodies[320]. Compared with the FSF, the number of members and participating parties have substantially increased, and goes beyond G7 countries, as the lack of international coordination in regulation, in today's borderless capital markets, was at the heart of the global financial crisis[321]. The FSB also compliments the global financial system as an agenda-setter (see scheme 8). However, we may raise the question of what the actual legal status of the FSB is?

Scheme 8. A Simplified Overview of the Global Financial Architecture and the FSB's Place[322]



[318] A full list of the FSB Members: Argentina, Australia, Brazil, Canada, China, France Germany, Hong Kong, India, Indonesia, Italy, Japan, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, South Korea, Spain, Switzerland, Turkey, the UK, US, European Union (European Commission, European Central Bank). See: Member Jurisdictions. Financial Stability Board, Basel. [accessed on 19 August 2018] <https://www.fsb.org/about/fsb-members/>.

[319] Participating international financial institutions: Bank for International Settlements (BIS), International Monetary Fund (IMF), Organisation for Economic Co-operation and Development (OECD), the World Bank. See: International Financial Institutions. Financial Stability Board, Basel. [accessed on 19 August 2018] <https://www.fsb.org/about/fsb-members/>.

[320] Participating international standard setting and other bodies: Basel Committee on Banking Supervision (BCBS), Committee on the Global Financial System (CGFS), Committee on Payments and Market Infrastructures (CPMI), International Association of Insurance Supervisors (IAIS), International Accounting Standards Boards (IASB). See: International standard setting and other bodies. Financial Stability Board, Basel. [accessed on 19 August 2018] <https://www.fsb.org/about/fsb-members/>.

[321] DOUGLAS; W. A. The Global Credit Crisis of 2008: Causes and Consequences. Asian Institute of International Financial Law, Faculty of Law, the University of Hong Kong, January 2009. P.

[322] Source: BRUMMER, C. Soft Law and the Global Financial System. Rule Making in the 21st Century. Cambridge University Press, New York, 2015. P. 70

1.3.2. The legal personality and status of the FSB

Following the G20 summit meeting in London and establishment of the FSB, its institutional strengthening was endorsed through the adoption of the Charter at the G20 Summit in Pittsburgh on 24-25 September 2009[323]. The Charter[324] further specified mandate and tasks of the FSB[325], as well as noted that the Members of the FSB *"[r]ecognise the need to promote financial stability by developing strong regulatory, supervisory and other policies and fostering a level playing field through coherent implementation across sectors and jurisdictions*"[326].

However, the Report provided by the Prime Minister of the UK to the G20 Leaders at the Cannes Summit in 2011 already indicated clear shortcomings of existing FSB set-up. It was noted that "*the FSB has operated along extremely informal lines, supported generously by the staff and resources of the Bank for International Settlements and its members*", highlighting that such a situation requires to "*properly <..> equip the FSB to ensure <…> its activities meet its written mandate*"[327]. What is more, it was acknowledged that *"<…>the FSB currently has no legal personality or separate identity <…>, and hence its authority, is blurred*"[328]. Finally, it was recommended to the G20 to "*ask the FSB to establish itself as a legal entity which provides it with the identity, authority and capability it needs to fulfil its comprehensive remit*"[329].

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[323] G20 Leaders Statement: The Pittsburgh Summit. The Leaders of G20, Pittsburgh, 24-25 September 2009. Paragraph 11. [access on 19 August 2018] [http://www.g20.utoronto.ca/2009/2009communique0925.html]

[324] Financial Stability Board Charter. The Members of the Financial Stability Board, 2009. [access on 19 August 2018] <https://www.fsb.org/wp-content/uploads/r_090925d.pdf>.

[325] *Ibid*, Art.

[326] Preamble of the Charter.

[327] Governance for growth. Building consensus for the future. A report by David Cameron, Prime Minister of the United Kingdom, London, November 2011. Paragraph 2.29 [accessed on 2 December 2011] <http://www.g20.utoronto.ca/2011/2011-cameron-report.pdf>.

[328] Governance for growth. Building consensus for the future. A report by David Cameron, Prime Minister of the United Kingdom, London, November 2011. Paragraph 2.30 [accessed on 2 December 2011] <http://www.g20.utoronto.ca/2011/2011-cameron-report.pdf>.

[329] Governance for growth. Building consensus for the future. A report by David Cameron, Prime Minister of the United Kingdom, London, November 2011. Paragraph 2.31 [accessed on 2 December 2011] <http://www.g20.utoronto.ca/2011/2011-cameron-report.pdf>.

As a result, ahead of the G20 Summit, the FSB Chair circulated the proposal[330] with the amendments to the Charter. The proposal also stated that *"[t]he FSB should remain a flexible, responsive, member-driven, multi-institutional and multidisciplinary institution; it should also continue to operate with active involvement of senior-level officials in a collegial spirit of mutual trust, and its decision making on policy issues should continue to be based on consensus*"[331]. In 2012 at the Los Cabos Summit in 2012, the Leaders of the G20 on the basis of the FSB Chair's proposals revised the FSB Charter in order to place *"the FSB on an enduring organisational footing, with legal personality, strengthened governance, greater financial autonomy and enhanced capacity to coordinate the development and implementation of financial regulatory policies, while maintaining strong links with the BIS*"[332], and endorsed the amended Charter (the Charter 2)[333]. It is important to note that the Charter was endorsed only at the G20 level and it did not go through the ratification procedure what is usually the case with the international treaties establishing the international organisations.

The FSB's legal status was further clarified only in 2013, once the Articles of Association[334] were adopted by the Plenary. They stated that "*[a]n an association by the name of Financial Stability Board is hereby established pursuant to Article 60 of the Swiss Civil code"*[335]. This was further supported by the G20 statement at the St. Petersburg Summit in 2013, as leaders welcomed the establishment of "*the FSB as a legal entity with greater financial autonomy and [an] enhanced capacity to coordinate the development and implementation of financial regulatory policies*."[336]

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[330] Report to the G20 Los Cabos Summit on Strengthening FSB Capacity, Resources and Governance. The Chair of the FSB, 12 June 2012. [accessed on 12 June 2012] <https://www.fsb.org/wp-content/uploads/r_120619c.pdf>.
[331] *Ibid,* P.1.
[332] G20 Leaders Declaration. The Leaders of the G20, Los Cabos, 18-19 June 2012. Paragraph 46. [accessed on 19 June 2012] < http://www.g20.utoronto.ca/2012/2012-0619-loscabos.pdf>.
[333] The revised Charter 2 of the Financial Stability Board, June 2012. [accessed on 24 August 2018] <https://www.fsb.org/wp-content/uploads/FSB-Charter-with-revised-Annex-FINAL.pdf>.
[334] The Articles of Association. FSB, Basel 2013. [accessed on 22 August 2018] <https://www.fsb.org/wp-content/uploads/FSB-Articles-of-Association.pdf>.
[335]Ibid., Art. 1(1).
[336] G20 Leaders' Declaration. The Leaders of the G20, St. Petersburg, 6 September 2013. Paragraph 64. [accessed on 22 August 2018] < http://www.g20.utoronto.ca/2013/2013-0906-declaration.html>.

The analysis shows that the FSB mandate and tasks have been gradually broadened by the G20, so did the clarification of its legal status. Though, the legal personality and status of the FSB is complex, as it is not established by the international treaty and, therefore, formally cannot be defined as an international organisation (e.g. as the IMF or the World Bank), rather an international body/association established and driven by its Members forming a transnational network of participating central banks, ministries of finance and international organisations and other bodies. On the other hand, as also highlighted by J. Wouters[337], if the FSB was created through a '*hard law*' international treaty[338], it would be much more complicated for the G20 members (or even hardly possible as it is the case with the IMF and the World Bank mandates) to dynamically adapt and modify the mandate of the FSB considering changing reality in the field of financial system and markets. All this stipulates another question, what is the legal power of international standards and guidelines adopted by the FSB.

1.3.3. The FSB international standards and their legal status

In 2008 at the Washington Summit, G20 Leaders committed to undergo radical reform of the financial system[339]. In the following meetings, they charged the re-established FSB with fixing the fault lines that caused the financial crisis. The comprehensive reform programme was composed of four main components, one of which was ending 'too big to fail' issue of systemically important banks[340]. We will have a closer look into the G20 requests and a decade of the FSB work when developing international

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[337] See WOUTERS, J; ODERMATT, J. Comparing the 'Four Pillars' of Global Economic Governance: A Critical Analysis of the Institutional Design of the FSB, IMF, World Bank, and WTO. In *International Economic Law*, 17 J.L. 49, 2014. P. 55 – 56.

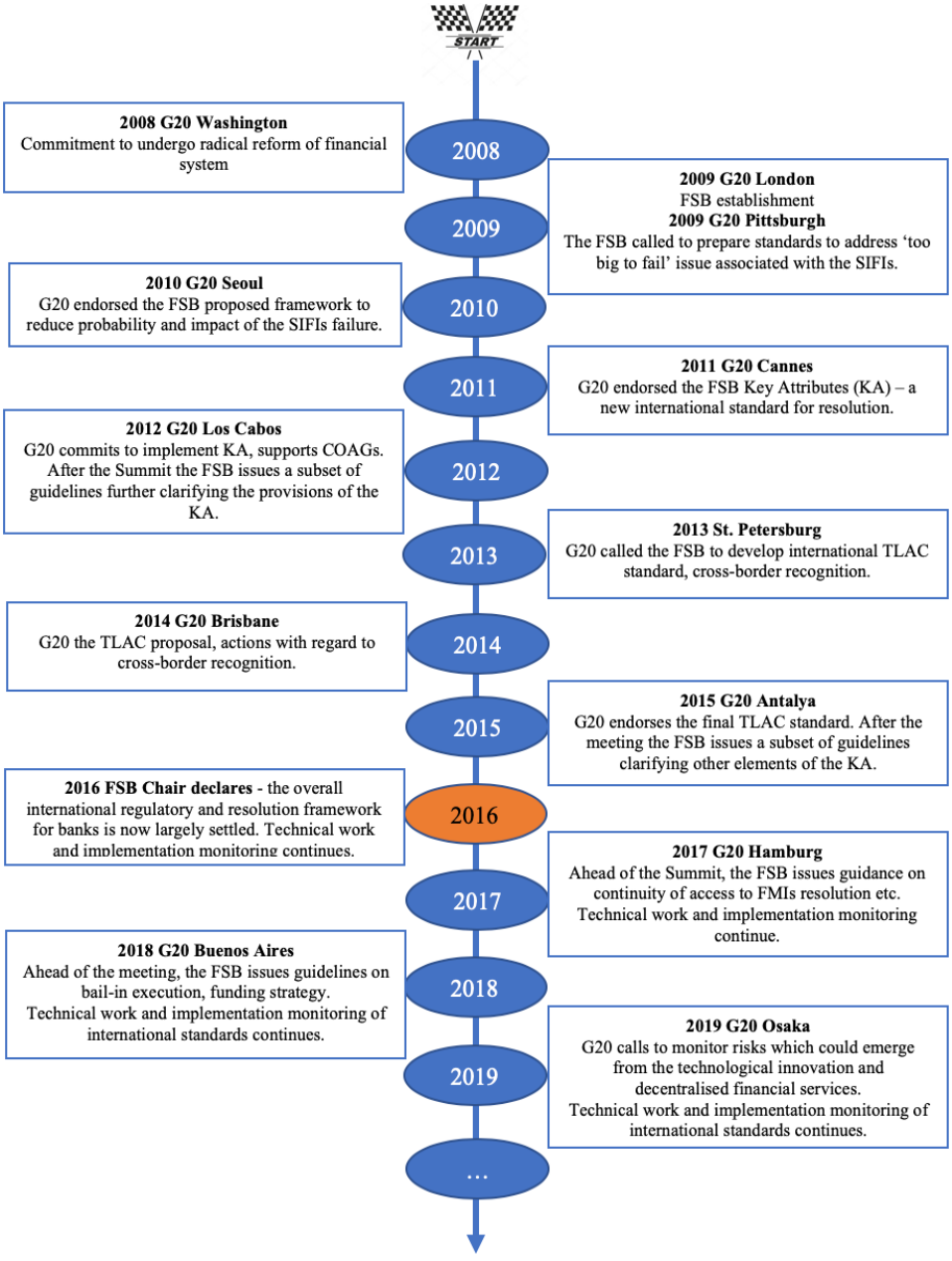
[338] Such scenario is also hardly ever possible, as it is unrealistic to imagine that the United States or the United Kingdom would ever agree to completely turn over the financial regulation powers to the international body.

[339] Declaration of the Summit on Financial Markets and the World Economy. The Leaders of the G20, Washington DC, 15 November 2008. [accessed on 20 November 2008] <http://www.g20.utoronto.ca/2008/2008declaration1115.html#principles>.

[340] Other components included creating resilient banks, transforming shadow banking into market-based finance, and making derivatives markets safer. See What A Difference a Decade Makes. Mark Carney, Governor of the Bank of England, Chair of the FSB. Remarks at the Institute of International Finance's Washington Policy Summit, the Reagan Centre, Washington DC, 20 April 2017. P.3. [accessed on 20 April 2017] <https://www.fsb.org/wp-content/uploads/What-a-Difference-a-Decade-Makes.pdf>.

standards, guidance and principles in order to end 'too big to fail issue' as well as the goal to both reduce the probability and impact of a failure of such bank (see Scheme 9).

Scheme 9. The G20 Global Agenda and the FSB Journey Towards Setting International Standards for Bank Recovery and Resolution Legal Framework



Already in 2009 at the Pittsburgh Summit, the G20 Leaders called the FSB to propose possible measures to address the 'too big to fail' problems associated with global systemically important financial institutions (the '**G-SIFIs**')[341]. Ahead of the FSB also shared a note on the exit measures from extraordinary financial sector support, focusing on policies to exit from such public financial support instruments as "*wholesale debt guarantees, deposit insurance extensions, capital injections to financial institutions, direct market-wide asset purchases (in some cases as part of quantitative easing by central banks), asset guarantee programs, special lending facilities, and/or extraordinary central bank liquidity facilities"*[342].

In 2010 at the Seoul Summit, the G20 Leaders endorsed the FSB proposed framework to reduce the probability and impact of SIFIs failure[343]. In 2011 at the Cannes Summit, the FSB published an initial list of global systemically important banks (the '**G-SIBs**')[344] while the G20 Leaders endorsed the FSB Key Attributes (updated in 2014) of effective Resolution Regimes for Financial Institutions as *'a new international standard for resolution regimes*'[345]. The Key Attributes (the '**KA**') set out the core elements (such as resolution tools and powers) that should be part of the resolution regime of all jurisdictions as they are considered to be necessary to allow designated public authorities to resolve bank (as well as for bank to prepare to be resolved) in an orderly manner without taxpayers exposure to loss from solvency support and maintaining the continuity of bank's critical functions which are essential to the real economy and financial stability (see Scheme 10). What is more, it was agreed to develop further guidance which would further clarify certain

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[341] Progress since the Pittsburgh Summit in Implementing the G20 Recommendations for Strengthening Financial Stability. Report of the Financial Stability Board to G20 Finance Ministers and Governors, 7 November 2009. P. 9. [accessed on 15 March 2018] < https://www.fsb.org/wp-content/uploads/r_091107a.pdf>.

[342] Exit from extraordinary financial sector support measures. Note for G20 Ministers and Governors meeting 6-7 November 2009. Financial Stability Board, Basel, 7 November 2009. [accessed on 8 November 2009] <https://www.fsb.org/wp-content/uploads/r_091107b.pdf>.

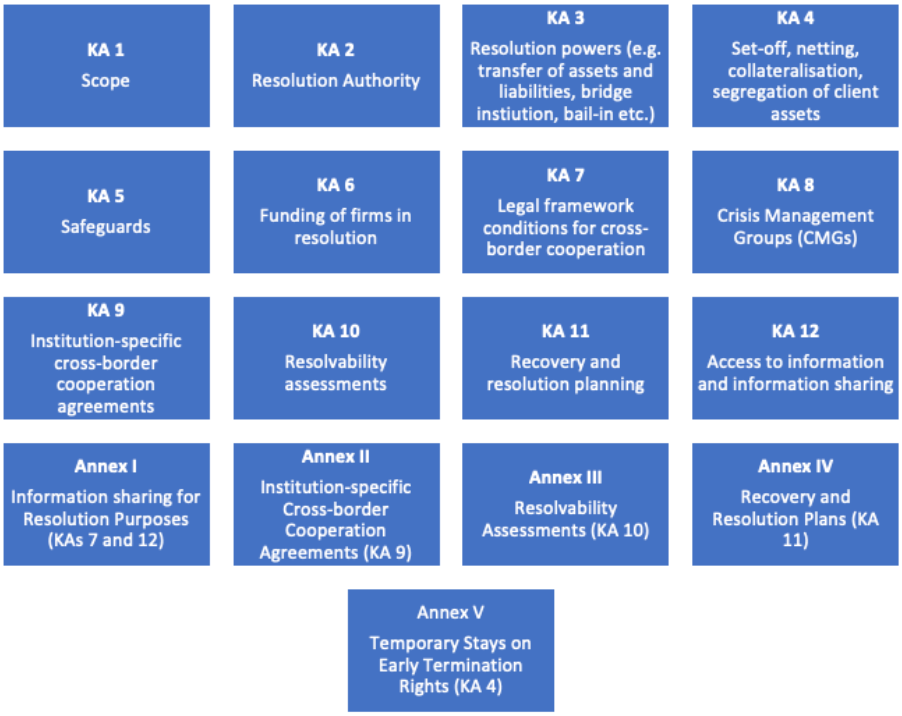
[343] The Soul Summit Declaration. The Leaders of the G20, Seoul, 11-12 November 2010. Paragraph 30. [accessed on 15 March 2018] <http://www.g20.utoronto.ca/2010/g20seoul-doc.pdf>.

[344] Since 2011, the FSB updates this list every year. The latest list was published in 2018. See: 2018 list of global systemically important banks (G-SIBs). The FSB, Basel, 16 November 2018. [accessed on 16 November 2018] <https://www.fsb.org/wp-content/uploads/P161118-1.pdf>.

[345] Communiqué: G20 Leaders' Summit. The Leaders of the G20, Cannes, 4 November 2011G20. Paragraph 13. [accessed on 15 March 2018] <http://www.g20.utoronto.ca/2011/2011-cannes-communique-111104-en.html>.

elements and requirements set in the KA in order to ensure greater consistency, common understanding and implementation.

Scheme 10. Structure and the Key Elements of the Key Attributes (KA)



In 2012 at the Los Cabos Summit, the G20 Leaders reiterated their commitment to make national resolution regimes consistent with the FSB Key Attributes, as well as supported the ongoing elaboration of recovery and resolution plans, bank-specific cross-border cooperation agreements (the 'COAGs') for all G-SIFIs, and welcomed the FSB's enhanced monitoring of implementation of agreed international standards at the national level[346]. After the Summit, the FSB issued a subset of guidance further clarifying the Key Attributes with regard to i) identification of critical functions (related Key

[346] The Los Cabos Summit Declaration. The Leaders of the G20, Los Cabos, Mexico, 18-19 June 2012. Paragraphs 36, 38, 40, 41. [accessed on 15 March 2018] <http://www.g20.utoronto.ca/2012/2012-0619-loscabos.pdf>.

Attribute 6)[347], ii) recovery triggers and stress scenarios (related Key Attribute 11)[348], and iii) effective resolution strategies (related Key Attribute 11)[349].

In 2013 at the St Petersburg Summit, the G20 called the FSB to continue its work and, in consultation with standard-setting bodies, to develop proposals on the adequacy of G-SFIs loss-absorbing capacity (known as the TLAC) [350] the ultimate aim of which is to promote financial stability by providing home and host authorities and markets with confidence that G-SIBs have appropriate capacity to absorb losses if needed, both before and during resolution, in order to implement the preferred resolution strategy and to maintain the continuity of critical functions. What is more, noting that that structural banking reforms can facilitate resolvability, the FSB was called, in collaboration with the IMF and the OECD, to assess cross-border consistencies and global financial stability implications, taking into account country-specific circumstances[351]. Furthermore, the FSB in its progress report[352] presented to the G20, among other things, highlighted identified uncertainties about the cross-border effectiveness of resolution measures as an important impediment to cross-border resolution. This remains an important aspect, as unless resolution actions can be given prompt effect in relation to assets that are located in, or liabilities or contracts that are governed by the law of a foreign jurisdiction, authorities are likely to face obstacles in implementing group-wide resolution plans effectively for cross-border groups. Considering this, the FSB made a commitment to developing policy proposals on how legal certainty in cross-border resolution can be further

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[347] Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Identification of Critical Functions and Critical Shared Services. Financial Stability Board, Basel, 2013. [accessed on 16 July 2013] < https://www.fsb.org/wp-content/uploads/r_130716a.pdf>.

[348] Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Recovery Triggers and Stress Scenarios. Financial Stability Board, Basel, 2013. [accessed on 16 July 2013] <https://www.fsb.org/wp-content/uploads/r_130716c.pdf>.

[349] Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Developing Effective Resolution Strategies Financial Stability Board, Basel, 2013. [accessed on 16 July 2013] <https://www.fsb.org/wp-content/uploads/r_130716b.pdf>.

[350] G20 Leaders' Declaration. The Leaders of the G20, St. Petersburg, 6 September 2013. Paragraph 68. [accessed on 22 August 2018] < http://www.g20.utoronto.ca/2013/2013-0906-declaration.html>.

[351] Ibid.

[352] Progress and Next Steps Towards Ending "Too-Big-To-Fail". Report of the Financial Stability Board to the G20, 2 September 2013. P. 3-4, 11. [accessed on 18 August 2018] <https://www.fsb.org/wp-content/uploads/r_130902.pdf>.

enhanced[353]. It also committed to developing recommendations to enhance further G-SIFI resolvability, including measures that support operational continuity in resolution, proposals for contractual or statutory approaches to prevent large-scale early termination of financial contracts in resolution[354].

In 2014[355] at the Brisbane Summit, the G20 Leaders welcomed the FSB's draft proposal (consultative document) requiring G-SIFIs banks to hold additional loss-absorbing capacity (the 'TLAC')[356] that would further protect taxpayers if these banks fail[357], as well as welcomed the FSB's consultative document on the cross-border recognition of resolution actions[358]. This was a significant move forward, in particular, with regard to the new international TLAC standard, the ultimate goal of which is to ensure that G-SIFI banks have sufficient loss-absorbing and recapitalisation capacity available in case they face difficulties and special resolution procedure should be initiated[359]. What is more, the standard is important as it aims to ensure the confidence of home

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[353] Progress and Next Steps Towards Ending "Too-Big-To-Fail". Report of the Financial Stability Board to the G20, 2 September 2013. P.14. [accessed on 18 August 2018] <https://www.fsb.org/wp-content/uploads/r_130902.pdf>.

[354] Progress and Next Steps Towards Ending "Too-Big-To-Fail". Report of the Financial Stability Board to the G20, 2 September 2013. P. 15. [accessed on 18 August 2018] <https://www.fsb.org/wp-content/uploads/r_130902.pdf>.

[355] This was an important year from the perspective that Mark Carney, Chair of the FSB and the Bank of England, in its letter to the G20 Leader sent before the Brisbane summit stated that "*the job of agreeing measures to fix the fault lines that caused the crisis is now substantially complete*"**.** See: The Chair Letter to G20 Leaders. Mark Carney, Chair of the FSB, 7 November 2014. P. 1. [accessed on 7 November 2014] <https://www.fsb.org/wp-content/uploads/FSB-Chair's-Letter-to-G20-Leaders-on-Financial-Reforms-Completing-the-Job-and-Looking-Ahead.pdf>.

[356] Adequacy of loss-absorbing capacity of global systemically important banks in resolution. Consultative Document. The FSB, Basel, 10 November 2014. [accessed on 10 November 2014] <https://www.fsb.org/wp-content/uploads/TLAC-Condoc-6-Nov-2014-FINAL.pdf >.

[357] G20 Leaders' Communiqué. The Leaders of the G20, Brisbane, 16 November 2014. Paragraph 12. [accessed on 18 August 2018] <http://www.g20.utoronto.ca/2014/2014-1116-communique.html>.

[358] Cross-border recognition of resolution action. Consultative Document. The Financial Stability Board, 29 September 2014. [accessed on 18 August 2018] <http://www.g20.utoronto.ca/2014/cross-border_recognition_resoultion_action.pdf>.

[359] In July 2019, the FSB published a review of the implementation of the Total Loss Absorbing Capacity (TLAC) Standard for G-SIBs--the standard was adopted by the FSB in 2015. There has been steady and significant progress in both the setting of external TLAC requirements by authorities and issuance of TLAC by G-SIBs. All relevant G-SIBs meet or exceed the TLAC target ratios set by the FSB. The FSB's Resolution Steering Group is working on the challenge of ensuring that, in a crisis, TLAC will be effectively available in the right amounts where needed within a group. Review of the Technical Implementation of the Total Loss- Absorbing Capacity (TLAC) Standard. FSB, Basel, 2 July 2019. [accessed on 3July 2019] <https://www.fsb.org/wp-content/uploads/P020719.pdf>.

and host authorities as well as the market that an orderly bank resolution is possible. While from the public interest perspective it is expected that orderly resolution of failing bank hopefully would allow ensuring the continuity of bank's critical functions, as a result, minimise the impact on financial stability, and, finally, avoid exposing taxpayers to loss.

In 2015 at the Antalya Summit, G20 welcomed the FBS's first annual report on the implementation of reforms across jurisdictions[360], finalised principles for cross-border resolution actions[361] as well as the final principles on TLAC and its term sheet[362]. The international TLAC standard aims to contribute to ending the '*too big to fail*' issue of systemically important banks by requiring having sufficient capacity to absorb losses before and during resolution without exposing public funds to loss. Subsequently, the FSB also issued guiding principles for the temporary funding of G-SIBs in resolution sought to address the risk of banks having insufficient liquidity to maintain the continuity of critical functions in resolution[363].

2016 marks an important moment in the journey of ending 'too big to fail' issue, as Mark Carney, Chair of the FSB, in its letter to G20 (ahead of the Hangzhou Summit in China), noted, that *"[w]ith the agreements reached in recent years, including the Basel III framework and the [TLAC] standard for [G-SIBs], the overall international regulatory and resolution framework for banks is now largely settled"*[364]. Though it was acknowledged that *"[t]he FSB, the Basel Committee and national authorities will continue to work to provide maximum clarity about the details of the framework, to instil confidence about*

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[360] G20 Leaders' Communiqué. The Leaders of the G20, Antalya, Turkey, 16 November 2015. Paragraph 14. [accessed on 17 November 2015] <http://www.g20.utoronto.ca/2015/151116-communique.html>.

[361] Principles for Cross-border Effectiveness of Resolution Actions. Financial Stability Board, Basel, 3 November 2015. [accessed on 3 November 2015] <https://www.fsb.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf>.

[362] Principles on Loss-absorbing and Recapitalisation Capacity of G-SIB in Resolution. Total Loss-absorbing Capacity (TLAC) Term Sheet. 9 November 2015. [accessed on 18 August 2018] <http://www.g20.utoronto.ca/2015/The-Common-International-Standard-on-Total-Loss-Absorbing-Capacity-for-Global-Systemically-Important-Banks.pdf>.

[363] Guiding principles on the temporary funding needed to support the orderly resolution of a global systemically important bank. Financial Stability Board, Basel, 18 August 2016. [accessed on 18 August 2016] <https://www.fsb.org/wp-content/uploads/Guiding-principles-on-the-temporary-funding-needed-to-support-the-orderly-resolution-of-a-global-systemically-important-bank-"G-SIB".pdf>.

[364] Building a resilient and open global financial system to support sustainable cross-border investment. Mark Carney, Chair of the FSB, letter to G20 Leaders, 30 August 2016. P. 6. [accessed on 3 September 2016] <http://www.g20.utoronto.ca/2016/160830-fsb.pdf>.

the stability of overall requirements, and to deliver transparency about the extent to which member jurisdictions and financial institutions meet them"[365]. This also marks the moment when the FSB started to reprioritise its work and draw attention also on other matters such as promoting resilient sources of market-based finance[366], developing robust financial market infrastructures[367], supporting effective macroprudential frameworks[368], and monitoring the consistent implementation of post-crisis financial reforms[369]. Following this remark, the subsequent G20 Summit also put more emphasis on these areas. However, technical work further clarifying the details of the recovery and resolution legal framework and making it operational has continued (and will continue as it is the case with the bank prudential supervision legal framework). The same year the FSB issued important guidance on arrangements to support continuity of critical shared services which are necessary to ensure the continued provision of critical services[370].

In 2017, ahead of the G20 Summit in Hamburg, the FSB issued another important piece of guidance on how banks that have entered resolution should continue to have access to financial market infrastructures in order to ensure the continuity of bank's critical functions (related Key Attribute 11; provisions linked to the legal concept of critical functions and implementation challenges are further discussed in the second Part)[371]. It also issued the guiding principles on the internal TLAC which provide guidance on the trigger mechanism, size and composition of the internal TLAC requirements

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[365] Ibid.
[366] Building a resilient and open global financial system to support sustainable cross-border investment. Mark Carney, Chair of the FSB, letter to G20 Leaders, 30 August 2016. P. 3. [accessed on 3 September 2016] <http://www.g20.utoronto.ca/2016/160830-fsb.pdf>.
[367] *Ibid*, P. 4.
[368] *Ibid*, P. 5.
[369] Ibid.
[370] Guidance on Arrangements to Support Operational Continuity in Resolution. The FSB, 18 August 2016. Author contributed to the development of these guidance as an expert at the FSB working group. [accessed on 18 August 2016] <http://www.fsb.org/wp-content/uploads/Guidance-on-Arrangements-to-Support-Operational-Continuity-in-Resolution1.pdf>
[371] Guidance on Continuity of Access to Financial Market Infrastructures (FMIs) for a Firm in Resolution. The FSB, 6 July 2017. Author contributed to the development of these guidance as an expert at the FSB working group. [accessed on 6 July 2017] < http://www.fsb.org/wp-content/uploads/P060717-2.pdf>.

(related Key Attributes 3 and 11)[372]. While during the G20 Summit in Hamburg, the Leaders expressed support to the FSB's work to analyse the effects of financial regulatory reforms and the structured framework for post-implementation evaluation[373].

The FSB has continued its technical work linked to the bank recovery and resolution by issuing another two guidelines ahead of the Buenos Aires G20 Summit in 2018. Namely, principles on the execution of bail-in resolution tool in order to assist authorities to make bail-in resolution strategies operational, and, therefore, allowing to ensure the continuity of critical functions[374]. Another guidance[375] (which are interlinked with a number of the FSB and the BCBS guidelines)[376], focused on clarification of certain funding strategy elements. Until now, these are the last guidance issued by the FSB in the field of bank resolution, and, even though there are still some technical products in the pipeline.

At the Summit in 2019, the G20 leaders acknowledge that technological innovations can deliver significant benefits to the financial system and the broader economy, however, also noted that developments should be closely monitored as well as existing and emerging risks[377]. To this regard, the G20 also noted that it welcomes on-going work by the FSB and other standard-

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[372] Guiding Principles on the Internal Total Loss-absorbing Capacity of G-SIBs ('Internal TLAC'). Financial Stability Board, Basel, 6 July 2017. [accessed on 6 July 2017] <https://www.fsb.org/wp-content/uploads/P060717-1.pdf>.

[373] G20 Leaders' Declaration: Shaping an Interconnected World. The Leaders of the G20, Hamburg, 8 July 2017. [accessed on 8 July 2017] < http://www.g20.utoronto.ca/2017/2017-G20-leaders-declaration.html>.

[374] Principles on Bail-in Execution. Financial Stability Board, Basel, 21 June 2018. [accessed on 21 June 2018] <https://www.fsb.org/wp-content/uploads/P210618-1.pdf>.

[375] Funding Strategy Elements of an Implementable Resolution Plan. The FSB, Basel, 21 June 2018. [accessed on 21 June 2018] <https://www.fsb.org/wp-content/uploads/P210618-3.pdf>.

[376] The guidance should be read in conjunction with the Guiding Principles, builds on the Key Attributes and other FSB guidance in relation to resolution planning (for example, Guidance on Developing Effective Resolution Strategies, the FSB, Basel, 15 July 2013 [accessed on 18 June 2017] <http://www.fsb.org/wp- content/uploads/r_130716b.pdf>, and Guidance on Continuity of Access to Financial Market Infrastructures for a Firm in Resolution, the FSB, Basel, 6 July 2017 [accessed on 6 July 2017] <http://www.fsb.org/wp-content/uploads/P060717-2.pdf)>, as well as existing supervisory guidance on liquidity risk management and monitoring (for example, Liquidity Coverage Ratio and liquidity risk monitoring tools, the BCBS, Basel, 7 January 2013 [accessed on 8 January 2013] <https://www.bis.org/publ/bcbs238.pdf>, and Principles for Sound Liquidity Risk Management and Supervision, the BCBS, Basel, 25 September 2008 [accessed on 25 September 2013] <http://www.bis.org/publ/bcbs144.pdf>.

[377] Paragraph 17. <http://www.g20.utoronto.ca/2019/2019-g20-osaka-leaders-declaration.html>.

setting bodies and ask them to advise on additional multilateral responses as needed, as well as, welcomed the FSB's work on the possible implications of decentralized financial technologies and how regulators can engage other stakeholders[378].

The latest G20 Summits indicate that the FSB's focus is clearly shifting towards monitoring of the implementation of all agreed international standards and guidelines as well as broader analysis of other emerging, including macroeconomic, risks to financial stability (stemming, for example, cyber-incidents[379], non-bank financial intermediation[380], FinTech[381], BigTech[382], crypto-assets[383] etc.). What is more, even though it was not clearly stated by the G20 yet, it is argued that the future FSB work will, in particular, require to assess what kind of potential implication those emerging risks and technological revolution in the field of financial services will have to the existing resolution legal framework and its objectives (this aspect will be discussed separately in Chapter III).

The performed analysis shows that since its establishment in 2009, the FSB did a lot of work when developing international standards and guidance aimed at ending 'too big to fail' issue of systemically important banks by coordinating approaches, setting international standards and harmonising the rules linked to the special bank recovery and resolution regime, and the potential challenge posed by the potential failure of banks that provide critical functions and operations across borders. This also clearly shows that the FSB had played and continues to play an important role in setting bank recovery

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[378] Ibid.

[379] Buenos Aires Action Plan. The Leaders of the G20, Buenos Aires, November 2018. Paragraph 16. [accessed on 23 November 2018] < http://www.g20.utoronto.ca/2018/2018-buenos-aires-action-plan.html>

[380] Buenos Aires Action Plan. The Leaders of the G20, Buenos Aires, November 2018. Paragraph 14. [accessed on 23 November 2018] < http://www.g20.utoronto.ca/2018/2018-buenos-aires-action-plan.html>

[381] FinTech and market structure in financial services: Market developments and potential financial stability implications. The FSB, Basel, 14 February 2019. [accessed on 15 February 2019] <https://www.fsb.org/wp-content/uploads/P140219.pdf>.

[382] The FSB already noted that "there could be new implications for financial stability from Big Tech in finance and greater third-party dependencies" (for example in cloud computing services). FinTech and market structure in financial services: Market developments and potential financial stability implications. The FSB, Basel, 14 February 2019. P. 1, 12. [accessed on 15 February 2019] <https://www.fsb.org/wp-content/uploads/P140219.pdf>.

[383] G20 Osaka Leaders' Declaration. The Leaders of G20, Osaka, Japan, 29 June 2019. Paragraph 17 [accessed on 29 June 2019] < http://www.g20.utoronto.ca/2019/2019-g20-osaka-leaders-declaration.html>.

and resolution standards at the international level and continues to monitor their implementation.

The above overview of the FBS's regulatory work in the field of bank crisis management also indicates a substantial shift in opinion of the states with regard to regulation and cooperation at the global level. As noted by the Mervin King, if before the crisis most countries were primarily concerned to ensure that their banking system was not regulated heavier than in other countries, so now ensuring a safer banking system is seen as in a country's self-interest[384]. As a result, continuously substantial efforts are put to increase cooperation at the global level by strengthening the role of the FSB and mandating it to develop international standards and guidance. However, considering its limited legal status, the question remains what the legal power of the FSB standards is. In order to answer this question, we have to look into the FSB Charter (which was originally adopted in 2009 (Charter I) and supplemented in 2012 (Charter 2)), and the broader context within which the FSB was set-up.

The FSB Charter notes that the Member of the FSB signs it by *"[r]ecognising the need to promote financial stability by developing strong regulatory, supervisory and other financial-sector policies, and fostering a level playing field through coherent policy implementation across sectors and jurisdictions*"[385]. With regard to tasks and mandates,[386] the Charter includes provisions which state that the FSB has a mandate to "set guidelines"[387], etc[388]. Furthermore, the Charter includes the provision which states that Member jurisdictions (what includes Ministries of Finance and Central Banks of each participating jurisdiction)[389], among other things, commit to "implement international financial standards"[390], Members also commit to "undergo

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[384] KING, Mervin. The End of Alchemy. Money, Banking and the Future of the Global Economy. Little Brow, London, 2016. P. 256.
[385] The Preamble of the Charter 1 and the Charter 2.
[386] A full list of tasks and mandate is set in Art. 2 of the Charter 2.
[387] Art. 2(1)(f) of the Charter 1 and the Charter 2.
[388] The FSB can also undertake any other tasks agreed by its Members in the course of its activities and within the framework of this Charter. Art. 2(1)(i) of the Charter 1, Art. 2(1)(j) of the Charter 2.
[389] A full list of FSB Members is provided in Annex A of the Charter 2.
[390] Art. 5(1)(c) of the Charter 1, Art. 6(1)(c) of the Charter 2.

periodic peer reviews"[391]. The decisions should be taken by the Plenary (composed of Member jurisdictions) by consensus[392].

It is important to note that the Charter 2 has expanded further the FSB tasks and mandate, as well as its Members' commitments. The Charter 2 introduced the provisions stating that the FSB should "*promote member jurisdictions' implementation of agreed commitments, standards and policy recommendations through monitoring of implementation, peer review and disclosure"*[393]. What is more, the Charter was supplemented with the other provisions expanding its mandate. Namely, the FSB should, as needed to address regulatory gaps that pose risk to financial stability, develop or coordinate development of standards and principles, in collaboration with the international standard-setting bodies and others, as warranted, in areas which do not fall within the functional domain of another international standard-setting body, or on issues that have cross-sectoral implications[394]. With regard to commitments of Members, it was added that Members commit to '*take part in implementation monitoring of agreed commitments, standards and policy recommendations*'[395].

On the one hand, this analysis clearly shows that the amendments to the Charter were gradual, strengthening the role and mandate of the FSB as well as commitments of Members. On the other hand, the amended Charter retained the provision stating that '*the Charter is not intended to create any legal rights or obligations*'[396] leaving the ambiguity with regard to the binding power of its decision and standards.

These provisions should be read keeping in mind the legal status of the FSB what stipulates that the FSB is a member-driven international association and is not endowed with real international legal personality as the Charter is

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[391] Art. 5(1)(d) of the Charter 1, Art. 6(1)(d) of the Charter 2.
[392] Art. (7(2) of the Charter 1, Art. 9(2) of the Charter 2.
[393] Art. 2(1)(i) of the Charter 2. *De facto* G20 Leaders already at the G20 London Summit in 2019 agreed that Members of the FSB commit to pursue the maintenance of financial stability, enhance the openness and transparency of the financial sector, and implement international financial standards (including the 12 key International Standards and Codes), and agree to undergo periodic peer reviews, using among other evidence IMF / World Bank public Financial Sector Assessment Program reports. The FSB will elaborate and report on these commitments and the evaluation process. See Declaration on Strengthening the Financial System – London Summit, 2 April 2009. The leaders of the G20, London, 2 April 2009. [accessed on 3 April 2009] <http://www.g20.utoronto.ca/2009/2009ifi.pdf>.
[394] Art. 2(3) of the Charter 2.
[395] Art. 6(1)(e) of the Charter 2.
[396] Art. 16 of the Charter 1, Art. 24 of the Charter 2.

not intended to create any legal rights or obligations. The FSB relies on its member's commitments as described in the Charter above to achieve its mandate, implementation and compliance with its international standards and principles[397]. This also means that the FSB's standards and guidance are not '*hard law*'[398] instruments, but rather '*soft law*[399]'. In the doctrine '*international soft law*' is defined as an international rule created by a group of specially affected states in a particular issue area that has a common intent to observe voluntarily the content of such a rule with the intention of possibly

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[397] This is similar to the BCBS, as its Charter states that "[t]he BCBS does not possess any formal supranational authority. <…> Rather, the BCBS relies on its members' commitments <…> to achieve its mandate." The Basel Committee Charter. The Bank of International Settlements, Basel, last update on 5 June 2018. [accessed on 10 June 2018] <https://www.bis.org/bcbs/charter.htm>.

[398] The term '***hard law'*** refers to legally binding obligations that are precise (or can be made precise through adjudication or the issuance of detailed regulations) and that delegate authority for interpreting and implementing the law. The Concept of Legalisation. In *International Organization Vol.* 54, No. 3, 2000, pp. 401 - 431. P. 421. S. Saurugger further clarifies that '***hard law***' corresponds to the situation where hard obligation (a binding norm) and hard enforcement (judicial control or at least some kind of control including the possibility of legal sanctions) are connected. SAURUGGER, S.; TERPAN, F. Studying Resistance to EU Norms in Foreign and Security Policy. In EFA Rev., Special Issue (2015). P. 1-20.

[399] The term '***soft law***' refers to those norms situated in-between hard law and non-legal norms. SAURUGGER, S.; TERPAN, F. Studying Resistance to EU Norms in Foreign and Security Policy. In EFA Rev., Special Issue (2015). P. 1-20. The term '***soft law***' was introduced by DUPY, R. J. Declaratory Law and Programmatory Law: From Revolutionary Custom to "Soft Law". In *Declarations on Principles*. Leyden, 1977. P. 252. Also see, KLABBERS, J. The Concept of Treaty in the International Law. Kluwer Law International, London, 1996. P. 160. Goodhart summarises ***the relations between*** the '***soft law'*** and '***hard law'*** as follows: "Law has progressed throughout time, both with regard to its substance and with regard to the way it is created (the process or procedures). It is in this context that soft law – as an instrument of change and reform – ought to be understood. Soft law is indeed law (rules of an informal nature, but yet rules). International financial soft law is often well suited to the changing needs and rapidly evolving structures that characterise the workings of financial markets. It would be wrong to dismiss it because of its 'softness'. It is 'soft' from the perspective of traditional mechanisms of enforcement (international standards are not international obligations), but in many instances it is or it can become as compelling as 'hard law'. Indeed, one can argue that there is hard 'soft law' (e.g. the international standards on money laundering, i.e. the Forty Recommendations on Money Laundering and the Eight Special Recommendations on Terrorist Financing by the Financial Action Task Force, where specific measures to be taken at the criminal justice and regulatory measures have been detailed) and soft 'hard law' (e.g. treaties dealing with economic integration in West Africa, such as the 1975 and 1993 ECOWAS Treaties37, notorious for their lack of enforcement). Furthermore, soft law can turn into hard law and/or complement hard law, as exemplified by the case of the IMF. GOODHART, Ch. The Basel Committee on Banking Supervision. A History of the Early Years 1974-1997. P. 559

incorporating it into the national law or administrative regulations[400]. What is more, the doctrine tends to acknowledge that soft law can lead to binding hard law and binding hard law can subsequently be elaborated through the soft-law instruments[401].

The FSB's status, it's standards and guidance as soft law instruments are not unique. International financial law is often developed through issuance of soft law instruments by the inter-agency institutions with ambiguous legal status, such as the Bank for International Settlement (the 'BIS'), the International Organization of Securities Commissions (the 'IOSCO') or the International Association of Insurance Supervisors (the 'IAIS')[402]. The doctrine also acknowledges that international financial law is dominated by the soft law standards[403], the role of which (as we see from the extensive FSB work in the field of bank recovery and resolution) has increased even more after the financial crisis. Some authors argue that this is because traditional rulemaking state legislators do not meet the expectation and requirements of the market participants, in particular, which perform cross border activities, and the market itself[404]. Furthermore, soft law standards could be developed quicker compared with the hard law instruments, which have to undergo lengthy formal legal procedures (e.g. ratification process, etc.). As a result, this facilitates quicker international regulatory reactions to the dynamic and quickly changing financial markets[405]. Of course, such a system also has

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[400] ALEXANDER, Kern; DHUMALE, Rahul; EATWELL, John. Global Governance of Financial Systems: The International Regulation of Systemic Risk. Oxford University Press, Oxford, 2006. P. 153.

[401] JEFFREY, I.; POLLACK, Mark. M. Interdisciplinary Perspectives on International Law and International Relations. The State of the Art. Cambridge University Press, Cambridge, 2013. P. 208. After performing an extensive analysis, these authors also conclude that scholars examining hard law and soft law as acting as compliments could be grouped into three categories: i) positivist legal scholars, who find that soft law is inferior to hard law but recognise that nonbinding instruments can potentially lead to hard law; ii) rationalist scholars, who view soft law as a complement to hard law that serves state interest in many contexts; and iii) constructivist scholars, who view soft law as a complement to hard law that can facilitate dialogic and experimentalist transnational and domestic processes that transform norms, understandings, and perceptions of interests. *Ibid.* P. 198 – 202, 208.

[402] WEBER, R. H.; ARNER, D. Towards a New Design for International Financial Regulation. In *University of Pennsylvania Journal of International Law*, Vol. 29, 2007. P. 393 – 401.

[403] BRUMMER, Chris. Why Soft Law Dominates International Finance—and not Trade. In *Journal of International Economic Law*, Volume 13, Issue 3, September 2010. P. 623–643.

[404] *Ibid.*, P. 623.

[405] POSNER, E. Soft Law: Lessons from Congressional Practice. In Stanford Law Review, Vol. 61, 2008. P. 573. GUZMN, A. International Soft Law. In Journal of Legal Analysis, Vol. 2, 2010. P. 171.

disadvantages, as certain jurisdictions may try to use the remaining flexibility for their own benefit[406]. What is more, sanctions that arise from the enforcement of rights and obligations under international law are not applicable in the soft law context and, therefore, states responsibility does not arise in a formal sense[407].

However, as scholars acknowledge, there are various degrees of soft liability in the form of official and market incentives and indirect sanctions (in particular, such instruments as official sector discipline, market discipline, restricted market access, market signalling, cross border externalities and regulatory costs) that influences state conduct[408]. For example, in order to be eligible for IMF financial assistance programme the state has to demonstrate official sector discipline through the compliance with the international standards[409], while a negative report during a regular country assessment may result in countries loss of credibility. The IMF also regularly carries the Financial Sector Assessment Programs (known as FSAP), as well as publishes global financial stability reports, which usually discusses the implementation of agreed international standards. For example, in the last report, the IMF noted that global policy coordination remains critical and highlighted that "*policymakers need to complete and implement regulatory reform agenda <…> [and that] international resolution framework needs to be developed further, and any rollback of regulatory standards should be avoided*"[410].

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[406] For example, as noted by N. Krisch, depicting the use of informal standard-setting as a departure of the sovereign equality of states, and thus as an opportunity for the United States to place itself above the law. Namely, the United States relies heavily on informal means of law-making and enforcement, as this very informality allows it to disregard many of the constraints otherwise imposed by sovereign equality. See KRISCH, N. More equal than the rest? Hierarchy, equality and US predominance in international law. Cambridge University Press, Cambridge, 2003. P. 135, 156.

[407] ALEXANDER, Kern; DHUMALE, Rahul; EATWELL, John. Global Governance of Financial Systems: The International Regulation of Systemic Risk. Oxford University Press, Oxford, 2006. P. 141.

[408] Ibid, P. 142. Some authors also argue that hard law treaty-backed regimes are not especially durable. For example, UN resolutions concerning the human rights and the environment are quite often ignored, while the commitments under trade regimes can be suspended, in particular, in times of economic stress. See BRUMMER, Ch. Soft Law and the Global Financial System. Rule Making in the 21st Century. Cambridge University Press, New York, 2015. P. 179.

[409] Ibid, P. 144 – 145.

[410] Global Financial Stability Report. Lower for Longer. International Monetary Fund, Washington, 18 October 2019. [accessed on 19 October 2019] <https://www.imf.org/en/Publications/GFSR/Issues/2019/10/01/global-financial-stability-report-october-2019#FullReport>.

From the perspective of market discipline, compliance with international financial standards may lower funding for the sovereign and its financial institutions. Not compliance with the international standards may result in restricted access to certain markets, for example, the EU or the US[411]. Compliance with the international standards could also work as a signal of good regulatory practice, enhance countries reputation with the market and help to attract banks. International investors often require that countries adopt international standards of best practices[412]. Finally, compliance and 'transplantation' of the global standards usually lower compliance costs both for banks and states as they can rely on work done at the global level and focus more on the enforcement rather than the development of the regulatory framework[413]. Finally, as a result of the regulator's failure to live up with its commitments, it could be more complicated for them to put forward their policy preferences in the future (as trust could be waisted), as a result, a market participant may suffer for the higher costs of raising capital or TLAC. As a result, soft liability significantly encourages voluntary incorporation of international standards into the national legal framework - scholars name this phenomenon as hardening of soft law[414]. All this also applies to standards and guidelines developed by the FSB.

What is more, the G20 importance in the creation of the soft law instruments and actions when seeking to determine whether certain standards are considered customary international law should not be underestimated. Since the FSB establishment, in each G20 meeting leaders express their commitment to comply with the agreed FSB standards and support the FSB's monitoring of their implementation. Moreover, as accurately noted by B. C. Matthews, the G20 is creating a process by which standards articulated by informal groups that have no legal personality (as for example, the FSB, the

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[411] For example, the right to refuse recognition or enforcement of third-country resolution proceeding, Art. 95 of the BRRD2.

[412] GOODHART, Ch. The Basel Committee on Banking Supervision. A History of the Early Years 1974 – 1997. Cambridge University Press, Cambridge, 2011. P. 558.

[413] ALEXANDER, Kern; DHUMALE, Rahul; EATWELL, John. Global Governance of Financial Systems: The International Regulation of Systemic Risk. Oxford University Press, Oxford, 2006. P. 148-149.

[414] For example, see BRUMMER, Chris. Why Soft Law Dominates International Finance—and not Trade. In *Journal of International Economic Law*, Volume 13, Issue 3, September 2010. P. 623–643; ARNER, D. W.; TAYLOR, M.A. The Global Financial Crisis and the Financial Stability Board: Hardening the Soft Law of International Financial Regulation? In *Asian Inst. of Int'l Fin. Law*. Working Paper No. 6, 2009. P. 1 – 22.

BCBS; the IOSC) are recognised and applied, if not 'ratified', by formal, treaty-based international organisations (such as the IMF or the BIS) and political groups, namely G20[415]. This adds a layer of legitimacy to the informal global normative process and provides positive evidence of the intent to rely on the standards generated by the global policy groups as binding international law[416]. Even though there are no formal sanctions in case of the infringement of the FSB soft law instruments, however, empirical evidence confirms that so-called soft liability does exist in the form of indirect sanctions which could be even more severe than the infringement of the hard law.

Finally, it should be acknowledged that although the FSB, considering its legal status, has a limited formal rulemaking authority and it's standards are not hard law instruments, it has become an increasingly important *de jure and facto* source of soft law international standards, in particular, in the field of bank recovery and resolution. Since the FSB establishing, in each G20 meeting leaders express their commitment to comply with the agreed FSB standards and supports the FSB's monitoring of their implementation. So do its Members.

1.3.4. The role of the EU at the FSB, and the implications of the FSB's international standards to the EU bank recovery and resolution legal framework and its objectives

In this part the author looks for the answer to the two key questions, namely: i) what the role of the EU at the FSB is; and ii) what the implications of the FSB's international standards to the EU financial law in the field of bank recovery and resolution are.

The position of the EU as a global player, its strength and visibility, has been gradually increasing, in particular, after the adoption of the Treaty of Lisbon[417]. As a result, its role in international organisations is increasingly getting more attention[418], though not so much with regard to its legal relationship with the FSB.

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[415] MATTHEW, B.C. Emerging Public International Banking Law? Lessons from the Law of the Sea Experience. In *Chicago Journal of International Law*. Vol. 10: No. 2, Article 8. P. 555.
[416] Ibid.
[417] Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community, signed at Lisbon, 13 December 2007. OJ C 306, 17.12.2007, p. 1–271.
[418] See, for example: VOOREN, B.; BLOCKMANS, S.; WOUTERS, J. The EU's Role in Global Governance: The Legal Dimension. Oxford University Press, Oxford, 2013.

The EU role and objectives for participation at the international level is defined in the Treaty of the EU[419], which states that "*[t]he [EU's] action on the international scene shall be guided by the principles which have inspired its own creation, development and enlargement, and which it seeks to advance in the wider world: democracy, the rule of law, the universality and indivisibility of human rights and fundamental freedoms, respect for human dignity, the principles of equality and solidarity, and respect for the principles of the United Nations Charter and international law."*[420] The Treaty on Functioning of the EU[421] further clarifies the means of how this provision could be formalised and implemented in practice. Namely, it states that *"[t]he [EU] may conclude an agreement with one or more third countries or international organisations where <…> where the conclusion of an agreement is necessary in order to achieve <…> one of the objectives referred to in the Treaties, or is provided for in a legally binding Union act or is likely to affect common rules or alter their scope*"[422]. As can be seen, this provision allows for the EU participation in international organisations by entering into an international treaty. Though in the case of the FSB it is not relevant as there is no international treaty. However, worth to note, besides possibility to enter into international treaties, less formal ways of participation are foreseen as

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NEWMAN, A; BACH, D. The European Union as hardening agent: soft law and the diffusion of global financial regulation. In *Journal of European Public Policy*, 2014 21:3, 430-452, DOI: 10.1080/13501763.2014.882968. P. 430 – 452. WESSEL, R.A. Wessel; ODERMATT, J. Research Handbook on the EU's Engagement with International Organisations. Edward Elgar Publishing, 2018. BLOCKMANS, S; WESSEL, R.A. Principles and Practices of EU external Representation. In Centre for the Law of EU External Relations, Vol. 2012/5, P. 1 – 144. WESSEL, R.A. The Legal Framework for the Participation of the European Union in International Institutions. European Integration. Vol. 33, No. 6, 621–635, November 2011. P. 621 – 635. The European Union's Role in International Economic For. Paper 1: The G20. Study for the ECON Committee. European Parliament, Brussels, 2015. IP/A/ECON/2014-15. [accessed on 24 October 2017] <http://www.europarl.europa.eu/RegData/etudes/STUD/2015/542207/IPOL_STU(2015)542207_EN.pdf>.

[419] Consolidated version of the Treaty on European Union - Protocols - Declarations annexed to the Final Act of the Intergovernmental Conference which adopted the Treaty of Lisbon, signed on 13 December 2007 - Tables of equivalences. Official Journal C 326, 26/10/2012 P. 0001 – 0390. (the '**Treaty of the EU**).

[420] Art. 21(1) of the Treaty of the EU.

[421] Consolidated version of the Treaty on the Functioning of the European Union - Protocols - Annexes - Declarations annexed to the Final Act of the Intergovernmental Conference which adopted the Treaty of Lisbon, signed on 13 December 2007 - Tables of equivalences. Official Journal C 32, 26/10/2012 P. 0001 – 0390 (the '**Treaty on the Functioning of the EU**').

[422] Art. 216 of the Treaty on the Functioning of the EU.

well: *"[t]he [EU] shall establish all appropriate forms of cooperation with the organs of the United Nations and its specialized agencies, <...> [and] shall also main such relations as are appropriate with other international organisations*"[423]. As we can see even though the latter article talks about the less formal ways, however, it still talks about the '*international organisations*', and there are no other provisions which would specifically talk about the participation in other international structures which, considering their legal status, are not considered as international organisations (e.g. the FSB). Therefore, only by interpreting this provision more broadly and by analogy with regard to the notion '*other international organisations*', we can conclude that the right to establish '*all appropriate forms of cooperation*" also captures the EU's power to develop appropriate forms of collaboration with such international bodies as the FSB and the G20.

What is more, it should not be forgotten that the EC is obliged by the Treaty of the EU *"<...>to promote the general interests of the Union and take appropriate initiatives to that end<..>"* as well as *"<...> with the exception of the common foreign and security policy, <...> shall ensure the [EU's] external representation*"[424] leaving the EC room to choose means to do this[425]. Moreover, on the one hand, the EC in its papers indicated a series of measures to reform the global financial architecture[426], on the other hand, a number of times stated that it "*is actively participating in the work of the FSB*"[427], "*is*

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[423] Art. 220 of the Treaty on the Functioning of the EU.
[424] Art. 17(1) of the Treaty of the EU.
[425] Also see ANDRADE, P. The Distribution of Powers Between EU Institutions for Conducting External Affairs through Non-Binding Instruments. In European Papers. European Forum, 16 April 2016. Vol. 1, 2016, No 1. P. 115 – 125. [accessed on 17 April 2016] <http://www.europeanpapers.eu/en/system/files/pdf_version/EP_EF_2016_I_021_Paula_Garcia_Andrade.pdf>.
[426] From financial crisis to recovery: A European framework for action. Communication from the Commission. Brussels, 29 January 2008. COM (2008) 706 final. [accessed on 29 October 2008] <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52008DC0706&from=en>.
[427] Proposal for a Directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (Text with EEA relevance). SEC (2011) 954 final. The European Commission, Brussels, 20 July 2011, 2011/0203 (COD). P.7. [accessed on 20 April 2018]
<https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52011PC0453&from=GA>.

helping to shape the work of the FSB and the 20, and is also closely monitoring international developments", and as a result sets out the policy orientations and legal acts[428]. The European Parliament has also acknowledged the importance of the EU to cooperate and participate in the work not only of international organisations but also international bodies[429]. While the EC noted that the EU representation in such international bodies as the FSB gives the means to provide input into the development and implementation of effective regulatory and supervisory policies[430], as well as to address vulnerabilities affecting financial systems in the interest of global financial stability[431]. Finally, it should also be mentioned that the Regulation establishing the European Banking Authority which is responsible for the development of the Single Rulebook in the Single Market and ensuring consistent implementation of these rules, states that the EBA is obliged to take fully into account the relevant international approaches when developing the criteria for the identification and measurement of systemic risk posed by

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[428] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, the Committee of the Regions and the European Central Bank: An EU Framework for Crisis Management in the Financial Sector. The European Commission, Brussels, 20 October 2010. COM (2010) 579 final. P.3. [accessed on 21 October 2010] <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52010DC0579&from=EN>.

[429] Global economic governance. European Parliament resolution of 25 October 2011 on Global Economic Governance (2011/2011(INI)). OJ C 131E, 8.5.2013, p. 51–59. [accessed on 26 October 2018] <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52011IP0457&from=EN>.

[430] On the other hand, the EC also acknowledged that the positions of the EU and Member States are not always aligned what complicates achievement of common interests, and, therefore the EC committed to work with Member States to establish enhanced mechanisms to coordinate positions for the Financial Stability Board and as appropriate for other relevant standard-setting bodies, as regards the euro area and wherever possible, for the Union as a whole. See: A roadmap for moving towards a more consistent external representation of the euro area in international fora. Communication from the Commission to the European Parliament, the Council and the European Central Bank. Brussels, 21 October 2015. P. 9 [accessed on 21 April 2018] <https://ec.europa.eu/transparency/regdoc/rep/1/2015/EN/1-2015-602-EN-F1-1.PDF>.

[431] A roadmap for moving towards a more consistent external representation of the euro area in international fora. Communication from the Commission to the European Parliament, the Council and the European Central Bank. Brussels, 21 October 2015. P. 4 [accessed on 21 April 2018] <https://ec.europa.eu/transparency/regdoc/rep/1/2015/EN/1-2015-602-EN-F1-1.PDF>.

financial institutions, including those established by the FSB, the International Monetary Fund and the Bank for International Settlements[432].

The FSB Charter states that its Members include the European Union, which is represented by the European Commission and the European Central Bank, where relevant. Therefore, the EU also participates in the development of the soft law international standards and guidelines as it is a Member of the FSB[433], and therefore it commits to the Member's commitments (e.g. to implement agreed standards) as defined in the Charter[434]. What is more, the EU consistently refers to the G20 and the FSB commitments, for example, in the preambles of the legal acts[435] as well as policy documents[436] and media

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[432] Art. 23(2) of the Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC. OJ L 331 15.12.2010.

[433] See Annex to the Charter 2. The European Union is represented by the European Commission and the European Central Bank. Worth to note that the European Commission delegates certain areas to the European Banking Authority, for example, in the field of bank recovery and resolution field.

[434] Art. 6 of the Charter 2.

[435] Recital 79 and 80 of the Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC Text with EEA relevance. OJ L 176, 27.6.2013, p. 338–436. P. 4.; Preamble 1 of the Directive of the European Parliament and of the Council amending Directive 2014/59/EU as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms and Directive 98/26/EC. Brussels, 2, May 2019. 2016/0362 (COD). [accessed on 2 May 2019] <https://data.consilium.europa.eu/doc/document/PE-48-2019-INIT/en/pdf>; Preamble 1 of the Regulation of the European Parliament and of the Council amending Regulation (EU) No 806/2014 as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms. Brussels, 2 May 2019. 2016/0361 (COD). [accessed on 2 May 2019] <https://data.consilium.europa.eu/doc/document/PE-47-2019-INIT/en/pdf>. Preamble 1 of the REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012. Brussels, 2 May 2019. 2016/0360 (COD). [accessed on 2 May 2019] <https://data.consilium.europa.eu/doc/document/PE-15-2019-INIT/en/pdf>

[436] For example, Proposal for a Directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (Text with EEA relevance). SEC(2011) 954 final. The European Commission, Brussels, 20 July 2011, 2011/0203 (COD). P.7. [accessed on 20 April 2018] <https://eur-lex.europa.eu/legal-

announcements[437], what confirms that the EU takes seriously the commitments made at the FSB and the G20 and takes a proactive role in the transposition into EU law. The EU bank recovery and resolution legal framework was developed with the aim to transpose agreed international standards into EU law. The EU legal framework continues to be amended in line with the agreed international standards and commitments made at the international bodies at the global level[438].

Considering the performed analysis, it could be concluded that as the FSB's legal status (i.e. it is considered an international body rather than an international organisation, see the previous subchapter), the legal basis for the EU participation in the international bodies, contrary to the international organisations, is not crystal clear. Though, relevant provisions of the Treaty of Functioning of the EU (Art. 220) which, besides participation via formal treaties, acknowledge the EU participation in the *international organisations*

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content/EN/TXT/PDF/?uri=CELEX:52011PC0453&from=GA>; Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, the Committee of the Regions and the European Central Bank: An EU Framework for Crisis Management in the Financial Sector. The European Commission, Brussels, 20 October 2010. COM(2010) 579 final. P.3. [accessed on 21 October 2010] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52010DC0579&from=EN etc.

[437] For example, when the European Parliament and the Council of the European Union reached a provisional political agreement on the banking package, a comprehensive set of reforms that the EC proposed to further strengthen the resilience and the resolvability of EU banks, the EC once again highlighted that the rules agreed incorporate the remaining elements of the regulatory framework agreed recently within the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB). See Completing the Banking Union: Commission welcomes political agreement to further reduce risks in the EU banking sector. European Commission Press Release, Brussels, 4 December 2018. [accessed on 6 December 2018] <https://europa.eu/rapid/press-release_IP-18-6659_en.htm>.

[438] For example, in 2015, the EC clearly expressed its commitment to bring forward a legislative proposal that the international standard of the TLAC would be incorporated into the EU law (See Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions, Towards the completion of the Banking Union. The European Commission, Brussels, 24 November 2015, COM (2015) 587 final. P 10. [accessed on 20 May 2016] <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015DC0587&from=en>); Subsequently a legislative proposal was made by the EC to transpose the international TLAC standard published by the FSB and adopted by the G20 (Proposal for a Directive of the European Parliament and of the Council on amending Directive 2014/59/EU of the European Parliament and of the Council as regards the ranking of unsecured debt instruments in insolvency hierarchy. Text with EEA relevance. The European Commission, Brussels, 23 November 2016, SWD (2016) 377, SWD(2016) 378, COM(2016) 853 final. P.3. [accessed on 23 November 2016] < http://www.europarl.europa.eu/RegData/docs_autres_institutions/commission_europeenne/com/2016/0853/COM_COM%282016%290853_EN.pdf>). It was adopted on 20 May 2019.

via '*all appropriate forms of cooperation',* could be used as an analogy for the EU participation in the *international bodies*. This is supported by the fact that the EU *de facto* actively participates in the work of international bodies such as the FSB and the G20, and regularly commits (in its policy statements, preambles of legal acts etc.) to implement agreed international soft law standards and guidance into the EU law. What is more, for example, the EBA is obliged by its Regulation to follow the FSB's criteria and standards, in particular linked to systemic risk of financial institutions[439].

Finally, it should also be noted that the EU not only participates in the development of the international financial soft law standards (e.g. such as the FSB standards and guidance). It also commits to implementing them. As a result, the EU also plays a crucial role in *hardening soft law* standards through transposing them into the EU law, what as a result promotes the formal adoption of soft law standards in other jurisdictions across the globe. The EU '*hardening*' of soft law international standards significantly reduces the risk of standards fragmentation, it also, paradoxically, makes the standard less flexible and amendable to change as, subsequently, they become the EU hard law.

1.4. An Overview and Conclusions of the First Part

A historical perspective and analysis show that the attempts to set a common legal framework and to harmonise rules in the field of banking supervision, prevention and crisis management has been an important matter since the creation of the EEC and subsequently the EU. Four fundamental waves of legal harmonisation, which ultimately lead to the adoption of the EU bank recovery and resolution legal framework, could be identified.

The first wave was followed by the creation of the EEC and issuance of the Segre report in 1996. The report noted that differences in legal rules result in variation for banking supervisory approaches across the Member States. It was also acknowledged that harmonisation of regulations should be systemic rather than be left to develop as an when local pressures build-up. As a result, in 1972, the Commission proposed an ambitious directive aiming to

[439] Art. 23(2) of the Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC. OJ L 331, 15.12.2010, p. 12–47.

harmonise many essential financial safety-net elements - banking prudential supervision, deposit insurance and winding-up rules for dealing with failing banks). However, this faced strong opposition from newly accepted Member States, in particular, the UK (it's banking industry) who had one of the most developed banking sectors and which was regulated on a principles-based approach rather than hard legislation. The UK didn't want to change it and won the fight. As a result, the Commission had to change tactics by moving from the systemic approach capturing all relevant elements in one directive, to the step by step approach.

The second wave of harmonisation was influenced by the publication of the 1985 White Paper. It took into account global developments at the BCBS and suggested steps to achieve a real Single Internal Market also in the field of financial services. Attempts to further harmonise the legal framework for dealing with failing banks also re-emerged during this period. The Commission put forward the proposal for a Council – the draft Directive on bank reorganisation and winding-up. Already at that time, it was acknowledged that there is a tendency in the laws and practices which are in force in the Member States to apply reorganisation measures, aimed at preventing credit institutions from becoming insolvent, as soon as financial difficulties become apparent, so as to maintain saver's confidence in the banking system usually this was done with the government support. Though it was also acknowledged that it would be too challenging to attempt to unify those laws and practices without firstly securing mutual recognition and introducing the home country control principle with regard to these proceedings across borders. The first attempts to reach a compromise on this Directive failed. The Commission came back to this Directive in light of the Bank of Credit and Commerce International collapse in 1991 which had direct implications for the amendments to the Basel Concordat at the global level, and which also highlighted issues with regard to mutual recognition of taken measures across the EU in the field of bank reorganisation and winding-up. However, this was not sufficient to achieve significant progress at that time.

The third wave captures the period from the creation of the EU in 1992 to the adoption of the FSAP in 1999 and endorsement of the Lamfalussy Report in 2001. The TEU included legal provisions for establishing a European System of Central Banks and a European Central Bank to oversee economic and monetary union. The FSAP also reminded about specific legislative proposals which were of significant relevance to the functioning of EU financial markets but were 'victims' to protracted political deadlocks. This

was the cases with regard to banking crisis management, reorganisation and winding-up legal framework. Furthermore, it was acknowledged that with the adoption of the First DGS Directive in 1994, the need for mutual recognition of reorganisation measures and winding-up proceedings became even more evident. Finally, a revised version of the draft Directive on bank reorganisation and winding-up was adopted only in 2001 (more than ten years after its initial proposal in 1987). Though, acknowledging that to harmonise national laws and practices in this field is too challenging. Therefore, the aim was (considering the approach used in other Directives linked to bank prudential supervisions) at least to establish a requirement for the mutual recognition by the Member States of the measures taken by each of them to restore the viability of the credit institutions which it has authorised.

The fourth wave of harmonisation (the biggest in the EU history) and discussion about the EU bank recovery and resolution legal framework were triggered by the eruption of the global financial crisis which encouraged individual actions at national level, what also showed evident need to act at the EU level. The high-profile EU banking failures (such as Fortis, Icelandic banks, Anglo Irish Bank, Dexia) and unprecedented amounts of public bailouts have also demonstrated that government support for banks which are 'too big to fail' squeezes public finances what is becoming increasingly unsustainable.

Approved BRRD (applicable in the whole Single Market), together with the SRM (applicable in the Euro area), set a new resolution paradigm aiming to strengthen this financial safety-net element across the Member States at the EU level. Though, further harmonisation of bankruptcy and winding-up rules remained out of the scope. By introducing a number of preparatory and early intervention measures, new tools and powers both for supervisory and newly established resolution authorities (see Scheme 7), as well as, obligations for banks, the BRRD aims to further strengthen the preparation, prevention and management of bank failures by seeking to ensure the continuity of the bank's critical functions which are essential to the real economy and financial stability when the bank faces difficulties.

It is evident that by 'upgrading' the EU institutional set-up and regulatory framework in the field of banking supervision, crisis prevention and management, the EU has taken a big step in improving financial safety-net elements and building bank crisis management architecture, ensuring greater harmonisation across the Member States as well as cooperation among supervisory and resolution authorities when dealing with bank recovery and

resolution issues. However, the institutional set-up and the regulatory framework is nothing without its actual and consistent implementation in the single market, what is a challenge. On the one hand, this challenge arises from the remaining national options and discretions allowed by directives, on the other hand, because of complexity and interlinks of the EU bank recovery and resolution legal framework with other parts of the EU and national legal frameworks (which are also either harmonised to a limited extent or exists only at the national level).

Furthermore, the development of the EU bank recovery and resolution legal framework could not be assessed without taking into the context even a broader perspective, namely, developments at the global level. This is in particular important considering that the FSB assumed one of the critical roles in developing international standards and promoting the regulatory reform of financial regulation and supervision, in particular, in the field of bank crisis management, recovery, resolution – with the aim to contribute to financial stability.

The legal personality and status of the FSB are complex. It is not established by the international treaty and, therefore, formally cannot be defined as an international organisation, but rather an international body established and driven by its Members. On the other hand, such legal status of the FSB makes it easier for Members to adapt and modify its mandate and tasks, taking into account the evolution of the financial system and market.

Although the FSB, considering its legal status, has a limited formal rule-making authority, it has become an increasingly important de jure and de facto source of soft law international standards, in particular, in the field of bank recovery and resolution. The G20 and the FSB's Members continuously express commitment to implement them and support the FSB's monitoring of their implementation.

As it is the case with the FSB's legal status (i.e. it is considered an international body rather than an international organisation), the legal basis for the EU participation in the international bodies, contrary to the international organisations, is not crystal clear as well. However, relevant provisions of the Treaty of Functioning of the EU (Art. 220) which, besides participation via formal treaties, also acknowledge the EU participation in the international organisations via 'all appropriate forms of cooperation', could be used as an analogy for the EU participation in the international bodies.

The EU not only participates in the development of the international financial soft law standards of the FSB, but it also commits to implementing

them. Through the transposition of soft law standards into the EU financial law, the EU is hardening those standards as they become part of the EU financial law and directly impact the financial law of the Member States. This, on the one hand, reduces the risk of standard fragmentation, on the other hand, limits their flexibility.

Finally, considering the performed analysis, it should be highlighted that when assessing the aims and content of the provisions of the EU bank recovery and resolution legal framework, due regard should be paid to the FSB standards and guidance – on the basis of which this framework has been developed.

II. THE EU BANK RECOVERY AND RESOLUTION LEGAL FRAMEWORK OBJECTIVES AND APPLICATION CHALLENGES

2.1. Introduction

The first Part provided an in-depth analysis of how the EU legal framework and financial safety-net elements have evolved in the EU, how drastically has changed the approach towards banking supervision and legal framework for the prevention and dealing with the failing banks, ultimately resulting in the adoption of the EU bank recovery and resolution legal framework. What is more, the performed research clearly shows that the international standards (which even though are soft law instruments) do have a significant influence on the EU legal framework development as well as that the EU regularly expresses its commitment to comply with them (though there is room for improvements).

Even though the EU reform is an important move forward (contributes to ensuring that the approach and rules for dealing with failing banks across the EU are harmonised), still grey areas and national discretions and discrepancies remain. Therefore, separate attention should be given to the EU bank recovery and resolution legal framework objectives which are in particular important for the application and implementation of this legal framework. More specifically, resolution objectives (which were introduced into the EU financial law taking into account the FSB KA) define and clarify the purpose of the EU bank recovery and resolution legal regime, establish the direction which should be followed by the authorities as they are obliged to have regard to these objectives a) when considering whether the conditions (including the public interests test) for resolution process have been met[440] and b) when applying the legal provisions and choosing the legal tools and powers that best achieve them[441]. Furthermore, resolution authorities are allowed to divert from the measures provided for in the resolution plans if resolution authority assesses that resolution objectives could be achieved more effectively by taking actions which are not provided for in the resolution plan of a bank[442].

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[440] Art. 31(5) of the BRRD and Art. 18(5) of the SRM.
[441] Art. 31(1) of the BRRD and Art. 14(1) of the SRM.
[442] Recital 54 of the BRRD.

What is more, the Member States and national authorities when using the remaining national discretions (e.g. by conferring upon resolution authorities addition tools and powers) should ensure that they are consistent with the resolution objectives and the general principles governing resolution[443]. Moreover, due consideration should be given to the resolution objectives when making decisions or taking action which may have an impact in more than one Member State, and in particular when making decisions concerning groups established in two or more Member States[444]. Finally, the resolution objectives could play an important role in the cases when natural or legal persons affected by a decision to take resolution actions seek for a judicial review (though there are restrictions[445]), as resolution authorities (when applying the resolution tools and exercising the resolution powers) should have regard to the resolution objectives and choose the tools and powers that best achieve them[446].

The EU bank recovery and resolution legal framework sets five resolution objectives[447]: i) to ensure the continuity of critical functions[448]; ii) to avoid a significant adverse effect on the financial system, in particular by preventing contagion, including to market infrastructures, and by maintaining market discipline[449]; iii) to protect public funds by minimising reliance on extraordinary public financial support[450]; iv) to protect covered depositors and investors[451]; and v) to protect client funds and client assets[452].

However, even though these objectives play an important role for the application and implementation of the EU bank recovery and resolution legal framework, the contents and terms of these objectives are not straightforward

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[443] It is required that such additional tools and powers were consistent with the resolution objectives and the general principles governing resolution. See Art. 31, 34, 37(9)(b) of the BRRD.
[444] Art. 6(3) of the SRM.
[445] Lodging of an appeal does not entail any automatic suspension of the effects of the challenged decision as the directive requires the decision of the resolution authority to be immediately enforceable and it gives rise to a rebuttable presumption that a suspension of its enforcement would be against the public interest. Art. 85(4)(a)(b) of the BRRD.
[446] Art. 31(1) of the BRRD and Art. 14(1) of the SRM.
[447] Art. 31(2) of the BRRD and Art. 14(2) of the SRM.
[448] Art. 31(2)(a) of the BRRD and Art. 14(2)(a) of the SRM.
[449] Art. 31(2)(b) of the BRRD and Art. 14(2)(b) of the SRM.
[450] Art. 31(2)(c) of the BRRD and Art. 14(2)(c) of the SRM.
[451] Art. 31(2)(d) of the BRRD and Art. 31(2)(d) of the SRM.
[452] Art. 31(2)(e) of the BRRD and Art. 31(2)(e) of the SRM.

and require further in-depth analysis as otherwise the legal provisions could be misinterpreted or understood too narrowly.

The academic research works usually either limit their scope to the high-level general description of these objectives[453] or just refer to the term of resolution objectives without explaining the content and avoid going into the in-depth analysis (in particular, with regard to the resolution objective – the continuity of critical functions)[454], what shows that there is a lack of relevant academic research in this field as well. Therefore, the second Part will further discuss each objective, by providing logical-systemic analysis of relevant terms (not all of them are defined in the BRRD) as well as interlink between them and relevant legal provisions, as well as application challenges.

2.2. Continuity of critical functions

The first resolution objective is – to ensure the continuity of a bank's critical functions[455]. It means the stable and continued functioning as well as the provision of day-to-day banking critical functions, supporting critical services and operations[456]. The banking industry performs a number of critical functions as it manages the distribution of savings and loans (what is essential for the economy to operate effectively), as well as, banks are a central vehicle for the exercise of a state's monetary policy due to their role in the payment system[457].

The EU bank recovery and resolution legal framework states that subject to different provisions of this Directive, the resolution objectives are of equal significance and oblige resolution authorities to balance them as appropriate to the nature and circumstances of each case[458]. However, as we will see from

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[453] E.g. BINDER, J. H.; SINGH, D. Bank Resolution. The European Regime. Oxford University Press, Oxford, 2015. Paragraphs 2.28 – 2.37.

[454] E.g. GLEESON, S.; GUYNN, R. Bank Resolution and Crisis Management: Law and Practice. Oxford University Press, Oxford, 2016. P. 217, 225, 245, 246, 250, 267, 275, 292.

[455] Art. 31(2)(a) of the BRRD.

[456] The research in this Subchapter is supported by findings published by BALČIŪNAS, L. The Legal Concept of Bank's Critical Functions, Implementation Challenges and the Role in the EU Bank Recovery and Resolution Framework. In *Teisės viršenybės link*, Vilnius University, Faculty of Law, 2019. P. 30 – 54.

[457] CAMINAL, R., O.; *et all*. Debt Restructuring 2nd Edition. Oxford University Press, Oxford, 2016. Paragraph 5.02.

[458] Art. 31(3) of the BRRD.

the in-depth analysis, the first objective is one of the most important and complex objectives, and other objectives contribute to its fulfilment.

The importance of the continuity of a bank's critical functions is also reinforced by the fact that this is one of the reasons why the bank recovery and resolution legal framework was developed overall[459]. Namely, the lack of relevant toolkit and the anxiety of the public for the use of unprecedented amounts of taxpayer's monies[460] for the banks' bailouts, encouraged the relevant bodies to act and look for new legal instruments which would allow to deal with failing banks by limiting the use of public monies and ensuring continuity of bank's critical functions. More specifically, a lack of legal instruments for dealing with banks which face difficulties contributed to the strong contagion concerns and fears that if bank fails, it's critical functions, essential for the real economy and financial stability, would be discontinued and this might create systemic crisis as the insolvency and bankruptcy proceedings allow legal entity to exit the market but are not aiming to ensure continuity of bank's critical functions. Therefore, in the circumstances there seemed often no alternative for dealing with the failing bank (in particular, those providing critical functions), apart from the use of taxpayer funds through the bailouts to banks to support the financial system. What is more, this identifies a paradigm shift in thinking, as mainstream policymaking is no longer built around the notion that the unrestrained growth of immense, interconnected financial markets and hyperintense constant financial innovation are inherently desirable from a social perspective[461]. This also shows that the public policy tried to go back to basics in recalling that the core functions of financial institutions are to provide payment mechanisms and deposit-taking facilities and to channel resources to where they are most

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[459] Recital 1 of the BRRD also explicitly states that the financial crisis has shown that there is a significant lack of adequate tools at Union level to deal effectively with unsound or failing credit institutions and investment firms ('institutions'). Such tools are needed, in particular, to prevent insolvency or, when insolvency occurs, to minimise negative repercussions by preserving the systemically important critical functions of the institution concerned.

[460] In order to maintain essential financial services for citizens and businesses, governments have had to inject public money into banks and issue guarantees on an unprecedented scale: between October 2008 and October 2011, the European Commission approved €4.5 trillion (equivalent to 37% of the EU GDP) of state aid measures to financial institutions. The European Commission. In *New crisis management measures to avoid future bank bail-outs*. [accessed on 8 August 2017] <http://europa.eu/rapid/press-release_IP-12-570_en.htm#footnote-1>.

[461] FERRAN, E.; et all. The Regulatory Aftermath of the Global Financial Crisis. Cambridge University Press, Cambridge, 2012. P. 10.

needed: financial services should support the real economy[462]. Thus, the legal framework focused on setting legal instruments which would allow the continuity of those critical functions.

The above-mentioned issues were taken into account during the development of international standards, namely, the FSB KA – from which this objective derives. The KA states that an effective resolution regime should ensure continuity of systemically important financial (or 'critical') services, and payment, clearing and settlement functions[463]. According to the KA, a key component of bank recovery and resolution planning is a strategic analysis that identifies bank's essential and systemically important functions (critical functions) and as a result, sets out the key steps to maintaining them in recovery as well as in resolution scenarios[464]. What is more, the KA clearly states that resolution regime should include stabilisation options that achieve continuity of systemically important (or 'critical') functions by way of a sale or transfer of the shares in the firm or of all or parts of the firm's business to a third party, either directly or through a bridge institution, and/or an officially mandated creditor-financed recapitalisation of the entity that continues providing the critical functions[465].

In line with the FSB standards, this was recognised at the EU level as well. Therefore, the continuity of critical functions is at the heart of the EU bank recovery and resolution legal framework (see scheme 11). Each step, whether it was recovery planning, resolution planning, identification of resolution conditions or application of resolution tools and powers, relates to the legal concept of critical functions and therefore the provisions of the EU bank recovery and resolution legal framework should be applied keeping in mind this concept.

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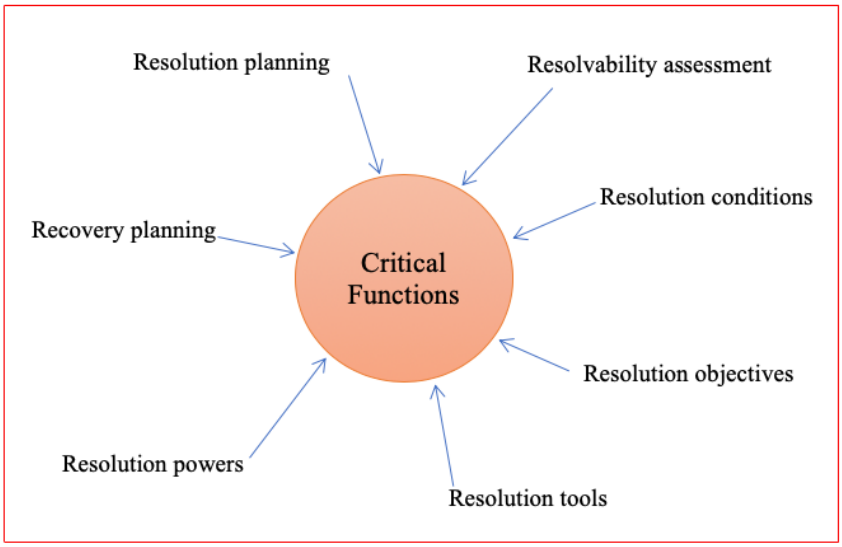
462 *Ibid*.
463 Point (i) of the Preamble of the KA.
464 2.3 of the KA.
465 Preamble of the KA.

Scheme 11. Preserving the critical functions is at the core of the EU bank recovery and resolution legal framework



For instance, the BRRD requires recovery plans to include identification of critical functions[466] as well as arrangements and measures necessary to maintain continuity of access to financial market infrastructures[467]. Furthermore, it should be noted that the content of recovery plans is further specified in the Commission Delegated Regulation[468] (the '**Delegated Regulation (EU) 2016/1075**') developed on the basis of the EBA relevant technical standards[469]. This legal act further specifies that strategic analysis

[466] Annex Section A 1(7) of the BRRD.
[467] Annex Section A 1(15) of the BRRD.
[468] Commission Delegated Regulation (EU) 2016/1075 of 23 March 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges (Text with EEA relevance). OJ L 184, 8.7.2016, p. 1–71.
[469] EBA final draft Regulatory Technical Standards on the content of recovery plans under Article 5(10) of Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms. <https://www.eba.europa.eu/documents/10180/760167/EBA-RTS-2014-11+Draft+RTS+on+content+of+recovery+plans.pdf/60899099-2dcb-4915-879d-8b779a3797cc>.

part of the recovery plan should identify core business lines and critical functions and set out the key steps to maintaining those core business lines and critical functions in a situation of financial stress[470]. Each recovery option among other things should indicate a range of capital and liquidity actions required to maintain or restore the viability and financial position of the entity or entities covered by the recovery plan which have as their primary aim ensuring the viability of critical functions and core business lines[471]. Impact assessment of recovery options should also include an assessment of external impact and systemic consequences which sets out the expected impact on critical functions performed by the entity or entities, covered by the recovery plan[472].

Preparation of recovery plans encourages banks to be aware of their critical functions, and supervisory authorities should encourage banks' responsibility to run business in a way that it would allow to separate and ensure continuity of critical functions if needed. Furthermore, it's worth highlighting that the identification and awareness of critical functions in recovery plans is a chance for banks to demonstrate that their plans are effectively mitigating the systemic threat caused by them. Therefore, they should be interested in a realistic self-assessment, although they may be tempted to hide risks or lack relevant expertise – supervisory authorities should be aware of this and ready to provide relevant assistance. When performing a critical review of the self-assessment of the bank, it is especially important for supervisory authorities to ensure and assess the quality of the information obtained from the bank, that this self-assessment reflects the purpose of the definition, in particular the external perspective on negative externalities to the real economy and financial markets.

With regard to resolution plans, the BRRD requires to demonstrate in the resolution plan how critical functions and core business lines can be legally and economically separated from other functions so as to ensure continuity upon failure of the bank[473]. Furthermore, the Commission Delegated Regulation developed on the basis of the EBA technical standards, further specify that when assessing the credibility of liquidation, resolution authorities shall consider the likely impact of the liquidation of the institution

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[470] Article 6 of the Delegated Regulation (EU) 2016/1075.
[471] Article 9 of the Delegated Regulation (EU) 2016/1075.
[472] Article 10 of the Delegated Regulation (EU) 2016/1075.
[473] Article 10(7)(c) of the BRRD.

or group on the financial systems of any Member State or of the Union to ensure the continuity of access to critical functions carried out by the institution or group and achieving the resolution objectives. For this purpose, resolution authorities should take into account the functions performed by the institution or group and assess whether liquidation would be likely to have a material adverse impact on i) financial market functioning and market confidence, ii) financial market infrastructures, iii) the real economy, in particular, the availability of critical financial services[474]. Furthermore, when assessing the credibility of the selected resolution strategy, resolution authorities are required to take into consideration the likely impact of resolution on the financial systems and real economies of any Member State or of the Union, with a view to ensuring the continuity of critical functions carried out by the institution or group[475].

As in the recovery planning process, a key component of resolution planning is a strategic analysis that allows identifying the bank's essential and systemically important critical functions. The FSB argues that such analysis should help to ensure that the resolution strategy and operational plan includes appropriate actions that help maintain continuity of these functions while avoiding unnecessary destruction of value and minimising, where possible, the costs of resolution to home and host authorities and losses to creditors[476]. This brings additional justification that for resolution authorities a term

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[474] Article 24 of Commission Delegated Regulation (EU) 2016/1075 of 23 March 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges (Text with EEA relevance). *OJ L 184, 8.7.2016, p. 1–71.*

[475] Article 32(1) of Commission Delegated Regulation (EU) 2016/1075 of 23 March 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges (Text with EEA relevance). *OJ L 184, 8.7.2016, p. 1–71.*

[476] Guidance on Identification of Critical Functions and Critical Shared Services. Financial Stability Board, 2013, Basel, P. 7. [accessed on 12 July 2015] <http://www.fsb.org/wp-content/uploads/r_130716a.pdf>

'*critical functions*' is one of the key concepts around which activities of the authority should go – starting from (i) resolution planning and resolvability assessment[477] – resolution authorities should prepare and review resolution plans, and where appropriate require applying structural means to bank (with a view to removing impediments to resolvability) until they are convinced that continuity of critical functions can be ensured; to (ii) the selection of the most appropriate resolution tool, which achieves the resolution objective of continuity of critical functions; and to (iii) ultimately the details in the application (e.g. justification for exclusions certain liabilities from the scope of the bail-in; selection of relevant resolution powers which would allow to reach aims defined in the resolution plans etc.).

With regard to the resolution stage, it is worth to note that the legal concept of critical functions is not only important for the public interest test (which was discussed in the first Part) but is also important for the actual application of resolution tools and resolution powers which are designed in a way that could contribute to the continuity of such functions. For example, where the bail-in tool is applied, the resolution authority may exclude or partially exclude certain liabilities[478] from the application of write-down or conversion powers where the exclusion is strictly necessary and is proportionate to achieve the continuity of critical functions and core business lines in a manner that maintains the ability of the institution under resolution to continue key operations, services and transactions[479]. In order to maintain critical functions in the bridge institutions, the BRRD provides resolution authorities with the power to transfer shares or other instruments of ownership, all or any assets, rights or liabilities of one or more institutions under resolution without obtaining the consent of the shareholders of the institution under resolution or

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[477] Making banks resolvable is a key component of the regulatory reform programme enacted in response to the crisis. A resolvable bank is one that is "safe to fail": it can fail and be resolved without cost to the taxpayer and without significant disruption to the financial markets or the economy at large. Read more: HUERTAS, Thomas. A resolvable bank. In LSE Financial Market group special paper series. London School of Economics and Political Science, March 2014. [access on 12 September 2017]. <http://www.lse.ac.uk/fmg/assets/documents/papers/special-papers/SP230.pdf>

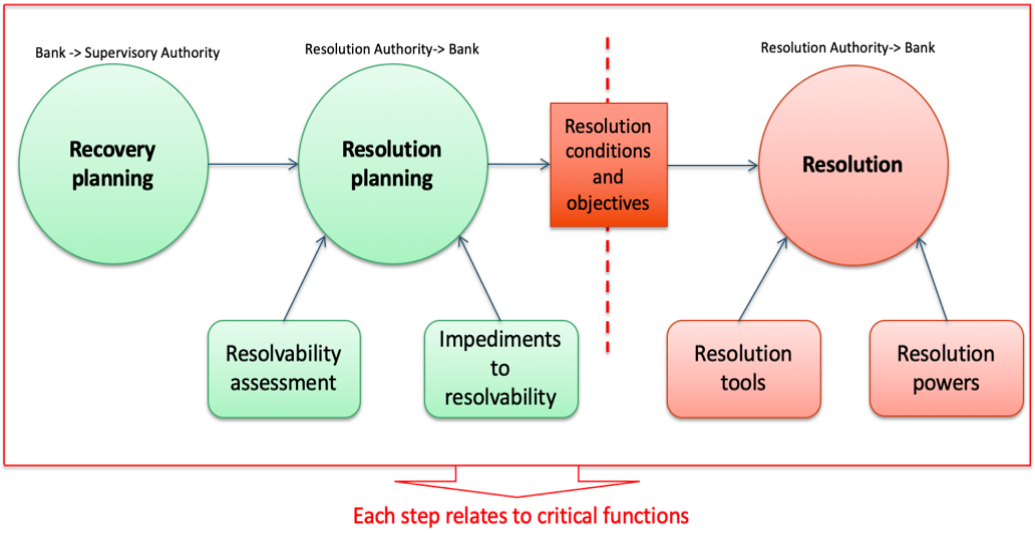
[478] Circumstances are further specified in the EBA technical advice. See BALCIUNAS, L., et all. Technical advice on the delegated acts on the circumstances when exclusions from the bail-in tool are necessary. The European Banking Authority, London, 6 March 2015. [accessed on 23 October 2017] <https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-07+Tehcnical+Advice+on+exclusion+from+the+bail-in+tool.pdf>

[479] Article 44(3)(b) of the BRRD.

any third party other than the bridge institution, and without complying with any procedural requirements under company or securities law[480]. Furthermore, the BRRD also foresees quite intrusive resolution powers which aim to provide resolution authorities with instruments to deal with continuity issues, for example, the power to temporarily suspend the termination rights of any party to contract[481] or power to require the provision of services and facilities that are necessary to enable a recipient to operate effectively the business transferred to it[482].

The above analysis shows that each step of the EU bank recovery and resolution legal framework relates to critical functions. Such a broader view gives a better understanding of the role of the legal concept of critical functions within the EU bank recovery and resolution legal framework, and, as a result, should be kept in mind when identifying the criticality of the bank's functions (see scheme 12).

Scheme 12. The Role of the Legal Concept of Critical Functions in the EU Bank Recovery and Resolution Legal Framework[483]



[480] Article 40(1) of the BRRD.
[481] Article 71 of the BRRD.
[482] Article 65 of the BRRD.
[483] For details with regard to the role of legal concept of critical functions see: BALČIŪNAS, L. The Legal Concept of Bank's Critical Functions, Implementation Challenges and the Role in the EU Bank Recovery and Resolution Framework. In *Teisės viršenybės link*, Vilnius University, Faculty of Law, 2019. P. 40 – 49.

The importance of this objective goes beyond the role in determining whether the public interest test was met and in selecting the right resolution tool and applying it correctly. Being one of the key resolution objectives, continuity of critical functions (as a public good) is also the justification for interfering with fundamental rights (i.e. property rights) and procedures when applying resolution tools (e.g. write-down, bail-in etc.) and powers (e.g. power to temporarily suspend terminations rights[484]; require service providers' to continue to provide services and facilities that are necessary to enable a recipient to operate effectively the business transferred to it[485] etc.). In this context, it is worth mentioning that under the European Convention on Human Rights and the Charter of Fundamental Rights of the European Union shareholders have the right to own, use and dispose of their property, and the right not to be deprived involuntarily of this property[486]. Both provisions include carve-outs from property rights, as long as a set of conditions are fulfilled: any interference should be made according to law, for reasons of public interest, and for fair consideration paid in due time. The European Court of Human Rights has formulated the condition that any interference should respect the principle of proportionality, which means that a fair balance should be struck between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights[487]. While in the banking context, the court has ruled that in the sensitive area of the stability of the banking system, national authorities have a wider margin of appreciation with regard to the proportionality of bank restructuring measures, and it has justified the derogation from shareholder rights on the grounds of public interest on several occasions[488]. Considering

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[484] Under the BRRD, the 'termination right' is understood as 'termination right' means a right to terminate a contract, a right to accelerate, close out, set-off or net obligations or any similar provision that suspends, modifies or extinguishes an obligation of a party to the contract or a provision that prevents an obligation under the contract from arising that would otherwise arise. Art. 2(1)(82) of the BRRD. Provisions linked to the termination right are set in Art. 33a, Art. 71 of the BRRD.

[485] Art. 65 of the BRRD.

[486] See Article 1 (Protection of property) of the European Convention on Human Rights of 1950 (as amended) and Article 17 (Right to property) of the Charter of Fundamental Rights of the European Union, OJ C 326, 26.10.2012, p. 391–407.

[487] see The European Court of Human rights decision No. 7152/75 of 23 September 1982. Sporrong and Lönnroth v Sweden, 23 09 1982.

[488] see the European Court of Human rights decision No. 30417/96 of 7 November 2002. Olczak v. Poland, 07 11 2002; the European Court of Human rights decision No. 50357/99 of 1 April 2004. Camberrow MM5 AD v Bulgaria, 01 04 2004.

the importance of the framework and its effect on key fundamental rights it's clear that the necessity of any measure for achieving continuity of critical functions will be challenged by the affected parties and assessed by courts in their assessment of the proportionality of the applied measure. Therefore, future court rulings will also further shape the legal concept of critical functions.

The above analysis clearly shows how important is this objective and the legal concept of critical functions which defines it. Therefore, in order to better understand the discussed objective, it is important to discuss the definition of '*critical functions*' interlinked legal provisions and elements, and how this term should be understood within the legal framework of the EU bank recovery and resolution as well as, what are the essential elements supporting the legal concept of critical functions and without which their continuity is hardly possible.

2.2.1. Definition of critical functions

At the global level, the key document defining the concept of critical functions is the FSB guidance on the identification of critical functions and critical shared services (the '***FSB Guidance on critical functions***')[489], which complements the KA provisions linked to resolvability assessments[490] and essential elements of recovery and resolution plans[491]. According to this guidance, the '*critical functions*' are defined as "*activities performed for third parties where failure would lead to the disruption of services that are vital for the functioning of the real economy and for financial stability due to the banking group's size or market share, external and internal interconnectedness, complexity and cross-border activities*"[492].

At the EU level, the key legal act defining the legal concept of critical functions is the BRRD. It defines 'critical functions' as "*activities, services or operations the discontinuance of which is likely in <u>one or more Member States</u>, to lead to the disruption of services that are essential to the real*

[489] Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Identification of Critical Functions and Critical Shared Services. The FSB, Basel, 16 July 2013. [accessed on 16 July 2013] <https://www.fsb.org/wp-content/uploads/r_130716a.pdf>.
[490] Annex II of the KA.
[491] Annex III of the KA.
[492] P. 7 of the FSB Guidance on Critical Functions.

economy or to disrupt financial stability due to the size, market share, external and internal interconnectedness, complexity or cross-border activities of an institution or group, with particular regard to the substitutability of those activities, services or operation"[493]. What is more, it is important to note that in 2015, following request from the Commission, the European Banking Authority (the '**EBA**') issued technical advice on the delegated acts on critical functions and core business lines[494] (the '**Technical advice on critical functions**') on the basis of which the Commission adopted delegated regulation further specifying the criteria for the determination of the activities, services and operations with regard to critical functions[495] (relevant provisions linked to critical functions could also be found in other EBA regulatory products and delegated regulations which will be further explained in this subchapter below).

At the global level an indicative list of five categories of critical functions is provided[496], namely: i) deposit-taking; ii) lending and loan servicing; iii) payments, clearing, custody and settlement; iv) wholesale funding markets; and v) capital markets and investment activities. However, it is important to note that if a certain function carried by a bank falls under the mentioned category, it does not necessarily mean per se that such function is critical . Criticality assessment should be done on a case by case basis. What is more, it is possible that a full-scale analysis (for the identification of critical functions, supporting critical services and operational continuity arrangements suggested methodological analysis, please see Subchapters 2.2.2. – 2.2.3.) could identify that other function, which may not fall under the indicative list of categories provided by the FSB, is critical. Therefore, the final list of critical functions could not be provided. This was one of the

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[493] Article 2(1)(35) of the BRRD2.

[494] BALČIŪNAS, L; et all. Technical advice on the delegated acts on critical functions and core business lines. The European Banking Authority, 6 March 2015, London. [accessed on 6 March 2015] <https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-05+Technical+Advice+on+critical+functions+and+core+business++++.pdf>.

[495] Commission Delegated Regulation (EU) 2016/778 of 2 February 2016, supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to the circumstances and conditions under which the payment of extraordinary *ex post* contributions may be partially or entirely deferred, and on the criteria for the determination of the activities, services and operations with regard to critical functions, and for the determination of the business lines and associated services with regard to core business lines. OJ L 131, 20.5.2016, p. 41–47.

[496] See Annex to the FSB Guidance on Critical Functions.

reasons why in the EBA technical advice the list of potential critical functions was not provided as well as why identification of specific indicators was left for a later stage, once authorities have gained more experience in recovery and resolution planning and more empirical data would be available on the basis of which common practice could be developed[497]. Furthermore, it was also concluded that defining and relying solely on quantitative indicators for determining core business lines should be avoided as this may result in 'automatic' decisions which may not accurately and completely reflect the complexity of the generation of profit in a bank with a high level of organisation and complex division of the business[498]. This was also the reason why the Delegated Regulation EU 2016/778 provides only an indicative list of indicators for identification of core business lines[499].

After comparing the BRRD definition of critical functions with the FSB definition, we can conclude that the EU definition is broadly aligned with the international definition set in the FSB guidance. The BRRD, considering the EU Single Market specificities, just further clarifies the link with the Member States and highlights substitutability element. However, this does not create a substantial difference between the definitions at the global and the EU level.
The EU legal framework also introduces a concept of '*core business lines*' and defines them as "*business lines and associated services which represent material sources of revenue, profit or franchise value for an institution or for a group of which an institution forms part"*[500]. This concept was further clarified in the Technical advice on critical functions[501]. At the global level,

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[497] This was one of the reasons why in the EBA technical advice the list of potential critical functions was not provided as well as why identification of specific indicators was left for a later stage, once authorities have gained more experience in recovery and resolution planning and more empirical data would be available. See also: BALČIŪNAS, L; et all. Technical advice on the delegated acts on critical functions and core business lines. The European Banking Authority, 6 March 2015, London. Paragraph 24. [accessed on 6 March 2015] <https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-05+Technical+Advice+on+critical+functions+and+core+business++++.pdf>.

[498] BALČIŪNAS, L; et all. Technical advice on the delegated acts on critical functions and core business lines. The European Banking Authority, 6 March 2015, London. Paragraph 38. [accessed on 6 March 2015] <https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-05+Technical+Advice+on+critical+functions+and+core+business++++.pdf>.

[499] See Art. 7(2) of the Delegated Regulation EU 2016/778.

[500] Article 2(1)(36) of the BRRD.

[501] BALČIŪNAS, L., et all. Technical advice on the delegated acts on critical functions and core business lines. EBA, 6 March 2015, p. 16. [accessed on 6 March 2015] <https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-05+Technical+Advice+on+critical+functions+and+core+business++++.pdf>

the KA mentions '*principal or essential business lines*'[502]; however, it does not elaborate further or provides the definition. As it can be seen from the definitions, '*critical functions*' should be assessed from a perspective of their importance for the functioning of the real economy and financial markets and therefore for financial stability as a whole, '*core business lines*' should be assessed from the perspective of the importance for the institution itself, for example, how much they contribute to revenues and profits of the institution[503]. Therefore, there is a link between these two elements and core business lines might be essential for ensuring the continuity of critical functions after resolution.

2.2.2. Identification of critical functions

The identification of critical functions exercise is not straightforward, and, as we will see from the empirical analysis, banks, supervisory and resolution authorities still struggle with the identification of critical functions. There is also a lack of academic analysis in this field. Therefore, considering author's practical experience gained when developing relevant EU legal acts and performing analysis how those requirements are reflected in plans, this part will discuss the methodological approach and will highlight key points which need to be considered by banks, supervisory and resolution authorities when identifying the critical functions.

The actual test for a determination whether the function is critical or not is based on a series of elements. Only the function which includes all these elements could be considered as critical. Namely, considering the definition of critical functions the test for determining whether the function is critical or not should include the following assessments and identification (see scheme 13): a) whether the function is provided by a bank to third parties not affiliated to the bank or group; and b) whether the sudden failure to provide that function would likely have a *material negative impact* on the third parties, *give rise to contagion* or undermine *the general confidence of market* participants due to

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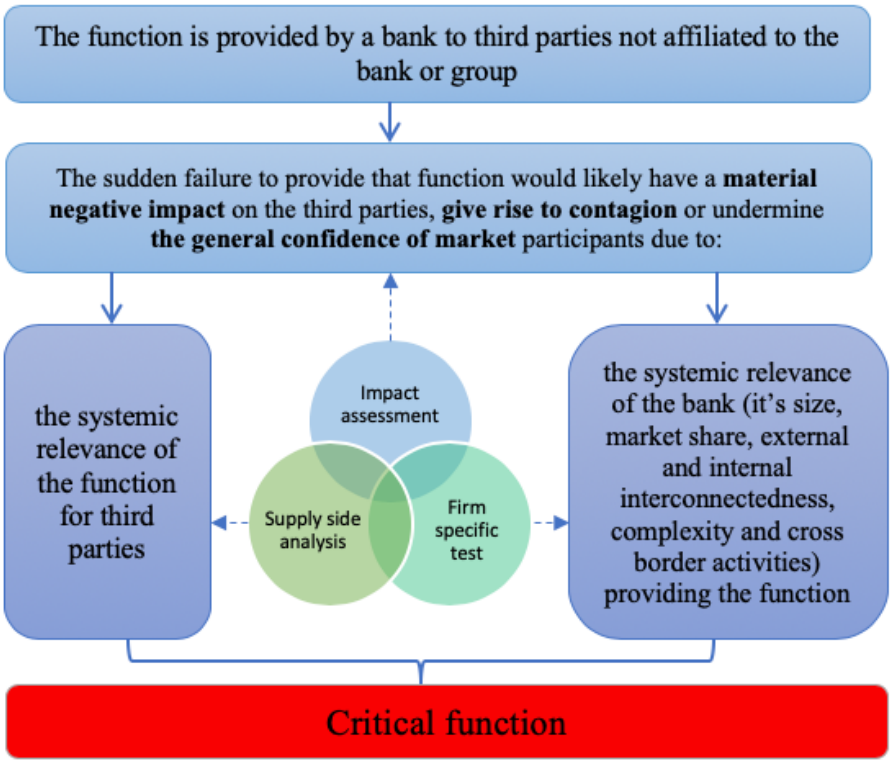
[502] Key Attributes of Effective Resolution Regimes for Financial Institutions. Financial Stability Board, 2014, Basel. P. 38. [accessed on 8 August 2017] < http://www.fsb.org/wp-content/uploads/r_141015.pdf>

[503] BALČIŪNAS, L., et all. Technical advice on the delegated acts on critical functions and core business lines. The European Banking Authority, 6 March 2015, London, paragraph 9. [accessed on 6 March 2015] <https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-05+Technical+Advice+on+critical+functions+and+core+business++++.pdf>

(the '**Impact assessment**'): i) the *systemic relevance* of the function for the third parties (the '**Supply-side analysis**'); and ii) the *systemic relevance* of the bank/group in providing the function (the '**Firm-specific test**').

Scheme 13. Identification of Critical Functions



The FSB Guidance on critical functions further specify questions which should be answered in each of the steps (i) Impact assessment[504], (ii) Supply-side analysis[505] and (iii) Firm-specific test[506]. There is no need to repeat the full details of the test provided in the Guidance, though it is important to highlight key elements and points which may not be straightforward, are not further elaborated or immediately clear.

[504] P. 8 – 9, the FSB Guidance on critical functions.
[505] *Ibid*, P. 9 – 11.
[506] *Ibid*, P. 11 – 12.

With regard to the '*Impact assessment part*'[507], it is worth mentioning a few important points linked to the i) impact on third parties, ii) market confidence, and iii) potential contagion effects, which are required to be assessed by the legal framework. If the failure to provide the function only has a direct negative impact on a small number of counterparties which are not systemic themselves due to their size or interconnectedness (given the circumstances at the time of the assessment), then the function should generally not be considered critical. With regard to market confidence, it should be noted that criticality can also result from the loss of market confidence caused by the disruption of a certain function. However, this involves forward-looking assumptions and forecasts. Therefore, this is a vague condition for verifying. Furthermore, as a bank failure will result in market uncertainty and question former assumptions of market participants, a certain degree of loss of market confidence seems unavoidable. Therefore, there is a risk that an excessively cautious resolution authority may use this as an argument not to carefully distinguish between critical functions and non-critical functions and because of that use its resources inefficiently or enforce insufficient loss absorption on creditors. Therefore, the resolution authority has to analyse carefully whether there is a concrete risk for a loss of market confidence from the disruption of the specific function and whether this cannot be prevented by resolution measures and appropriate communication, even if ultimately the function in question will be wound down. Moreover, criticality can also result from contagion effects. Here the situation is similar as in the case of market confidence. There will always be a certain degree of contagion if functions are not provided uninterruptedly or creditors have to bear losses. Therefore, the causality between the discontinuance of the specific function and the impact on further market participants has to be verified by concrete evidence.

With regard to '*Supply-side analysis'* (what includes the assessment of the systemic relevance of the function for third parties), two aspects should be highlighted: i) substitutability; and ii) concentration. In general, substitutability is understood as an ability to replace the provision of a certain function in comparable terms (i.e. to a comparable extent and quality and with an acceptable cost from existing or new market participants) and within a

[507] Impact assessment includes the assessment whether the sudden failure to provide that function would likely have a material negative impact on the third parties, give rise to contagion or undermine the general confidence of market participants.

reasonable timeframe, thereby, avoiding a disruption in the provision of functions that are essential to the real economy and financial markets[508]. This means that the market should be able to substitute the functions of failing providers quickly. The logic of the market stipulates that if there is a demand for a function, usually there will be a supplier. However, the question is timing, quality of services, willingness to do this. Therefore, the key question for resolution authorities in most cases will need to answer not whether the function can be replaced at all, but whether it can be done within the required timeframe and whether there could be a significant change in terms of costs and quality. Only if the bank function can be substituted timely, the impact of the disruption can be minimised. The acceptable timeframe depends on the function and the expected impact. However, the timely substitution of a failing provider might be very difficult or impossible without adversely affecting the stability of the financial system. This means that the substitutability assessment is closely linked to the impact assessment in the previous step. Furthermore, the assessment of substitutability has many aspects, which all relate to an analysis of the market of that function, supply and demand side. The resolution authority has to take into account the market conditions under the assumption that the bank fails. This is important because during the non-crisis time we may have one result, however, during the crises, other banks and other market participants might also be stressed and their capabilities to substitute certain service might not be so good or even not possible at all. The resolution authority may, however, take into account that by using legal resolution powers, functions can be transferred to other market participants, and there are tools in the BRRD to incentivise potential transferees. Concentration is another aspect of consideration. Comparable to the competition law (e.g. when assessing a merger or a dominant position in the market) the resolution authority has to identify the relevant market (which can be but not necessarily is identical to the Member State's market). Taking into account the market, the resolution authority has to analyse all factors affecting the capacity of existing or future competitors to take over the function or to enter the market, and how attractive it is for them to do so. Finally, the

[508] BALČIŪNAS, L; et all. Technical advice on the delegated acts on critical functions and core business lines. The European Banking Authority, 6 March 2015, London. P. 5. [accessed on 6 March 2015] <https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-05+Technical+Advice+on+critical+functions+and+core+business++++.pdf>.

discontinuance of the function as such may also have an impact on the ability of other suppliers to replace the function if infrastructures are affected.

The '*Firm-specific test'* (assessment of the systemic relevance of the bank/group in providing the function) is closely linked with the supply side analysis as well as the impact assessment. The failure of a bank to provide a certain critical function may depend on the importance of the bank and its function within the market, therefore, due regard should be to size, market share, external and internal interconnectedness, complexity, and cross-border activities of a bank or group.

In the EU, the Commission Delegated Regulation[509] (the '**Delegated Regulation EU 2016/778**') was adopted on the basis of the Technical advice on the critical functions[510] prepared taking into account the EU commitment to comply with the FSB standards, and which further specified how recovery and resolution planning legal process, defined in the BRRD, could facilitate the identification of critical functions. Namely, it specifies a two-step approach for clarification which functions of the bank are critical functions: i) bottom-up approach (as banks are required to perform a self-assessment when drawing-up recovery plans); and ii) top-down approach (as supervisory authorities and, in particular, resolution authorities should critically review the recovery and resolution plans to ensure consistency and coherence across approaches used by individual banks[511]). In particular, the top-down approach is an important point, as supervisory and resolution authorities should keep in mind that a bank may have a limited view on how their own activity relates to the whole economy[512], as contrary to the supervisory and resolution authorities

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[509] Commission Delegated Regulation (EU) 2016/778 of 2 February 2016, supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to the circumstances and conditions under which the payment of extraordinary *ex post* contributions may be partially or entirely deferred, and on the criteria for the determination of the activities, services and operations with regard to critical functions, and for the determination of the business lines and associated services with regard to core business lines. OJ L 131, 20.5.2016, p. 41–47.

[510] BALČIŪNAS, L; et all. Technical advice on the delegated acts on critical functions and core business lines. The European Banking Authority, 6 March 2015, London. Paragraph 18. [accessed on 6 March 2015] <https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-05+Technical+Advice+on+critical+functions+and+core+business++++.pdf>.

[511] See Recital 7 of the Delegated Regulation EU 2016/778.

[512] For example, the EBA comparative report identified that banks were familiar with the concept of core business lines, and while not always extensively addressed, they were generally better covered than critical functions. See Comparative report on the approach to determining critical functions and core business lines in recovery plans. European Banking Authority, 6 March 2015, London [accessed on 23 October 2017]

it does not benefit from the overarching view as to which functions are vital for the functioning of the real economy and for financial stability.

All this shows that the identification of whether a certain function is considered as a critical or not requires a comprehensive individual assessment, and all elements identified in the legal definition of critical functions and further specified in the Delegated Regulation EU 2016/778 should always be considered when identifying whether a function is critical or not. Furthermore, the above analysis also raises the question what the progress of banks, supervisory and resolution authorities is concerning the identification of critical functions and implementation of the legal concept of critical functions and interlinked elements in practices.

In 2015 the EBA compared recovery plans of 27 European cross-border banking groups with a specific focus on examining whether and how the banks identified critical functions in their recovery plans. This analysis showed that the identification of critical functions was included in a limited number of reviewed recovery plans[513], there were substantial variations across banking groups in terms of the overall approach to identification performed analysis of issued a comparative report on the approach to determining critical functions and core business lines in recovery plans[514].

In 2017, the author had worked and performed analysis of the recovery plans of 23 European cross-border banking groups with parent institutions located across 12 different EU countries, on the basis of which the EBA comparative report on recovery options was issued[515]. Even though this report did not focus specifically on the identification of critical functions, they were

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<https://www.eba.europa.eu/documents/10180/950548/EBA+Report+-+CFs+and+CBLs+benchmarking.pdf>.

[513] However, it should also be noted that until the BRRD came into force on 1 January 2015, banks were under no obligation to address these matters in their plans, although their inclusion was recommended in the FSB Key Attributes and EBA template issued in 2012 (EBA Discussion Paper on a template for recovery plans. The European Banking Authority, London, 15 May 2012, EBA/DP/2012/2. [accessed on 5 March 2017] <https://eba.europa.eu/documents/10180/41487/Discussion-Paper-on-Template-for-Recovery-Plans.pdf>.

[514] Comparative report on the approach to determining critical functions and core business lines in recovery planning. The European Banking Authority, 6 March 2015, London. [accessed on 6 March 2015] <https://eba.europa.eu/documents/10180/950548/EBA+Report+-+CFs+and+CBLs+benchmarking.pdf>.

[515] BALČIŪNAS, L.; et all. Comparative report on recovery plan options. The European Banking Authority, London, 1 March 2017. [accessed on 5 May 2018] <https://eba.europa.eu/documents/10180/1720738/EBA+Comparative+report+on+recovery+options+-+March+2017.pdf>.

touched as an analysis of recovery options must be included in the strategic analysis section of the recovery plan, the aim of which is to identify the key steps to maintaining the proper functioning of core business lines and critical functions in a situation of financial stress[516]. The analysis showed the progress of identification of critical functions, as most (though not all to the satisfactory level) of the recovery plans provided information on critical functions and core business lines, as well as critical services (such as the institutions' IT systems)[517].

In 2018, the EBA, with regard to critical functions in the resolution plans, noted that it sees material progress, in particular on the identification of critical functions, operational continuity and access to financial market infrastructures, though acknowledged that plans are not yet fully finalised [518]. Furthermore, it also noted that in some cases differences remained between the assessment of critically of critical functions by home and host authorities[519].

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[516] What is more, recovery options included in the recovery plans should indicate as well a range of capital and liquidity actions required to maintain or restore the viability and financial position of the entity or entities covered by the recovery plan which have as their primary aim ensuring the viability of critical functions and core business lines[516] as well as operational impact assessment of recovery options which includes impact on continuity of critical functions, core business lines and access to FMIs. See Art. 6(2), Art. 9(1)(a) and Art. 10 of the Commission Delegated Regulation (EU) 2016/1075 of 23 March 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges (Text with EEA relevance). OJ L 184, 8.7.2016, p. 1–71. The '**Delegated Regulation (EU) 1075/2016**'.

[517] BALČIŪNAS, L.; et all. Comparative report on recovery plan options. The European Banking Authority, London, 1 March 2017. P. 15. [accessed on 5 May 2018] <https://eba.europa.eu/documents/10180/1720738/EBA+Comparative+report+on+recovery+options+-+March+2017.pdf>.

[518] EBA Report on the Functioning of Resolution Colleges in 2017. The European Banking Authority, London, July 2018. P.3. [accessed on 5 August 2018]. <https://eba.europa.eu/documents/10180/2087449/EBA+Report+on+the+functioning+of+resolution+colleges+-+July+2018.pdf>.

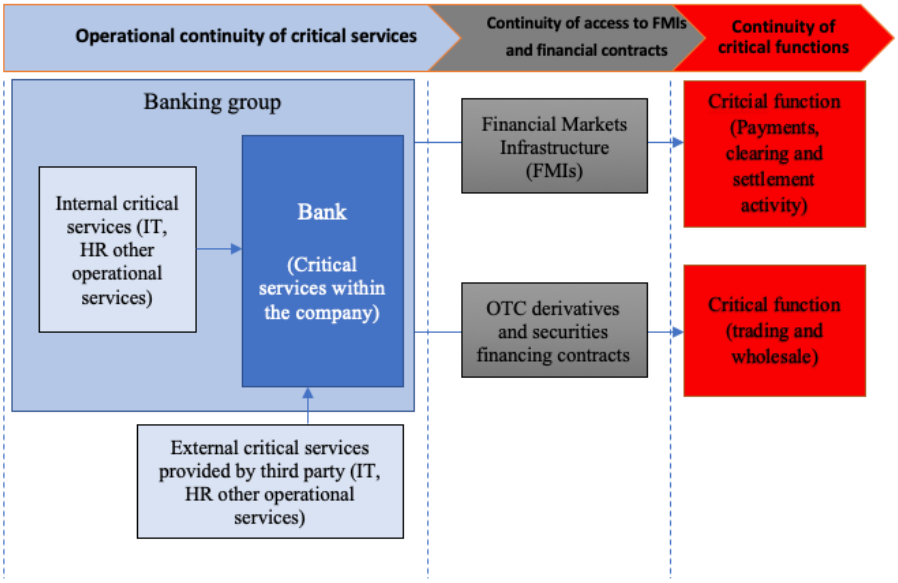
[519] Paragraph 30 of the EBA Report on the Functioning of Resolution Colleges in 2017. The European Banking Authority, London, July 2018. [accessed on 5 August 2018]. <https://eba.europa.eu/documents/10180/2087449/EBA+Report+on+the+functioning+of+resolution+colleges+-+July+2018.pdf>.

On the one hand, on the basis of the empirical analysis performed at the EU level we can conclude that there is a continuous progress of banks, supervisory and resolution authorities in identifying and understanding the legal concept of critical functions. On the other hand, considering that five years have already passed since the adoption of the BRRD and still a number of improvements with regard to identification of critical functions and interlinked relevant elements need to be made in both recovery and resolution plans, we can conclude that banks, supervisory and resolution authorities continue their learning journey of the new paradigm and some still struggle with the identification and understanding of the concept of critical functions. At least a few reasons could be identified why banks, supervisory and resolution authorities face difficulties in identifying the critical functions. Firstly, even though the legal framework includes the test for a determination whether a certain function is critical or not, a comprehensive application of this test requires to pay due regard to the economic notions and interlinked legal provisions. To navigate between them and see a full picture of how they interlink to each other is a hard task and requires specific expertise. Though some may argue that the prudential supervision legal framework is even more complex as, compared with the EU bank recovery and resolution legal framework which is relatively new, the prudential supervision legal framework is much longer in place, it has been developing gradually, and supervisors are much more used to it as well as there is more relevant practical expertise. Secondly, the bank recovery and resolution legal framework and the legal concept of critical functions is a paradigm-shifting approach. This requires changing the attitude not only of banks but also, of supervisory and resolution authorities. Thirdly, potential divergent approaches could naturally emerge considering assigned different roles by the legal framework to supervisory and resolution authorities which, among other things, also aim to protect financial stability as a public good, on the one hand, and business interests of banks, on the other.

Moreover, it is important to note that the first resolution objective talks about the '*continuity*' of the critical functions. Therefore, just identification whether certain bank function is critical or not without ensuring its continuity during the turbulent times would not satisfy the aim of this objective, and therefore, the overall aim of the legal framework. As a result, it is important to discuss how the '*continuity*' should be understood in the EU bank recovery and resolution legal framework as well as other elements linked to it. More specifically, the continuity of critical functions is not possible without the

operational continuity arrangements, continuity of access to the FMIs and financial contracts (see scheme 14). All these elements and legal provisions defining them both at the global and the EU level as well as their links with the continuity of critical functions will be discussed below.

Scheme 14. Continuity of Critical Functions Depends on the Continuity of Critical Services



2.2.3. Critical services supporting critical functions and operational continuity arrangements

As it was discussed in the first Part, at the global level, the FSB KA require jurisdictions to put in place on-going recovery and resolution plans. One of the main objectives of those strategies and plans should be to ensure as far as possible that the bank retains continued access to the services it needs to enable it to continue to perform its critical functions – the activities it performs for third parties the failure of which would lead to the disruption of services that are critical for the functioning of the real economy and for financial stability.

At the global level, critical functions are usually discussed together with critical services[520] necessary to maintain these functions as the discontinuation of the critical services can present a serious impediment and completely prevent the performance of critical functions. The '*critical shared services*' are defined as "*an activity, function or service performed by either an internal unit, a separate legal entity within the group or an external provider, performed for one or more business units or legal entities of the group, the failure of which would lead to the collapse of (or present a serious impediment to the performance of) critical functions"*[521] *(the 'critical services')*. Furthermore, the critical services are divided into two groups[522]: a) '*finance-related services*' which involve the management of financial resources of the financial institution or group related to the operation or provision of critical function(s). For example, treasury-related services, trading, asset management, cash handling, risk management and valuation; and b) '*operational services*' which provide the necessary infrastructure to enable the bank or group to operate or provide a critical function(s). For example, IT infrastructure and software-related services; personnel and human resources support, procurement and facilities management; transaction processing; legal and compliance.

In the EU, the BRRD does not provide a definition of critical services, though, includes the legal power to require continuity of essential services from other parts of a group[523] which were further clarified the EBA

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[520] See: Guidance on Identification of Critical Functions and Critical Shared Services. Financial Stability Board, Basel, 2013. [accessed on 12 July 2015] <http://www.fsb.org/wp-content/uploads/r_130716a.pdf>.

[521] Guidance on Identification of Critical Functions and Critical Shared Services. Financial Stability Board, Basel, 2013. P. 12. [accessed on 12 July 2015] <http://www.fsb.org/wp-content/uploads/r_130716a.pdf>

[522] Guidance on Arrangements to Support Operational Continuity in Resolution. The FSB, 18 August 2016, P. 7. Author contributed to the development of these guidance as an expert at the FSB working group. [accessed on 18 August 2016] <http://www.fsb.org/wp-content/uploads/Guidance-on-Arrangements-to-Support-Operational-Continuity-in-Resolution1.pdf>. (the '**FSB Guidance on operational continuity)**.

[523] Art. 65 of the BRRD. The rational of this power is to ensure that where the resolution tools have been used to transfer the critical functions or viable business of a bank to a sound entity such as a private sector purchaser or bridge institution, the directive stipulates that the residual part of the bank should be liquidated within an appropriate time frame having regard to the need for the failing institution to provide services or support to enable the purchaser or bridge institution to carry out the activities or services acquired by virtue of that transfer. Therefore in this case, the directive gives resolution authorities the ancillary power to require the residual institution that is being wound up under normal insolvency proceedings to provide the services

Guidelines[524], however, even though these two terms are linked they are not the same. This was recognised during the development of the Technical advice on critical functions and considering discussions carried out it was suggested to define such services as "*the underlying operations, activities, services performed for one (dedicated services) or more business units or legal entities (shared services) within the group which are needed to provide one or more critical functions <..> Critical services can be either performed by one or more entities (separate legal entity, internal unit, etc.) within the group (Internal service) or be outsourced to an external provider (External service)*"[525]. The Commission followed the Technical advice and added this definition to the Delegated Regulation EU 2016/778[526]. The determination of critical services as the determination of critical functions is based on a series of elements which are already stemming from its definition (see scheme 15). In order to determine whether a service is critical, in addition to the elements mentioned in the definition, it should also be assessed whether its disruption can present a serious impediment to, or completely prevent, the performance of critical functions[527]. The service should be considered as critical if it has all of these elements. If one (or more) of these elements are missing, this suggests that the service is not critical. For example, if an internal service, such as facilities management, can be substituted easily from other, external, sources that shared service is not critical, even if it is necessary for maintaining the

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that are required to enable the institution to which assets or shares have been transferred by applying the sale of business tool or the bridge institution tool to operate its business.

[524] Guidelines on the minimum list of services or facilities that are necessary to enable a recipient to operate a business transferred to it under Article 65(5) of the BRRD. The European Banking Authority, 2015, London. [accessed on 16 September 2017] <https://www.eba.europa.eu/documents/10180/1080790/EBA-GL-2015-06+Guidelines+on+the+minimum+list+of+services.pdf/e840a987-eade-4796-8a26-31fcc6884358>

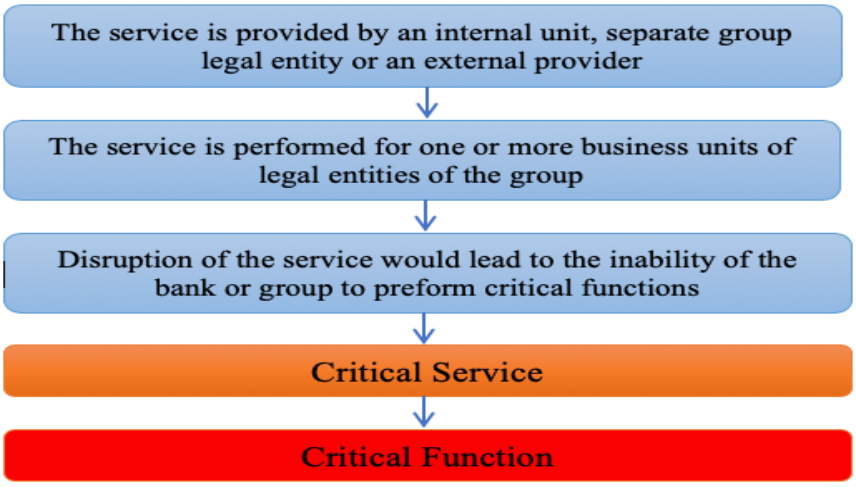
[525] It also noted that critical services are inherently attached to the critical function and their identification follows the identification of a critical function. This advice presents elements of a test to determine whether a critical service is essential to the performance of a critical function. If an underlying operation/activity/service can be substituted easily by another provider, to a comparable extent, with a comparable quality, with an acceptable cost and within a reasonable timeframe, then it should not be considered a critical service. See: BALČIŪNAS, L; et all. Technical advice on the delegated acts on critical functions and core business lines. European Banking Authority, London, 6 March 2015. P. 4. [accessed on 6 March 2015] <https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-05+Technical+Advice+on+critical+functions+and+core+business++++.pdf>.

[526] See Recital 8 of the Delegated Regulation EU 2016/778.

[527] Ibid.

critical functions of the financial institution or group. Similarly, the fact that a service is shared does not necessarily mean that it is a critical service, as it may support tasks not directly related to maintaining critical functions (e.g. a centralised marketing department). It should also be noted that while some services have to be continuously provided, there might be others which might be interrupted for a short period without leading to a collapse of the critical functions. As a result, ranking services in order of priority could be useful.

Scheme 15. Identification of Critical Services



Another aspect which is important is service provision models. After performing extensive consultation with market participants and its members, the FSB concluded that three key service provision models could be identified. Namely, the provision of services by a division within a regulated legal entity (bank). This model means that services are provided in-house from a regulated entity either to other entities in the group or within the regulated entity itself[528]. The provision of services by an intra-group service company was identified as another model. Under this model, services are provided to different group entities from a dedicated intra-group service company[529]. Finally, the provision of services by a third-party service provider was identified as the third model. Under this structure, a bank outsources services to an external service provider on a contractual basis[530]. Of course, it was also acknowledged

[528] P. 9 of the FSB Guidance on operational continuity.
[529] P. 10 of the FSB Guidance on operational continuity.
[530] *Ibid.*

that banks for different services might use or combine different service provisions models and, therefore, these aspects should be adequately considered during the recovery, resolution planning and resolvability assessment[531].

Furthermore, just identification of the critical services is not sufficient as their continuity is not possible without an operational continuity arrangement. This statement is supported by the fact that already in 2013, in its report to the G20[532], the FSB identified operational continuity of critical services as one of the issues that remain to be addressed to enhance G-SIB resolvability. In 2014, the FSB further identified that a lack of adequate arrangements for operational continuity poses an obstacle to the orderly resolution of many G-SIBs[533] and committed to developing dedicated guidance on measures to support operational continuity[534]. The draft guidance was published in October 2015[535] and identified a number of arrangements that could support operational continuity in resolution and help address obstacles to resolvability that arise from uncertainties about the continuity of critical shared services.

In 2016, the final FSB Guidance on operational continuity was issued and defined the '*operation continuity*' as the means of ensuring or supporting continuity of the critical services that are necessary to maintain the provision or facilitate the orderly wind-up of a firm's critical functions in resolution[536]. The guidance identifies and further elaborates on seven categories of arrangements that can support operational continuity (see scheme 15), and

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[531]

[532] Progress and Next Steps Towards Ending "Too-Big-To-Fail" (TBTF). Report of the Financial Stability Board to the G-20, Basel, 2 September 2013. [accessed on 15 October 2017] <https://www.fsb.org/wp-content/uploads/r_130902.pdf>.

[533] Towards full implementation of the FSB Key Attributes of Effective Resolution Regimes for Financial Institutions. Report to the G20 on progress in reform of resolution regimes and resolution planning for global systemically important financial institutions (G-SIFIs). The FSB, Basel, 12 November 2014. P. 13. [accessed on 15 April 2017] < https://www.fsb.org/wp-content/uploads/Resolution-Progress-Report-to-G20.pdf>.

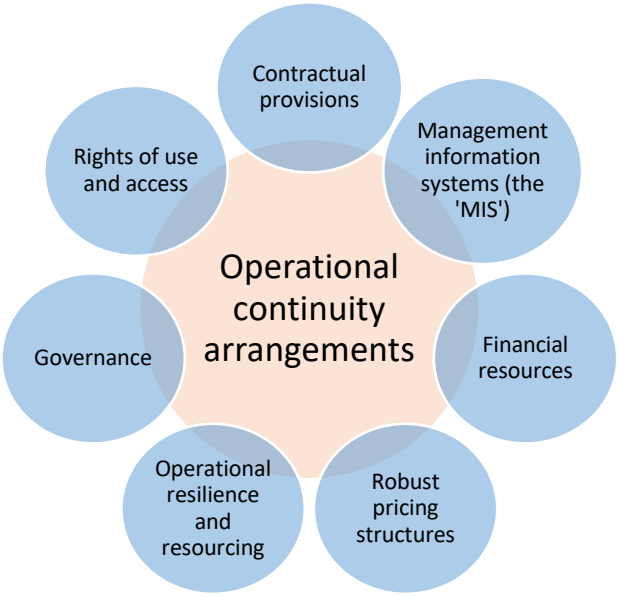
[534] *Ibid*. P. 14.

[535] Guidance on Continuity of Access to Financial Market Infrastructures ("FMIs") for a Firm in Resolution. Consultative Document. The FSB, Basel, 16 December 2016. [accessed on 16 December 2016] <https://www.fsb.org/wp-content/uploads/Continuity-of-Access-to-FMIs-Consultation-Document-FINAL.pdf>.

[536] P. 7 of the FSB Guidance on Operational Continuity.

which are relevant for different service models, though means of application may differ[537].

Scheme 16. Arrangements Supporting Operational Continuity



Considering that a lack of adequate arrangements for operational continuity is likely to impair bank's resolvability and ability to perform critical services and, therefore, the continuity of its critical functions, the operational continuity should be one of the key aspects of recovery and resolution planning for individual banks.

In the EU, the term '*operational continuity*' is neither defined nor explicitly mentioned in the legal provisions of the BRRD. Though, legal provisions linked to the critical functions in several places highlight the need to consider certain arrangements which should contribute to their continuity, for example, during the recovery, resolution planning and resolvability assessment[538]. For instance, the BRRD specifies that recovery plans should not only identify critical functions[539] but should also include arrangements necessary to maintain the continuous functioning of the institution's

[537] Paragraph 4.4 of the FSB Guidance on operational continuity.
[538] The continuity is also highlighted in a number of other provisions of the BRRD, e.g. Recital 5, 45, 70, 72, 90, Articles 10(7)(c), 15(1), 16(1), 31(2)(a), 44(3)(b) of the BRRD etc.
[539] Annex Section C (7) of the BRRD.

operational process[540], including infrastructure and IT services[541]. Furthermore, Commission Delegated Regulation (EU) 2016/1075[542] further specifies that each recovery option should also contain an assessment of how the continuity of operations will be ensured when implementing that option[543] and that such assessment should include an analysis of internal operations (for example, information technology systems, suppliers and human resources operations)[544].

What is more, the recovery plan forms the basis of the resolution plan. Even though it is a statutory duty of the supervisory authorities to assess the recovery plans prepared by the banks, they should be examined as well by the resolution authorities with a view to identifying any actions in the recovery plan which may adversely impact the resolvability of the institution[545]. Bank's self-assessment in identifying critical functions and supporting critical services informs supervisory and resolution authorities about functions of the bank, important for the real economy and financial stability. However, the resolution authority is encouraged to conduct its own assessment of the analysis performed by the bank or group itself during recovery planning with regard to identification and continuity of critical functions when establishing the resolution plan and to demonstrate how critical functions could be legally and economically separated from other functions so as to ensure continuity upon the failure of the institution[546].

Group resolution plans go further. For instance, under the BRRD, they should: (i) examine the extent to which the resolution tools and powers could

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[540] Art. 10(7(q) of the BRRD.
[541] Annex Section C 16) of the BRRD.
[542] Commission Delegated Regulation (EU) 2016/1075 of 23 March 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges (Text with EEA relevance). OJ L 184, 8.7.2016, p. 1–71. (the '**Delegated Regulation (EU) 2016/1075**').
[543] For example, the recovery option may involve the separation of a bank or entity from the group, or the separation of a business unit or business line, in such case it is also important to demonstrate adequate operational continuity arrangements in order to avoid a disruption in the provision of critical functions.
[544] Art. 12(1)(2) of the Delegated Regulation (EU) 2016/1075.
[545] Art. 6 of the BRRD.
[546] Recital 5 of the Delegated Regulation (EU) 2016/778.

be applied and exercised in a coordinated way to group entities, including measures to facilitate the purchase by a third party of the group as a whole, or separate business lines or activities that are delivered by a number of group entities, or particular group entities, and identify any potential impediments to a coordinated resolution[547]; and (ii) identify measures, including the legal and economic separation of particular functions or business lines, that are necessary to facilitate group resolution when the conditions for resolution are met[548].

While during the resolvability assessment of a bank or group, generally the resolution authorities are required to consider the feasibility of resolution actions to mitigate threats to ensure continuity of critical functions[549]. Therefore, under the BRRD, for instance, resolution authorities are required to consider, among other things: (i) the extent to which the bank is able to map core business lines and critical functions to legal persons[550]; (ii) the extent to which legal and corporate structures are aligned with core business lines and critical functions[551]; (iii) the extent to which there are arrangements in place to provide for essential staff, infrastructure, funding, liquidity and capital to support and maintain the core business lines and the critical functions[552]; (iv) the extent to which the service agreements that the bank maintains are fully enforceable in the event of resolution of the bank[553]; and (v) the extent to which the bank has a process for transitioning the services provided under service level agreements to third parties in the event of the separation of critical functions or of core business lines[554]. Furthermore, the Delegated Regulation (EU) 2016/1075 requires resolution plans to include a description of arrangements to ensure operational continuity of access to critical functions during resolution, including at least the description of i) critical shared systems and operations which need to be continued to maintain continuity of critical functions and arrangements for ensuring the contractual and operational robustness of their provision in resolution; and ii) internal and external

[547] Art. 12(3)(b) of the BRRD.
[548] Art. 12(3)(d) of the BRRD.
[549] Art. 32 of the BRRD.
[550] Annex Section C (1) of the BRRD.
[551] Annex Section C (2) of the BRRD
[552] Annex Section C (3) of the BRRD.
[553] Annex Section C (4) of the BRRD.
[554] Annex Section C (6) of the BRRD.

interdependencies which are critical to the maintenance of operational continuity[555].

To sum up, both during the recovery and resolution planning it should be kept in mind by both banks and public authorities that these plans should aim at making sure that when bank faces difficulties and, for example, recovery options have to be implemented, or if those options do not help and ultimately a bank faces resolution – adequate operational continuity arrangements need to be put in place which would allow facilitating the continuity of critical services irrespective of the service delivery model adopted. As regards the legal framework provisions, even though the EU legal framework does not define the operational continuity, it includes general provisions which require among other things also to consider arrangements supporting operational continuity, however, the EU legal framework terminology, compared with the FSB guidance, is confusing and it is not always clear how different elements are interlinked to each other leaving this consideration for banks, supervisory and resolution authorities. This is a very important aspect which needs to be duly considered by the authorities and banks as the robust operational continuity is needed to enable critical functions to be preserved in resolution.

The importance of the operational continuity both in planning and resolution stages was also recognised by the SRB as well. In 2016 the SRB focused on such topics as critical functions, preferred resolution strategy, liquidity, access to financial market infrastructures, resolvability assessment and recovery aspects[556], as well as, on the advanced work on operational continuity and the operationalisation of resolution tools for the purposes of resolution planning[557]. In 2017 the SRB reviewed the self-assessments of critical functions of the banks with a view to reaching a final conclusion on criticality of the functions, focused on mapping and assessment of critical services which are necessary for the continuity of critical functions[558] as well as on the need for preparatory measures including repository requirements, principles for resolution-proof contract clauses, information requirements and

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[555] Art. 22(4)(a)(b) of the Delegated Regulation (EU) 2016/1075.
[556] Annual Report. Single Resolution Board, Brussels, 2016. P. 21. [accessed on 21 November 2018] <https://srb.europa.eu/sites/srbsite/files/srb_2017.2496_annual_report_2016_web_0.pdf>.
[557] *Ibid*, P. 18.
[558] Annual Report. Single Resolution Board, Brussels, 2017. P. 14, 22. [accessed on 20 November 2018] <https://srb.europa.eu/sites/srbsite/files/srb_annual_report_2017_en_0.pdf>.

service-delivery models[559]. The SRB high-level expectations for banks with regard to operational continuity were highlighted as well during the SRB and banking industry meeting on 18 June 2019. During this meeting, it was also highlighting that the SRB follows the approach defined in the relevant global FSB guidance[560].

Furthermore, the author had worked and performed an analysis of the recovery plans of 23 European cross-border banking groups with parent institutions located across 12 different EU countries. The analysis of those plans showed the progress of identification of critical functions, as most of the recovery plans provided information on critical functions and to a certain extent on critical services (such as the institutions' IT systems). Though, the analysis revealed that the assessment of the impact on the continuity of critical functions when implementing specific recovery options was very limited and was not always provided for all recovery plan options to which such an assessment was pertinent[561]. More specifically, roughly one-third of the recovery plans included detailed information on operational impact and continuity in the individual analysis of the options on the critical services (infrastructure and IT services, and risk management)[562]. Furthermore, even though the explanation of operational continuity was often part of the general description of operational systems, it was not specified if operational continuity was warranted when implementing a particular option since only general statements were provided as assurance that continuity of operations was always guaranteed[563]. All this shows that even though banks and authorities have progressed with the development of the recovery plans in line with the requirements set in the BRRD, they still do struggle with the legal concept of critical functions, operational continuity, critical serves, and

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[559] *Ibid.,* P. 17.
[560] The SRB – Banking Industry Dialogue Meeting. SRB Expectations for banks. Brussels, 18 June 2019. [accessed on 20 June 2019] <https://srb.europa.eu/sites/srbsite/files/presentation_on_srb_expectations_for_banks_1.pdf>.
[561] BALČIŪNAS, L.; et all. Comparative report on recovery plan options. European Banking Authority, 1 March 2017, London, P. 15-16. [accessed on 5 May 2018]<http://www.eba.europa.eu/documents/10180/1720738/EBA+Comparative+report+on+recovery+options+-+March+2017.pdf>
[562] *Ibid.,* P. 4.
[563] BALČIŪNAS, L.; et all. Comparative report on recovery plan options. European Banking Authority, 1 March 2017, London, P. 4. [accessed on 5 May 2018] <http://www.eba.europa.eu/documents/10180/1720738/EBA+Comparative+report+on+recovery+options+-+March+2017.pdf>

consideration how the recovery options are foreseen in the plan could impact the operational continuity of critical services what as a result might create complications to ensure the continuity of critical functions when implementing the recovery plan. Considering that the resolution plans to a certain extent are based on the recovery plans (in particular, with regard identification and continuity of critical functions and supporting critical services) it is expected that that challenges should exist there as well. This is also supported by the fact, even though progress was identified by the EBA with regard to the identification of critical functions and operation continuity in the plans, it was acknowledged that they are not fully finalised yet as well[564].

The empirical analysis of recovery and resolution plans shows that banks and authorities have progressed with the identification of critical services and set-up of operational continuity arrangements considering the provisions of the legal framework, though improvements are still needed. Currently, at the EU level, there is no dedicated legal act or guidance which would further specify or focus specifically on actual operational continuity arrangements and would explain the link with the critical functions. Therefore, the FSB guidance on operational continuity is the only public source. Furthermore, worth to note that certain national authorities in order to fill this gap, on the basis of the FSB Guidance, have adopted and published national guidance (e.g. the UK[565]) which further elaborate the concept of operational continuity of critical services at the national level. As a result, such a situation creates a risk that a variation of views could emerge across the Member States in the absence of the EU legal act or guidance which would clearly transpose into the EU law the FSB Guidance on operational continuity. This issue, to a certain extent, was already identified in the Banking Union. The SRB in its 2019 work programme noted that it is committed to publishing, among other things, also the policy paper on operational continuity[566]. However, even when

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[564] EBA Report on the Functioning of Resolution Colleges in 2017. The EBA, London, July 2018. P. 3 – 4. [accessed on 5 August 2018] <https://eba.europa.eu/documents/10180/2087449/EBA+Report+on+the+functioning+of+resolution+colleges+-+July+2018.pdf>.

[565] Ensuring operational continuity in resolution. Policy Statement, PS21/16. Bank of England, Prudential Regulation Authority, London July 2016. [accessed on 15 August 2016] <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2016/ps2116.pdf?la=en&hash=31C2D0A887C1BA2AD005778AEE4C1CD05E8976DE>.

[566] Single Resolution Board Work Programme 2019. Brussels, 2019. P.16. [accessed on 8 October 2019] <https://srb.europa.eu/sites/srbsite/files/wp2019_final.pdf>.

published, it would apply only to the Member States in the Banking Union and would not capture the whole Single Market. Such a situation could be solved by delegating to the EBA (of course with a full involvement of national resolution authorities and the SRB) to prepare relevant legal act or guidance as part of its Single Rulebook which would be applicable in the whole Single Market, in particular, taking into account that the EU is committed to complying with the FSB standards and guidance.

2.2.4. Continuity of access to FMIs

Another aspect which requires more attention when discussing this objective is the continuity of access to financial market infrastructures (the '**FMIs**')[567] (see table 17). The importance of this element is also highlighted in the FSB KA which state that an effective resolution regime (interacting with applicable schemes and arrangements for the protection of depositors, insurance policyholders and retail investors) should ensure continuity of systemically important financial services, and payment, clearing and settlement functions[568].

The ability to use and have continuous access to clearing, payment, settlement, custody and other services provided by FMIs is essential for banks to perform their critical functions. This is because no economic function can be performed without the bank's ability to send and receive payments. Hence participation in payment systems or access to payment services offered by another financial institution is necessary. Therefore, maintaining access to FMIs is necessary for the uninterrupted provision of critical functions and, thereby, continued access to FMIs may minimise the impact of a bank resolution on financial stability and/or the real economy.

What is more, with regard to the cross border dimension the important point is that a large number of FMIs exist across the globe (see table 15) which provide critical services to banks, and in particular, to G-SIBIs which usually

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[567] The term '**FMIs**' is defined as a multilateral system among participating financial institutions, including the operator of the system, used for the purposes of recording, clearing, or settling payments, securities, derivatives, or other financial transactions". It includes payment systems, central securities depositories (CSDs), securities settlement systems (SSSs), central counterparties (CCPs), and trade repositories (TRs). See: Principles for Financial Market Infrastructures. CPSS-IOSCO, April 2012 [accessed on 25 April 2015] <http://www.bis.org/cpmi/publ/d101.htm>; and the FSB KA.

[568] P. 3 of the FSB KA.

(depending on the coverage of their activities) will need access to FMIs in more than their home jurisdiction given the global nature of their business. While a great number of the global payment and settlement infrastructures, like financial markets and economies they support, are increasingly connected through a wide array of complex interrelationships[569].

Table 17. Jurisdictions and Operating FMIs

Type of FMI	Number	Jurisdictions and operating FMIs
Central Clearing Counterparties (CCP)	21	For example Canada (CDCS[570]), France (LCH Clearnet S.A.[571]), Germany (ECC[572], Eurex[573]), Italy (CC&G[574]), Japan (JSCC[575], JDCC, Inc.[576], TFX[577]), the Netherlands (EuroCCP[578]), Portugal (OMIClear, C.C., S.A.[579]), Spain (BME Clearing[580]), Sweden (Nasdaq

[569] The Interdependencies of Payment and Settlement Systems. BIS, Basel, June 2008. P. iii. [accessed on 15 September 2018] <https://www.bis.org/cpmi/publ/d84.pdf>.

[570] CDS Clearing and Depository Services Inc. Bank of Canada. [Accessed on 15 April 2015] <https://www.bankofcanada.ca/core-functions/financial-system/clearing-and-settlement-systems/>.

[571] LCH SA is the Continental European clearing house, offering clearing services for credit default swaps (CDS), repos and fixed income, commodities, cash equities, and equity derivatives. France. [accessed on 15 April 2015] <https://www.lch.com/about-us/our-clearing-houses>.

[572] European Commodity Clearing. Germany. [accessed on 15 April 2015] <http://www.ecc.de/ecc-en/about-ecc>.

[573] Eurex, Germany. [accessed on 15 April 2015] <https://www.eurexchange.com/exchange-en/about-us>.

[574] CC&G is the LSEG Italian-based provider. [accessed on 15 April 2015] <https://www.lseg.com/markets-products-and-services/post-trade-services/ccp-services/ccg-english-version/about-us>.

[575] Japan Securities Clearing Corporation. Japan. [accessed on 15 April 2015] <https://www.jpx.co.jp/jscc/en/>.

[576] Japan Securities Depository Centre, Inc. Japan. [accessed on 15 April 2015] <https://www.jasdec.com/en/about/jdcc/>.

[577] Tokyo Financial Exchange Inc. Japan. [accessed on 15 April 2015] <https://www.tfx.co.jp/en/about_tfx/outline/outline03.html>.

[578] European Central Counterparty N.V. The Netherlands. [accessed on 15 April 2015] <https://euroccp.com/home/about/company-info/>.

[579] The Iberian Energy Clearing House OMIClear, C.C., S.A. Portugal. [accessed on 15 April 2015] <https://www.omiclear.pt>.

[580] BME Clearing is the central counterparty (CCP) of the BME Group that offers clearing services. Spain [accessed on 15 April 2015] <https://www.bde.es/bde/en/areas/sispago/Sistemas_de_comp/vigilancia-de-lo/BME_Clearing.html>.

		Clearing AB[581]), Switzerland (SIX x-cleared Ltd.[582]), the UK (LCH Clearnet Ltd.[583], ICE Clear Europe[584], LME Clear[585]), the US (CME[586], FICC[587], ICE[588], NSCC[589], OCC[590]).

[581] Nasdaq Clearing AB, a private limited company incorporated in Sweden and subject to Swedish company law, is authorized and supervised as a multi-asset clearing house by the Swedish Financial Supervisory Authority and is also authorized to conduct clearing operations via its Norwegian branch Nasdaq Oslo. Sweden. [accessed on 15 April 2015] <https://business.nasdaq.com/trade/clearing/nasdaq-clearing/about-nasdaq-clearing/>.

[582] Founded as the central counterparty (CCP) for the Swiss market in 2003, SIX x-clear Ltd today clears multiple instruments in most European markets – and has been at the forefront of interoperability and competition since its creation. Switzerland. [accessed on 15 April 2015] < https://www.six-group.com/securities-services/en/home/clearing/about.html>.

[583] LCH Ltd is the UK registered clearing house, offering clearing services for a diverse range of asset classes. [accessed on 15 April 2015] <https://www.lch.com>.

[584] ICE Clear Europe is one of the world's most diverse and leading clearing houses. It provides central counterparty clearing and risk management services for interest rate, equity index, agricultural and energy derivatives, as well as European credit default swaps (CDS). UK. [accessed on 15 April 2015] <https://www.theice.com/clear-europe>.

[585] LME Clear is the clearing house for the London Metal Exchange. Launched in 2014 it was designed and built in consultation with the market to provide cost-efficient, EMIR compliant clearing services, using cutting edge technology. [accessed on 15 April 2015] <https://www.lme.com/en-GB/LME-Clear>.

[586] Chicago Mercantile Exchange & Chicago Board of Trade) is a global markets company. It owns large derivatives, options and futures exchanges in Chicago and New York City using its CME Globex trading platforms. US. [accessed on 15 April 2015] <https://www.cmegroup.com/clearing.html>.

[587] Fixed Income Clearing Corporation (FICC), was created in 2003 to reduce costs and give DTCC customers a common approach to fixed income transaction processing by integrating the Government Securities Clearing Corporation and the Mortgage-Backed Securities Clearing Corporation. [accessed on 15 April 2015] < http://www.dtcc.com/about/businesses-and-subsidiaries/ficc>.

[588] Intercontinental Exchange (ICE) is an American company that owns exchanges for financial and commodity markets, and operates 12 regulated exchanges and marketplaces. US. [accessed on 15 April 2015] <https://www.theice.com/about?utm_source=ICEhomepage&utm_medium=busine>

[589] National Securities Clearing Corporation (NSCC), established in 1976, provides clearing, settlement, risk management, central counterparty services and a guarantee of completion for certain transactions for virtually all broker-to-broker trades involving equities, corporate and municipal debt, American depositary receipts, exchange-traded funds, and unit investment trusts. US. [accessed on 15 April 2015] < http://www.dtcc.com/about/businesses-and-subsidiaries/nscc>.

[590] The Options Clearing Corporation (OCC), is the world's largest equity derivatives clearing organisation and the foundation for secure markets. US. [accessed on 15 April 2015] <https://www.theocc.com>.

Payment System	27	For example: Austria (CS.A.[591], HOAM. AT[592]), Belgium (CEC[593]), Canada (LVTS[594]), France (Core[595]), Euro Systems (TARGET2[596], EURO1[597], STEP1[598], STEP2[599]), Italy (BI-

[591] The Clearing Service Austria (the 'CS.A') has been developed by Geldservice Austria (GSA) and is the new Austrian Clearing House for processing domestic payments. RBI offers local banks indirect participation in this new payment infrastructure. Austria [accessed on 16 April 2015] <https://www.geldservice.at/cms/cms.php?pageName=75&gsaProductGroupId=7&gsaProductId=40>.

[592] OAM.AT: Austrian Real Time Interbank Settlement, TARGET: Trans-European Automated Real-time Gross Settlement Express Transfer system. Austria. [accessed on 16 April 2015] < https://www.oenb.at/en/Statistics/Standardized-Tables/Means-of-Payment-and-Payment-Systems/Payment-Systems-Statistics/Volume-and-Value-of-HOAM.AT-Transactions.html>.

[593] The Centre for Exchange and Clearing (the 'CEC') is the Belgian automated interbank payment system for retail payments. The platform was setup in 1974 and is owned by its users, namely the banks. The National Bank of Belgium is responsible for supervising its activities. Belgium [accessed on 16 April 2015] < https://www.cecbelgium.be/en>.

[594] The Large Value Transfer System (the 'LVTS'), is an electronic wire system that lets financial institutions and their customers send large payments securely in real time, with certainty that the payment will settle. It was launched in 1999. Canada. [accessed on 16 April 2015] <https://www.bankofcanada.ca/core-functions/monetary-policy/lvts/>.

[595] Compensation Retail (the 'CORE') s a multilateral netting system, where settlement of payments is deferred and occurs once a day. [accessed on 16 April 2015] <https://www.banque-france.fr/en/financial-stability/market-infrastructure-and-payment-systems/financial-market-infrastructures/payment-systems>.

[596] Trans-European Automated Real-time Gross Settlement Express Transfer System (the 'TARGET2') is the real-time gross settlement (RTGS) system owned and operated by the Euro system. The ECB. [accessed on 16 April 2015] <https://www.ecb.europa.eu/paym/target/target2/html/index.en.html>.

[597] EURO1 is the only private sector large-value payment system for single same-day euro transactions at a pan-European level. [accessed on 16 April 2015] <https://www.ebaclearing.eu/services/euro1/overview/>.

[598] STEP1 is a payment service for individual commercial payments, complementary to EURO1. [accessed on 16 April 2015] <https://www.ebaclearing.eu/services/step1/overview/>.

[599] STEP2 is a Pan-European Automated Clearing House processing mass payment in euro. The platform is one of the key clearing and settlement mechanisms in the Single Euro Payments Area (SEPA), both in terms of processing volumes and participating institutions. [accessed on 16 April 2015] <https://www.ebaclearing.eu/services/step2-t-platform/overview/>.

		COMP[600]), Japan (BOJ-NET[601], FXYCS[602]), the Netherlands (Equens SE[603]), Spain (SNCE[604]), Sweden (Bangirot[605], RIX[606]), Switzerland (SIC[607]), Lithuania (CENTROlink[608]), the UK

[600] BI-Comp is the clearing system managed by Bank of Italy. It enables participants to settle retail payments in euro. [accessed on 16 April 2015] < https://www.bancaditalia.it/compiti/sistema-pagamenti/bicomp/index.html?com.dotmarketing.htmlpage.language=1>.

[601] The Bank of Japan Financial Network System (the 'BOJ-NET') is a computer network operated by the Bank, which was established with the aim of efficiently and safely executing online funds transfers and Japanese government bond (JGB) settlements between the Bank and financial institutions that conduct transactions with the Bank. [accessed on 16 April 2015] < https://www.boj.or.jp/en/announcements/education/oshiete/kess/i10.htm/>.

[602] Foreign Exchange Yen Clearing System. Japan. [accessed on 16 April 2015] < https://www.swift.com/news-events/press-releases/japanese-payment-market-infrastructure-supports-swift-gpi-tracking-of-cross-border-payments>.

[603] Payment, clearing and settlement systems in the Netherlands. Bank of International Settlements. [accessed on 16 April 2015] <https://www.bis.org/cpmi/publ/d105_nl.pdf>.

[604] The National Electronic Clearing System (SNCE) is the Spanish retail payment system managed by IBERPAY (Sociedad Española de Sistemas de Pago) a private company whose shareholders are the credit institutions participating in the SNCE. The Banco de España is responsible for approving the rules of the system and for its oversight. Spain. [accessed on 16 April 2015] <https://www.bde.es/bde/en/areas/sispago/Sistemas_de_pago/El_SNCE/El_SNCE.html>.

[605] Bankgirot is a proprietary clearing system (a giro) in Sweden used for transactions such as bill payments. Sweden. [accessed on 16 April 2015] <http://www.bankgirot.se/en/>.

[606] RIX is the Swedish payment system. [accessed on 16 April 2015] <https://www.riksbank.se/en-gb/payments--cash/the-payment-system---rix/>.

[607] SIX Interbank Clearing operates the payment system SIC on behalf of and under the supervision of the Swiss National Bank. The system processes Swiss franc payments between financial institutions in real time on a gross settlement basis. [accessed on 16 April 2015] < https://www.six-group.com/interbank-clearing/en/home/payment-services/sic.html>.

[608] CENTROlink is a payment system operated by the Bank of Lithuania, providing the gateway to the Single Euro Payments Area (SEPA). Via its infrastructure, the Bank of Lithuania provides technical access to SEPA for all types of payment service providers – banks, credit unions, e-money or payment institutions – licensed in the European Economic Area (EEA).[accessed on 16 April 2015] <https://www.lb.lt/en/centrolink>.

		(CHAPS[609], BACS[610], FPS[611], Visa[612], LINK[613], C&CCC[614], MasterCard[615]), the US (CLS[616], CHIPS[617]).
Central Securities	14	For example: Canada (CDSX[618]), Belgium (Euroclear[619]), France (ESES[620]), Germany

[609] The Clearing House Automated Payment System (the 'CHAPS') is one of the largest high-value payment systems in the world, providing efficient, settlement risk-free and irrevocable payments. There are over 30 direct participants and over five thousand financial institutions that make CHAPS payments through one of the direct participants. [accessed on 16 April 2015] <https://www.bankofengland.co.uk/payment-and-settlement/chaps>.

[610] Bacs Payment Schemes Limited (the 'Bacs') is responsible for the schemes behind the clearing and settlement of UK automated payment methods, Direct Debit and Bacs Direct Credit. [accessed on 16 April 2015] < https://www.bacs.co.uk>.

[611] Faster Payments Service (the 'FPS') is a UK banking initiative to reduce payment times between different banks' customer accounts from the three working days that transfers take using the long-established BACS system, to typically a few seconds. [accessed on 16 April 2015] < http://www.fasterpayments.org.uk>.

[612] Visa International Service Association (the 'VISA') issues and manages products including credit cards and debit cards which can be used internationally for retail payment, online transaction, ATM, merchants, managing payments among financial institutions and more. [accessed on 16 April 2015] < https://www.visa.co.uk/pay-with-visa/visa-card-payments.html>.

[613] Effectively every cash machine in the UK is connected to LINK, and is the only way banks and building societies can offer their customers access to cash across the whole UK. [accessed on 16 April 2015] < https://www.link.co.uk>.

[614] The Cheque & Credit Clearing Company (the 'C&CCC) is a wholly owned subsidiary of the new home for UK retail payments, Pay.UK. The C&CCC managed the cheque and credit clearing system in England and Wales from 1985 and in Scotland from 1996. Since its launch in October 2017 the company also managed the Image Clearing System, which enables digital images of cheques to be exchanged between banks and building societies across the whole of the UK for clearing and settlement. [accessed on 16 April 2015] < https://www.chequeandcredit.co.uk/about-us>.

[615] Interbank Master Charge (the 'MasterCard') operates the world's fastest payments network, processing transactions in more than 150 currencies. [accessed on 16 April 2015] < https://www.mastercard.co.uk/en-gb/about-mastercard/what-we-do/payment-processing.html>.

[616] The CLS is the world's leading provider of FX settlement services. [accessed on 16 April 2015] < https://www.cls-group.com/about-us>.

[617] The Clearing House Interbank Payments System (the 'CHIPS') is a United States private clearing house for large-value transactions. [accessed on 16 April 2015] < https://www.theclearinghouse.org/payment-systems/chips>.

[618] The Canadian Depository for Securities Limited (CDS) is Canada's national securities depository, clearing, and settlement hub. [accessed on 16 April 2015] <https://www.investopedia.com/terms/c/canadian-depository-for-securities-limited.asp>.

[619] Euroclear is a Belgium-based financial services company that specializes in the settlement of securities transactions as well as the safekeeping and asset servicing of these securities. It was founded in 1968 as part of J.P. Morgan & Co. to settle trades on the then developing eurobond market. [accessed on 16 April 2015] <https://www.euroclear.com/en.html>.

[620] The Euroclear Settlement of Euronext-zone Securities (ESES) platform makes cross-border settlement as low-cost and straightforward as domestic transactions. [accessed on 16 April 2015] < https://www.euroclear.com/about/en/business.html>.

Depository (CSD) and Security Settlement System		(Clearstream[621]), Italy (Monte Titoli S.p.A[622]), Japan (JASDEC[623], BOJ-NET[624]), Luxembourg (LuxCSD[625]), the Netherlands (Euroclear NL[626]), Spain (IBERCLEAR[627]), Sweden (Euroclear Sweden AB[628]), Switzerland (SIX Securities Services AG[629]), the UK (EUI[630]), the US (DTC[631]).

[621] As a central securities depository (the 'CSD') based in Frankfurt, it also provides the post-trade infrastructure for the German securities industry offering access to a growing number of international markets. [accessed on 16 April 2015] < https://www.clearstream.com/clearstream-en/about-clearstream>.

[622] Monte Titoli is a company that offers post-trading and centralised administration of financial instruments. [accessed on 16 April 2015] < https://www.lseg.com/post-trade-services/settlement-and-custody/monte-titoli>.

[623] Japan Securities Depository Center, Inc. (JASDEC) is Japan's central securities depository. [accessed on 16 April 2015] <http://www.jasdec.com/en/>.

[624] The Bank of Japan Financial Network System (BOJ-NET) is a computer network operated by the Bank, which was established with the aim of efficiently and safely executing online funds transfers and Japanese government bond (JGB) settlements between the Bank and financial institutions that conduct transactions with the Bank. [accessed on 16 April 2015] < https://www.boj.or.jp/en/announcements/education/oshiete/kess/i10.htm/>.

[625] Clearstream founded LuxCSD together with the Luxembourg Central Bank, to act as a CSD for Luxembourg. [accessed on 16 April 2015] <https://www.clearstream.com/clearstream-en/products-and-services/market-coverage/europe-t2s/luxembourg>.

[626] Euroclear Nederland is the Dutch Central Securities Depository (CSD) and, together with the CSDs Euroclear Belgium and Euroclear Nederland, part of ESES. [accessed on 16 April 2015] <https://www.euroclear.com/services/en/provider-homepage/euroclear-nederland.html>.

[627] IBERCLEAR is the Spanish Central Securities Depository and a subsidiary of Bolsas y Mercados Españoles (BME), the operator of all stock Markets and financial systems in Spain. [accessed on 16 April 2015] < http://www.iberclear.es/ing/Home>.

[628] Euroclear Sweden is the Swedish Central Securities Depository offering efficient securities management services to companies, and clearing and settlement. [accessed on 16 April 2015] < https://www.euroclear.com/sweden/en.html>.

[629] SIX is a financial service provider that operates the infrastructure of Switzerland's financial centre. [accessed on 16 April 2015] < https://www.six-group.com/en/home.html>.

[630] The Euroclear UK & Ireland Ltd (the 'EUI') operates the CREST settlement system. The Company provides access for companies without a direct connection that wish to hold and settle securities transactions electronically. [accessed on 16 April 2015] < https://www.bloomberg.com/profile/company/1752992Z:LN>.

[631] The Depository Trust Company (the 'DTC') is a New York corporation known as a trust company which performs the functions of a Central Securities Depository as part of the US National Market System. [accessed on 16 April 2015] <http://www.dtcc.com/about/businesses-and-subsidiaries/dtc>.

What is more, in 2013 the FSB in its report to the G20[632] not only identified operational continuity of critical services as one of the issues that remain to be addressed to enhance G-SIB resolvability but also noted the importance of maintaining access to critical FMIs as a key part of ensuring operational continuity of critical functions. The continuing need for work in this area was further underlined by the findings of Crisis Management Groups and of the Resolvability Assessment Processes (the '**RAP**') that were carried out on G-SIBs in 2014 and mid-2015. In 2014, the FSB further identified that multiple interdependencies within a G-SIB put at risk the operational continuity of critical functions and critical shared services and infrastructure in a resolution as services provided by affiliates or third parties might be interrupted, or access to payment and clearing capabilities might be lost[633]. Furthermore, it also highlighted that the Existing Service Level Agreements need to be improved and arrangements (such as separately capitalised group services companies or entities providing infrastructure services) need to be put in place to support operational continuity of critical services; arrangements to ensure continued access to FMI services in resolution and avoid automatic termination of FMI memberships need to be put in place[634]. In its 2015 report to the G20[635], the FSB noted that '*a key finding from the RAP is that authorities do not yet have an appropriate level of confidence that direct or indirect access to FMIs can be maintained*'[636].

As a result, in 2016 the FSB prepared and issued a consultative document on Continuity of Access to Financial Market Infrastructures for a Firm in Resolution[637] (the '**Consultative Document**'). After analysing and reviewing

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[632] Progress and Next Steps Towards Ending "Too-Big-To-Fail" (TBTF). Report of the Financial Stability Board to the G-20, Basel, 2 September 2013. [accessed on 15 October 2017] <https://www.fsb.org/wp-content/uploads/r_130902.pdf>.

[633] Towards full implementation of the FSB Key Attributes of Effective Resolution Regimes for Financial Institutions. Report to the G20 on progress in reform of resolution regimes and resolution planning for global systemically important financial institutions (G-SIFIs). The FSB, Basel, 12 November 2014. P. 13< https://www.fsb.org/wp-content/uploads/Resolution-Progress-Report-to-G20.pdf>.

[634] Ibid.

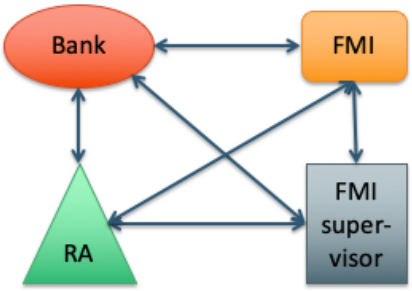
[635] Removing Remaining Obstacles to Resolvability. Report to the G20 on progress in resolution. The FSB, Basel, 9 November 2015. [accessed on 9 November 2015] <https://www.fsb.org/wp-content/uploads/Report-to-the-G20-on-Progress-in-Resolution-for-publication-final.pdf>.

[636] *Ibid*, P. 17.

[637] Guidance on Continuity of Access to Financial Market Infrastructures ("FMIs") for a Firm in Resolution. Consultative Document. The FSB, Basel, 16 December 2016. [accessed on 17

the public responses[638] to the Consultative Document, it could be concluded that the following more specific issues were revealed. Namely: i) a potential lack of coordination in information flow and actions across authorities (resolution authorities and FMI supervisors), and between authorities and the market (banks and FMIs) (see scheme 18); ii) FMI discretion to terminate or suspend access as the FMI rules did not explicitly recognise resolution powers to stay terminations rights provided that the substantive obligations are met what is more it showed that FMI contractual arrangements give them broad discretion to terminate or suspend access; iii) bank's dependence from the critical FMIs as there is a lack of alternative providers that could be set up on a timely basis; iv) the fact that stay provisions and continuity powers are unlikely to be recognised in foreign jurisdictions or for foreign FMIs, meaning that entry into resolution of bank in one jurisdiction may not prevent and FMI in another jurisdiction from placing a bank in default what as a result could trigger cross-default terminations; v) the fact that banks may not be able to provide relevant information (for example, on critical FMIs and relations with them) on a timely basis what as a result could limit the ability of a bank in resolution to meet its obligations in a timely manner; and vi) that under existing arrangements it is unlikely that stay provisions and continuity powers will be recognised in foreign jurisdictions etc.

Scheme 18. A Variety of Communication Channels and Complexity to Coordinate Legal Actions



April 2017] <https://www.fsb.org/wp-content/uploads/Continuity-of-Access-to-FMIs-Consultation-Document-FINAL.pdf>

[638] Responses can be found here: [accessed on 17 April 2017] <https://www.fsb.org/2017/03/public-responses-to-the-december-2016-consultative-document-continuity-of-access-to-financial-market-infrastructures-fmis-for-a-firm-in-resolution/>.

What is more, a potential tension exists between the alignment of the objectives of the prudential supervisions and resolution legal framework provisions. Namely, on the one hand, the need for the FMI to manage prudential risk and, on the other hand, the need to ensure that critical FMI services continue to be provided to the bank under resolution. The tension comes because when managing prudential risks, the FMIs have the ability to take actions (e.g. call for additional margin; default fund contributions; cutting credit line etc.) to reduce the on-going risks to the FMI that arise from providing a service what as a result may create possible liquidity issues for bank under resolution.

Against this context, the FSB developed the final Guidance on continuity of access to FMIs[639] (it builds on Part II of II Annex 1 of the FSB KA as well as supplements the FSB KA 11) which define '*critical FMI services*' as "*clearing, payment, securities settlement and custody activities, functions or services, the discontinuation of which could lead to the collapse of (or present a serious impediment to the performance of) one or more of the firm's critical functions*"[640]. The critical FMI services include related activities, functions or services whose on-going performance is necessary to enable the continuation of the clearing, payment, securities settlement or custody activities, functions or services[641]. The critical FMI services are identified in the course of the recovery and resolution planning for a bank and may be provided to a firm either by an FMI or through an FMI intermediary[642].

As summarised in the Scheme 19 bellow, the preventive arrangements set in the guidance could be grouped into the three categories: i) continuity of access arrangements at the level of the provider of critical FMI services[643]; ii)

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[639] Guidance on Continuity of Access to Financial Market Infrastructures ("FMIs") for a Firm in Resolution. The FSB, Basel, 6 July 2017. Author worked on the development of those guidance as a member of the working group [accessed on 7 July 2017] <https://www.fsb.org/wp-content/uploads/P060717-2.pdf>.

[640] Guidance on Continuity of Access to Financial Market Infrastructures ("FMIs") for a Firm in Resolution. The FSB, Basel, 6 July 2017. P. 5. [accessed on 7 July 2017] <https://www.fsb.org/wp-content/uploads/P060717-2.pdf>.

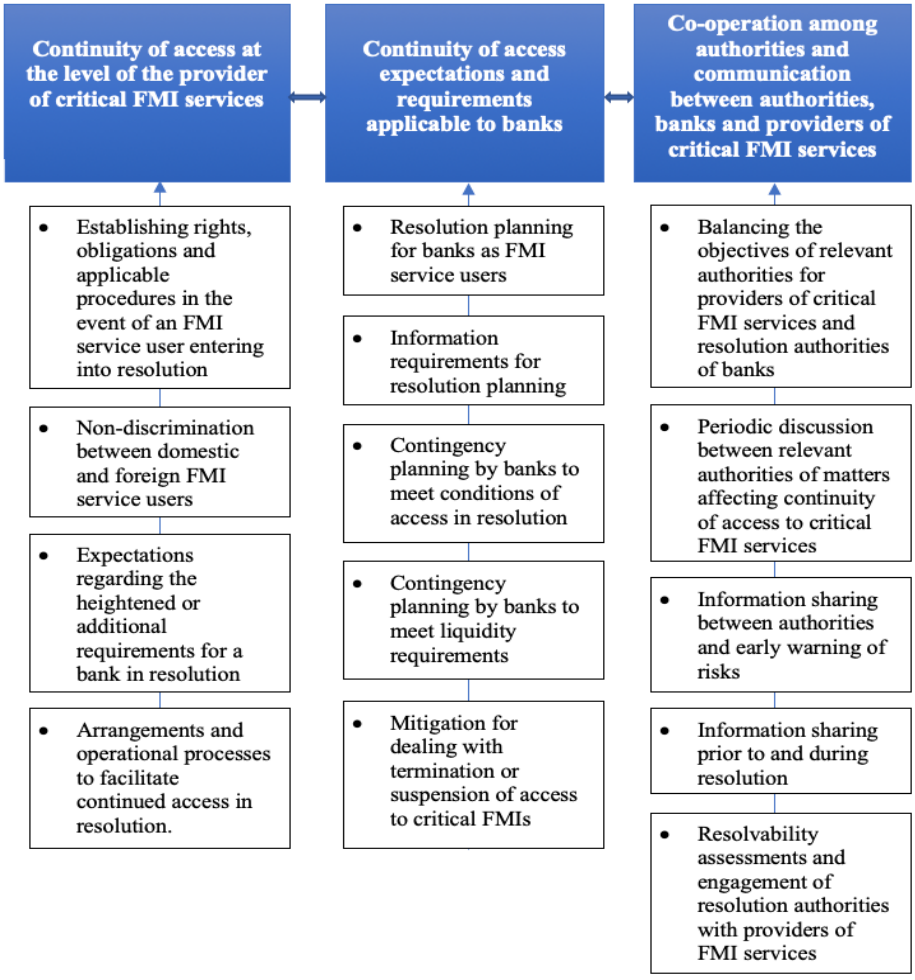
[641] Ibid.

[642] An '**FMI intermediary'** is an entity that provides clearing, payment, securities settlement and/or custody services to other firms in order to facilitate the firms' direct or indirect access to an FMI. See: Guidance on Continuity of Access to Financial Market Infrastructures ("FMIs") for a Firm in Resolution. The FSB, Basel, 6 July 2017. P. 5. [accessed on 7 July 2017] <https://www.fsb.org/wp-content/uploads/P060717-2.pdf>.

[643] Worth to mention that following the financial crisis in general the supervisory requirements applicable to the FMIs have been strengthened. Furthermore, at the global level principles for

continuity of access expectations and requirements applicable to banks; and iii) co-operation among authorities and communication between authorities, banks and providers of critical FMI services.

Scheme 19. Arrangements to Ensure Continuity of Access to the Critical FMIs



financial market infrastructures were adopted. However, even though these principles acknowledged the importance of access to FMIs, they mostly focused on the requirements linked to FMIs and did not consider how banks' resolution legal framework requirements will interact with the set requirements and the prudential supervision principles of the FMIs. This gap was filled to a certain extent by issuing the FSB Guidance on continuity of access to FMIs. See: Principles for financial market infrastructures. OICU-IOSCO, Bank for International Settlements, April 2012. [accessed on 10 April 2014] <https://www.bis.org/cpmi/publ/d101a.pdf>.

Considering the international standards and the global level, it is also important to discuss what is the situation in the EU. In order to answer this question, we have to look into the legal provisions of the BRRD and second level EU legal acts.

For instance, in relation to information which must be included in recovery plans, the BRRD requires information on arrangements and measures necessary to maintain continuous access to FMIs[644]. Furthermore, the resolution plans must also include a description of options for preserving access to payments and clearing services and other infrastructures, and an assessment of the portability of client positions[645]. Also, resolution plans should include information on each payment, clearing or settlement system of which the bank is directly or indirectly a member, including a mapping to the bank's legal persons, critical operations and core business lines[646].

What is more, when assessing the resolvability of a bank, the resolution authority shall also consider the extent to which there are contingency plans and measures in place to ensure continuity in access to payment and settlement systems[647]. Commission Delegated Regulation (EU) 2016/1075[648], adopted on the basis of the EBA RTS on resolution plans and the assessment of resolvability[649], further specify that resolution plans should include arrangements for ensuring any access to payment systems or other financial infrastructures necessary to maintain critical functions, including an

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[644] Annex Section A of the BRRD.
[645] Article 10(7)(l) of the BRRD.
[646] Annex, Section B (12) of the BRRD.
[647] Annex Section C (7) of the BRRD.
[648] Commission Delegated Regulation (EU) 2016/1075 of 23 March 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges (Text with EEA relevance). C/2016/169. OJ L 184, 8.7.2016, p. 1–71. (the 'Commission Delegated Regulation (EU) 2016/1075').
[649] EBA Final Draft Regulatory Technical Standards on the content of resolution plans and the assessment of resolvability. EBA/RTS/2014/15. The EBA, 19 December 2014. [accessed on 15 April 2017] <https://eba.europa.eu/documents/10180/933992/EBA-RTS-2014-15+%28Final+draft+RTS+on+Resolution+Plan+Contents%29.pdf/dec9cabc-271f-431f-9d4b-015b5998899c>.

assessment of the portability of client positions[650]. The same legal act also requires the communication and disclosure plan with regard to external communication to include also matters linked to FMIs[651]. When assessing feasibility and credibility of liquidation under normal insolvency proceedings (what is also part of the BRRD's test for identifying whether the use of resolution powers is in the public interest), resolution authorities are required to assess whether liquidation would be likely to have a material adverse impact on FMIs and in particular whether the sudden cessation of activities would constrain the normal functioning of FMIs in a manner which negatively impacts the financial system as a whole and whether and to what extent FMIs could serve as contagion channels in the liquidation process[652].

The EBA Guidelines on measures to reduce impediments to resolvability[653] require resolution authorities to consider requiring institutions to take precautions to meet, in a resolution situation, the specific requirements of any FMI in which they participate, including access to clearing, payment and settlement services for all subgroups and material entities of the subgroup during resolution and, if applicable, for a recipient to whom critical functions have been transferred. Where necessary, resolution authorities should consider requiring institutions to make reasonable efforts to re-negotiate contracts with FMIs accordingly, subject to safeguards to protect the sound risk management and safe and orderly operations of the FMI[654].

What is more, under the BRRD Member States are required to ensure that resolution authorities have the power to suspend the termination rights of any party to a contract with an institution under resolution from the publication of the notice pursuant to Article 83(4) until midnight in the Member State of the resolution authority of the institution under resolution at the end of the business day following that publication, provided that the payment and delivery obligations and the provision of collateral continue to be

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[650] Art. 3(d)(iii) of the EBA RTS, Art. 22(4)(c) of the Commission Delegated Regulation (EU) 2016/1075.
[651] Art. 14(1)(b) of the Commission Delegated Regulation (EU) 2016/1075.
[652] Art. 24(2) of the Commission Delegated Regulation (EU) 2016/1075
[653] Guidelines on the specification of measures to reduce or remove impediments to resolvability and the circumstances in which each measure may be applied under Directive 2014/59/EU. EBA/GL/2014/11. EBA, London, 19 December 2014. [accessed on 20 December 2014] <https://eba.europa.eu/documents/10180/933988/EBA-GL-2014-11+%28Guidelines+on+Impediments+to+Resolvability%29.pdf/d3fa2201-e21f-4f3a-8a67-6e7278fee473>.
[654] Art. 13(g) of the EBA Guidelines.

performed[655]. However, the BRRD also provided that any such suspension shall not apply to systems or operators of systems designated for the purposes of Settlement Finality Directive, central counterparties, or central banks[656].

In the bank resolution stage, Member States are required to ensure that when exercising a resolution power, resolution authorities have the power to provide for the recipient to be treated as if it were the institution under resolution for the purposes of any rights or obligations of, or actions taken by, the institution under resolution, including (subject to provisions on sale of business tool[657] and bridge bank tool[658]), any rights or obligations relating to participation in a market infrastructure. More specifically, in relation to the sale of business tool Member States must ensure that the purchaser may continue to exercise the rights of membership and access to payment, clearing and settlement systems, stock exchanges, investor compensation schemes and deposit guarantee schemes of the institution under resolution, provided that it meets the membership and participation criteria for participation in such systems. Notwithstanding this requirement Member States should ensure that access is not denied on the ground that the purchaser does not possess a rating from a credit rating agency, or that rating is not commensurate to the rating levels required to be granted access to those systems. Where the purchaser does not meet the membership or participation criteria for a relevant payment, clearing or settlement system, stock exchange, investor compensation scheme or deposit guarantee scheme, the rights are exercised for such a period of time as may be specified by the resolution authority, not exceeding 24 months, renewable on application by the purchaser to the resolution authority[659]. The same rules apply in relation to a bridge institution[660].

Finally, Commission Implementing Regulation (EU) 2018/1624 adopted on 23 October 2018[661], requires banks to provide information in relation to all

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[655] Art. 71 (1) of the BRRD.
[656] Art. 71(3) if the BRRD.
[657] Art. 38 of the BRRD.
[658] Art. 40 of the BRRD.
[659] Art. 38 (12) of the BRRD.
[660] Art. 40(10) of the BRRD
[661] Commission Implementing Regulation (EU) 2018/1624 of 23 October 2018 laying down implementing technical standards with regard to procedures and standard forms and templates for the provision of information for the purposes of resolution plans for credit institutions and investment firms pursuant to Directive 2014/59/EU of the European Parliament and of the Council, and repealing Commission Implementing Regulation (EU) 2016/1066. Text with EEA

financial market infrastructures, the disruption of which would present a serious impediment or prevent the performance of any critical functions[662]. This is the only provision which more clearly states the link between the critical functions and FMIs. This could be explained by the fact that this legal act was adopted after the publication of the FSB Guidance on continuity of access to the FMIs.

The SRB has also, to a certain extent, recognised not only the importance of operational continuity of critical services but also the importance of the continuity of access to FMIs. In 2017 the SRB also focused on the collection of comprehensive information on the FMI service providers used by banks[663]. In 2019, the SRB during the meeting with banking industry also highlighted that the SRB follows the approach defined in the relevant global FSB guidance[664].

This is quite an important point as the empirical analysis of the recovery plans shows that in practice consideration and identification of arrangements linked to the continuity of FMIs in line with the legal framework provisions is quite a challenging exercise for both banks and authorities. More specifically, the analysis of 23 European cross-border banking groups with parent institutions located across 12 different EU countries[665] have identified that more than half of the reviewed recovery plans do not provide a comprehensive assessment of the likelihood of continued access to FMI upon execution of recovery options.

With regard to the continuity of access to FMIs in resolution plans, the EBA couldn't say much after performing the analysis of selected plans in 2018. It just noted that it sees material progress on the continuity of access to the FMIs acknowledged that the plans are not yet fully finalised[666]. Therefore,

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relevance. C/2018/6841. OJ L 277, 7.11.2018, p. 1–65. (the '**Commission Implementing Regulation (EU) 2018/1624**').

[662] Art. 4(2)(i) of the Commission Implementing Regulation (EU) 2018/1624.

[663] *Ibid.,* P. 23.

[664]The SRB – Banking Industry Dialogue Meeting. SRB Expectations for banks. Brussels, 18 June 2019. [accessed on 20 July 2019] <https://srb.europa.eu/sites/srbsite/files/presentation_on_srb_expectations_for_banks_1.pdf>.

[665] BALČIŪNAS, L.; et all. Comparative report on recovery plan options. The European Banking Authority, London, 1 March 2017. [accessed on 5 May 2018] <https://eba.europa.eu/documents/10180/1720738/EBA+Comparative+report+on+recovery+options+-+March+2017.pdf>.

[666] EBA Report on the Functioning of Resolution Colleges in 2017. The European Banking Authority, London, July 2018. P.3. [accessed on 5 August 2018].

this shows that understanding the concept, applying legal provisions linked to the continuity of access to FMIs and lining with the critical functions remains challenging for banks and resolution authorities.

In the context of Brexit, operational continuity and continuity of access to critical FMI services arrangements are quite important as well. In particular, continuous access to relevant market infrastructures as the EU27 heavily rely on UK FMI services[667]. Therefore, for the EU banks, it is important to put in place legal arrangements which would not only ensure continuity of access to critical FMIs services which support critical functions in resolution but also to prepare to avoid disruption of access to critical FMI services during Brexit. In particular, this is relevant for the so-called 'hard Brexit' scenario (in case, the political negotiations during the transitional period will fail).

The performed analysis of the BRRD and the second level acts shows that they include the provisions which require to consider continuity of access to the FMIs in the preparation stage during the recovery, resolution planning and resolvability assessment, as well as, during actual resolution. However, neither the BRRD nor the second level legal acts do provide the definition of the critical FMI services. Furthermore, the BRRD provisions with regard to continuity of access to FMIs are quite general. The second level legal acts try to further link different elements (recovery, resolution planning and resolvability assessment) to FMIs, though in a general way and just referring to the need to consider access to FMIs without much going into the details of arrangements. The legal provisions just mention the need to consider the access to FMIs, without further specifying what actual aspects or arrangements should be taken into account. The analysis also shows that the provisions of the FSB Guidance are not fully incorporated into the EU law. As a result, without looking into the global standards, the link between the resolution objective – the continuity of access to critical functions - and continuity of access to FMIs as well as relevant arrangements may not be

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<https://eba.europa.eu/documents/10180/2087449/EBA+Report+on+the+functioning+of+resolution+colleges+-+July+2018.pdf>.

[667] For more details see: Implications of Brexit on EU Financial Services. Study for the ECON Committee. Policy department, Economic and Scientific Policy. European Parliament, Brussels, 2017. [accessed on 20 June 2017] http://www.europarl.europa.eu/RegData/etudes/STUD/2017/602058/IPOL_STU(2017)602058_EN.pdf; How Brexit will redraw Europe's financial infrastructure. Financial Times, London, 19 November 2018. [access on 19 November 2018] < https://www.ft.com/content/7c44100e-d601-11e8-ab8e-6be0dcf18713>.

immediately clear from the EU legal framework. This is also supported by the fact that empirical analysis of the recovery and resolution plans of the banks shows that banks and authorities struggle to understand how the element of the continuity of access to the FMIs should be embodied into the plans and how different parts and elements are linked to it.

Considering the above analysis, it is argued that a greater work could be done at the EU level by further incorporating the arrangements foreseen in the FSB Guidance and clarifying the legal framework. This could facilitate in better understanding of the continuity of access to the critical FMIs concept, how it is linked with the legal concept of critical functions and their continuity, as well as, help banks, supervisory and resolution authorities to understand better what arrangements should be considered. The EBA's thematic comparative reports could also contribute towards greater consistency and better understanding across the EU.

2.3. Prevention of contagion to avoid adverse effects on financial system and maintenance of market discipline

The second legal objective which is linked with other objectives encourages to avoid a significant adverse effect on the financial system, in particular, by preventing contagion, including to market infrastructures[668], and by maintaining market discipline[669]. For the purposes of analysis, this objective could be split into two parts: i) prevention of contagion; and ii) maintenance of market discipline.

2.3.1. Prevention of contagion

The first part of this objective focuses on the '*prevention of contagion*' requiring avoiding a significant adverse effect on the financial system and market infrastructure[670]. This is an important and challenging objective as, within the financial system, banks are particularly prone to contagion and panics. In the literature, the definition of '*contagion*' has variations depending

[668] What is important for the continuity of critical functions as discussed in the previous Subchapter.
[669] Art. 31(2)(b) of the BRRD2.
[670] Art. 31(2)(b) of the BRRD.

on the context within which it is discussed. For example, the Handbook of International Financial Terms defines the '*contagion*' as a feature of the behaviour of financial markets where adverse developments in one specific company spreads through the industry[671]. A Dictionary of Finance and Banking defines the '*contagion*' as the situation in which a financial shock in one market or country is transmitted to another, causing a change in asset prices in this secondary market that is not related to economic fundamentals[672]. It is argued that contagion increases with increasing global interdependence[673]. However, all of them also have a common element as they talk about the situation in which problems spread from one place to another.

Discussions with regard to prevention of contagion in the context of the banking system are not new. H. S. Scott highlights that "*the problem of contagion is of hoary vintage*" as the issues are discussed since the US banking crises of early 1930[674]. He argues that contagion theory historically focused on runs by uninsured depositors to explain the wave of bank failures, for example, of the 1930 and elsewhere in modern financial history[675]. However, it should also be noted that quite for a long time in the literature, it is argued that other financial safety-net elements such as the lender of last resort help to deal with the contagion risk[676]. This shows that '*the contagion*' is a complex matter interlinked with all other elements of the financial safety-net (i.e. prudential supervision, macro-prudential supervision, deposit insurance, the

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[671] TERRY, N.; MOLES, P. Oxford Handbook of International Financial Terms. Oxford University Press, Oxford, 1997. The term 'contagion'.

[672] LAW, J. Oxford Dictionary of Finance and Banking (6 ed.). Oxford University Press, Oxford, 2018. The term 'contagion'.

[673] ENDERWICK, P. Oxford Dictionary of Business and Management in India. Oxford University Press, Oxford, 2017. The term 'contagion'.

[674] SCOTT, S.H. Interconnectedness and Contagion – Financial Panics and the Crisis of 2008. Harvard Law School, 26 June 2014. P. 70. Also see BILLINGS, M.; CAPIE, F. Financial crisis, contagion, and the British banking system between the world wars. In *Business History*, 53, 193–215, 2011.

[675] *Ibid*., P 77.

[676] The term the '*lender of last resort'* originates with Sir Francis Baring who referred to the central bank as '*the dernier resort*' from which all banks could obtain liquidity in times of crisis. see BARING, F. Observations on the Establishment of the Bank of England, and on the Paper Circulation of the Country. 1st Baronet, 1797. On the Bank of England role as lender of last resort when responding to the bank crisis in early times see BAGEHOT, W. Lombard Street – A Description of the Monetary Market. Henry S. King & Co, 1873; In Prussia the Reichsbank was beginning to act as a lender of last resort when the Leipziger Bank and Dresdner Kreditanstalt collapsed in 1901 and the Reichsbank intervened to avert contagion. SINGLETON, J. Central Banking in the Twentieth Century. Cambridge University Press, Cambridge, 2011. P. 44

lender of last resort and resolution). What is more, F. Allen groups the theoretical economic and policy literature on contagion into two approaches: i) papers which look for contagion effects via direct linkages; and ii) papers which look for contagion via indirect balance-sheet linkages[677]. With regard to the first group of papers, in particular, F. Allen and D. Gale researches[678] are important as they discuss how the banking system responds to contagion when banks are connected under different network structures. The authors conclude that incomplete networks are more prone to contagion than complete structures. Under this category also fall papers which have linked the risk of contagion to financial innovation and the accounting system in use.

The second group captures papers focusing on indirect balance-sheet linkages by, for example, simulating different models where banks are linked in the sense that the return on bank's portfolio depends on the portfolio allocations of other banks[679]. As another work falling into this category F. Allen refers to a model presented by Cifuentes, Ferrucci and Shin[680] where financial institutions are connected via portfolio holdings, the network is complete as everyone holds the same asset, and, although the authors incorporate in their model direct linkages through mutual credit exposures as well, contagion is mainly driven by changes in asset prices[681].

As we can see from the overview and as noted by R. Lastra, the literature[682] on banks runs and contagion focusing on the banking system ('domino effect',

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[677] BERGER, N.; MOLYNEUX, P.; WILSON, O.S. The Oxford Handbook of Banking, Second Edition. The Role of Banks in Financial Systems. Oxford University Press, Oxford, 2014. Subchapter 2.5.

[678] ALLEN, F.; GALE, D. M. Financial Contagion. In Journal of Political Economy, Vol. 108, No. 1, February 2000, pp. 1 - 30. Other relevant works by authors: ALLEN, F.; GALE, D. M. Bubbles and Crises. In *Economic Journal* 110, 2000, pp. 236 – 255. ALLEN, F.; GALE, D. M. Comparing Financial Systems. In *MIT Press*, Cambridge, 2001; ALLEN, F.; CARLETTI, E. Credit Risk Transfer and Contagion. In *Journal of Monetary Economics* 53, 2006, pp. 89–111; etc.

[679] LAGUNOFF, R.; SCHREFT, S. A Model of Financial Fragility. In *Journal of Economic Theory,* no 99, 2001, pp. 220 – 264.

[680] For details see: CIFUENTES, R.; FERRUCCI, G.; SHIN, H. Liquidity Risk and Contagion. In *Journal of European Economic Association* 3, 2005, pp. 556–566.

[681] BERGER, A.; MOLYNEUX, P.; WILSON, J. The Oxford Handbook of Banking. Second Edition. Oxford University Press, Oxford, 2014. P. 36.

[682] Besides already mentioned literature, for an extensive literature overview linked to the systemic risk and bank contagion see BANDT, O.; HARTMANN, P. Systemic Risk: A Survey. Working Paper No. 35. European Central Bank, Frankfurt, November 200. P. 18 – 23. Specifically, on the discussion how contagion spreads, see DORNBUSCH, R.; PARK, Y. C.; CLAESSENS, S. Contagion: Understanding How it Spreads. In *The World Bank Research Observer*, vol. 15 no. 2 (August 200), pp. 177 – 197.

a chain reaction in the case of a liquidity shortage, negative spill over effects) is extensive[683]. Though, a different story is with the legal literature in respect to the analysis of contagion as the legal resolution objective and its role in understanding and applying the legal provisions of the bank recovery and resolution legal framework. Usually, papers in this field either just mention the contagion issue[684] or just provide a general description of this objective without going into deeper analysis how it is linked with the bank recovery and resolution legal framework provisions[685] what makes this analysis even more important.

Firstly, it is worth highlighting that this part of the second legal resolution objective (the prevention of contagion) is interlinked with the first legal resolution objective – the continuity of critical functions. Namely, the discontinuation of the critical function could give rise to the contagion and, therefore, when identifying whether the function is critical or not, among other things, banks and authorities (depending on the procedural step) should also assess whether the sudden failure to provide that functions would be likely to have a material impact on the third parties, give rise to contagion or undermine the general confidence of the market participants (see the previous Chapter)[686].

For example, a primary reason for considering wholesale functions to be critical is the potential for contagion across the financial system, as disruption of certain wholesale markets may expose counterparties to significant liquidity and solvency strain what, ultimately, could prevent counterparties from providing other critical functions. However, it should also be taken into account that wholesale activities take place in highly segmented markets, and not all of them do have the potential to cause substantial contagion.

Furthermore, the legal resolution objective requiring to prevent the contagion also means that the instruments, tools and powers foreseen in the

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[683] LASTRA, R. International Financial and Monetary Law. 2nd Edition. Oxford University Press, Oxford, 2015. Paragraph 4.115.

[684] GLEESON, S.; GUYNN, R. Bank Resolution and Crisis Management: Law and Practice. Oxford University Press, Oxford, 2016. Paragraphs 1.11, 3.48 etc.

[685] BINDER, J. H.; SINGH, D. Bank Resolution. The European Regime. Oxford University Press, Oxford, 2015. Paragraphs 2.33.

[686] For example, the primary reason for considering wholesale functions to be critical is the potential for contagion across the financial system, as disruption of certain wholesale markets may expose counterparties to significant liquidity and solvency strain what, ultimately, could prevent counterparties from providing other critical functions. However, it should be also taken into account that wholesale activities take place on highly segmented markets and not all of them do have the potential to cause substantial contagion.

BRRD should be applied by paying regard to it, and therefore, during the recovery and resolution planning, resolvability assessment authorities are also required to consider the extent to which contagion to other banks or to the financial markets could be contained through the application of the resolution tools and powers[687].

More specifically, in order to limit the contagion and in order to be ready to execute orderly resolution and restructuring or wind-down of the failing bank, the BRRD puts a lot of emphasis on the preparation by banks and authorities through the development of their recovery[688] and resolution plans[689]. What is more, an important element of the whole legal framework is the requirement for banks and resolution authorities to ensure that banks were resolvable, and recovery and resolution plans should contribute to this. The legal framework sets that a bank should only be deemed to be resolvable if it is feasible and credible for the resolution authority to either liquidate it under normal insolvency proceedings or to resolve it by applying the different resolution tools and powers to the institution while avoiding to the maximum extent possible any significant adverse effect on the financial system, including in circumstances of broader financial instability or system-wide events, of the Member State in which the institution is established, or other Member States of the EU and with a view to ensuring the continuity of critical functions carried out by the institution[690].

The BRRD also acknowledges that foreseen legal tools could be contagion sensitive. Therefore, to reduce the risk of systemic contagion, the BRRD by default provides that certain liabilities are excluded from the bail-in (for more details on this tool see the part on the protection of public funds). For example, to avoid run risks covered deposits are excluded; to avoid contagion to key financial markets and infrastructures liabilities arising from a participation in payment systems which have a remaining maturity of less than seven days, or liabilities to institutions, excluding entities that are part of the same group, with an original maturity of less than seven days; to ensure the continuation of the operations of the bank liabilities to liabilities to employees, tax and social security authorities etc. are excluded[691].

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[687] Annex Section C of the BRRD.
[688] Art. 5 and Art. 7 of the BRRD2.
[689] Art. 10 and Art. 13 of the BRRD.
[690] Art. 15(1) 2 paragraph and Art. 16(1) 2 paragraph of the BRRD.
[691] Art. 44(2)(d) to (f) of the BRRD.

In addition, the legal framework foresees that the necessity to avoid giving rise to widespread contagion could be (to a certain extent) the justification for the resolution authority to decide to exclude or partially exclude liabilities from the bail-in tool which by default are not excluded[692]. However, it is important to note that as it was highlighted in the Technical advice, a certain risk of some contagion is inherent to the bail-in tool, and the legislative decision to enshrine the tool in the BRRD as a key resolution tool, together with the principle that creditors and shareholders should bear losses[693], means that this necessary risk of contagion must not be considered a reason to exclude liabilities[694].

Furthermore, in order to prepare and mitigate the risk of banks structuring their liabilities in a way which could impede the effectiveness of bail-in or other resolution tools and powers, and to avoid the increased risk of contagion or bank runs, the BRRD requires that banks meet, at all times, a robust minimum requirement for eligible liabilities (MREL)[695]. Moreover, the MREL instrument is designed with the idea in mind that that shareholders and unsecured creditors would be able to bear losses regardless of which resolution tool is applied[696]. Therefore, authorities by setting the MREL should aim to ensure sufficient loss-absorbing and recapitalisation capacity that the holders of MREL eligible instruments are able to absorb losses in the financial markets without spreading contagion and without necessitating the allocation of loss to where that would cause disruption to critical functions or significant financial instability (it is calculated that in the EU 117 banks out of 222 exhibit

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[692] Recital 72 and Art. 44(3)(c) of the BRRD.

[693] The BRRD2 explicitly states that resolution authorities take all appropriate measures to ensure that the resolution action is taken following the principle that the shareholders of the institution under resolution bear first losses, and creditors of the institution under resolution bear losses after the shareholders in accordance with the order of priority of their claims under normal insolvency proceedings, save as expressly provided otherwise in the BRRD2. See Art. 34(1)(a)(b) of the BRRD2.

[694] BALČIŪNAS, L; et all. Technical advice on the delegated acts on critical functions and core business lines. European Banking Authority, London, 6 March 2015. P. 13. [accessed on 6 March 2019] <https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-05+Technical+Advice+on+critical+functions+and+core+business++++.pdf>

[695] Art. 45(1) of the BRRD, Recital 83 of the SRM.

[696] For more details on the MREL requirement calibration see: Report on the Implementation and Design of the MREL framework. EBA-Op-2016-21. European Banking Authority, London, 14 December 2016. [accessed on 15 December 20117] <https://eba.europa.eu/documents/10180/1695288/EBA+Final+MREL+Report+%28EBA-Op-2016-21%29.pdf>.

MREL shortfall reaching EUR 178 bn).[697] Furthermore, to limit contagion, the international FSB standard on the TLAC requires authorities to place appropriate prudential restrictions on G-SIBs and other internationally active banks' holdings of instruments issued by G-SIBs that are eligible to meet the minimum TLAC requirement[698].

The above analysis also further contribute to the explanation how the second legal resolution objective is linked to the first objective as the discontinuation of critical functions (and protection of market infrastructure which is essential for the continuity of bank's critical functions) may give rise to contagion[699] and have a significant adverse effect on the financial system. The first resolution objective and the BRRD requirements linked to the identification, mapping, protection and continuity of bank's critical functions should ensure that authorities do have a better understanding of individual bank's critical functions, their importance to the real economy and financial stability, and are able to limit the potential risk of contagion by being ready to ensure the continuity of such functions during the resolution.

Finally, with regard to the prevention of contagion, it should also be noted that the contagion to a certain extent is unavoidable as the BRRD requires in resolution shareholders and other creditors always to bear losses[700]. Ultimately, not only authorities but also market participants should get used to the new game rules and new 'standard' situation, though challenges are expected during the transitional stage.

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[697] Data as of December 2018. See: EBA Quantitative MREL Report. EBA, Rep/2020/07. P 4.
[698] Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution. Total Loss-absorbing Capacity (TLAC) Term Sheet. FSB, Basel, 9 November 2015. P. 7. [accessed on 22 November 2018] <https://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf>.
[699] When performing the analysis of the impact of the sudden discontinuance of the function on third parties, among other things authorities are encouraged to consider *contagion effect*: "whether the failure of the function is likely to disrupt the respective market and therefore to affect unrelated participants that are exposed to that market and thereby interconnected with the institution. For instance, if the institution's function of market making for certain financial instruments fails, it can have a serious impact in drying up the liquidity of that asset market. The sudden decline in liquidity may have a material impact on the prices of those financial assets which consequently can jeopardise the liquidity or solvency of other counterparties in a "domino effect". See more: BALČIŪNAS, L; et all. Technical advice on the delegated acts on critical functions and core business lines. European Banking Authority, London, 6 March 2015. P. 8. [accessed on 6 March 2019] <https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-05+Technical+Advice+on+critical+functions+and+core+business++++.pdf>.
[700] Art. 34(1)(a)(b) of the BRRD.

2.3.2. Market discipline

The second part of the discussed objective encourages to '*maintain market discipline*'. The BRRD does not provide the definition of this term, therefore, in order to better understand the meaning of the second part of the legal resolution objective we also have to look beyond the legal text of the Directive.

In the literature, the definition of '*market discipline*' varies. However, in broad terms, it was usually understood as the mechanism via which market participants monitor and discipline excessive risk-taking behaviour by banks[701]. For a long time, banking was explicitly reliant on market discipline, i.e. the influence of customers, borrowers, auditors, rating agencies, and investors on bank behaviour. After performing an extensive analysis of the literature C. Leuz and P. D. Wysock[702] note that even though capital markets already provide substantial incentives for banks to disclose information voluntarily in order to lower their cost of capital, however, this does not necessarily mean that the level of disclosure is economically efficient as banks may still prioritise profit maximisation over social welfare[703].

Gradually, it was not only acknowledged that in order for a market to operate effectively investors need access to information about bank's risk profile, but also that common *regulatory* requirements on banks' disclosure could provide an important channel through which relevant information can be obtained. The market discipline in the regulatory framework for the first time was included with the adoption of Basel II[704]. This standard, compared to Basel I[705], substantially expanded international regulatory standards for

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[701] DELIMATSIS, P.; HERGER, N. Financial Regulation at the Crossroads: Implications for Supervision, Institutional Design and Trade. Wolters Kluwer, the Netherlands, 2011. P. 213.
[702] LEUZ, Ch.; WYSOCKI, P.D. The Economics of Disclosure and Financial Reporting Regulation: Evidence and Suggestions for Future Research. In Journal of Accounting Research, Vol. 54 No. 2 May 2016, Printed in U.S.A. pp. 525 – 622.
[703] *Ibid*. P. 543.
[704] International Convergence of Capital Measurement and Capital Standards (known as Basel II). BCBS, Basel, originally published in June 1999 (revised in 2004). [accessed on 15 April 2013] < https://www.bis.org/bcbs/history.htm>.
[705] Basel I (also known as the Basel Capital Accord) was adopted in the onset of the Latin American debt crisis which heightened concerns that the capital ratios of the main international banks were deteriorating at a time of growing international risks. G10 and the Basel Committee acknowledged the overriding need for a multinational accord to strengthen the stability of the international banking system and to remove a source of competitive inequality arising from differences in national capital requirements. A capital measurement system commonly referred

prudential supervision of banks by setting three pillars, namely: i) the first pillar – minimum capital requirements, which sought to develop and expand the standardised rules set out in Basel I[706]; ii) the second pillar accompanying the first pillar – supervisory review of bank's capital adequacy and internal assessment process[707]; and iii) the third pillar complementing the other two pillars – use of disclosure as a lever to strengthen market discipline and encourage sound banking practices[708]. The third pillar aimed at standardising requirements with regard to disclosure of capital structure, capital adequacy, credit risk, securitisation, market risk, operational risk, equities and interest rate risk.

However, not only the disclosure of information but disclosure by using standard definitions via, e.g. standardised templates, allows market participants to compare banks much more easily. Basel II provisions standardised disclosure requirements to a certain extent, though, they did not ensure that disclosure would include the necessary standardised information which would allow for investors to assess or compare banks' capital adequacy.

In 2010 at the Seoul Summit, G20 Leaders endorsed new Basel III[709] and restated their commitment that the updated soft law international standard will

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to as the Basel Capital Accord (Basel I) was approved by the G10 Governors and released to banks in July 1988. It included soft law provisions that needed to be transposed by the various national and regional authorities (including the European Communities), into law. Furthermore, as noted by Ch. Goodhart, after Basel I, the work of the BCBS became more widely recognised as of major importance. See: International Convergence of Capital Measurement and Capital Standards (Basel Capital Accord). Basel Committee on Banking Supervision, Basel, July 1988. [accessed on 25 May 2017] <https://www.bis.org/publ/bcbs04a.pdf>. GOODHART, Ch. Basel Committee on Banking Supervision. A History of the Early years 1974 - 1997. Cambridge University Press, Cambridge, 2011. P. 6, 52.

[706] The First Pillar – Minimum Capital Requirements. BCBS, Basel, 2004. [accessed on 15 May 2015] <https://www.bis.org/publ/bcbs107b.pdf>.

[707] The Second Pillar – Supervisory Review Process. BCBS, Basel, 2004. [accessed on 15 May 2015] <https://www.bis.org/publ/bcbs107c.pdf>.

[708] The Third Pillar – Market Discipline. BCBS, Basel, 2004. P. 175. [accessed on 15 May 2015] <https://www.bis.org/publ/bcbs107c.pdf>.

[709] Basel III: International framework for liquidity risk measurement, standards and monitoring. BCBS, Basel, December 2010. [accessed on 15 December 2018] <https://www.bis.org/publ/bcbs188.pdf> (which was replaced by two other documents in 2013: Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools. BCBS, Basel, January 2013. [accessed on 15 December 2018] <https://www.bis.org/publ/bcbs238.pdf> and Basel III: the net stable funding ratio. BCBS, Basel, October 2014. [accessed on 15 December 2018] https://www.bis.org/bcbs/publ/d295.pdf) and Basel III: A global regulatory framework for more resilient banks and banking systems. BCBS, Basel, December 2010. [accessed on 15 December 2018] https://www.bis.org/publ/bcbs189_dec2010.pdf (which was revised in 2011: Basel III: A global regulatory framework for more resilient banks and banking systems. BCBS,

be transposed into national laws and regulations[710]. Basel III updated all three pillars: i) the pillar one was updated by enhancing minimum capital and Liquidity requirements; ii) the pillar two was updated by enhancing supervisory review process for bank-wide risk management and capital planning; and iii) the third pillar – market discipline – further consolidated and enhanced framework, taking into account all the amendments to the Basel framework and introduced a dashboard of banks' key prudential metrics[711]. Furthermore, considering investor's demand for better risk disclosures as an important element for their confidence in banks and their business models, the FSB established a private sector Enhanced Disclosure task Force (the 'EDTF') in 2012[712]. The same year the EDTF issued principles and recommendation for enhancing the risk disclosure of banks[713], which were used by the BCBS for the subsequent revision of Basel III Pillar III disclosure requirements[714].

Basel, June 2011. [accessed on 15 December 2018] <https://www.bis.org/publ/bcbs189.pdf>; and revised again in 2017: Basel III: Finalising post-crisis reforms. BCBS, Basel, December 2017. [accessed on 15 December 2018] https://www.bis.org/bcbs/publ/d424.pdf).

[710] The document issued after the Seoul Summit meeting stated that "We [G20 Leaders] endorsed the landmark agreement reached by the BCBS on the new bank capital and liquidity framework, which increases the resilience of the global banking system by raising the quality, quantity and international consistency of bank capital and liquidity, constrains the build-up of leverage and maturity mismatches, and introduces capital buffers above the minimum requirements that can be drawn upon in bad times. The framework includes an internationally harmonized leverage ratio to serve as a backstop to the risk-based capital measures. With this, we have achieved far-reaching reform of the global banking system. The new standards will markedly reduce banks' incentive to take excessive risks, lower the likelihood and severity of future crises, and enable banks to withstand – without extraordinary government support – stresses of a magnitude associated with the recent financial crisis. This will result in a banking system that can better support stable economic growth. We are committed to adopt and implement fully these standards within the agreed timeframe that is consistent with economic recovery and financial stability. The new framework will be translated into our national laws and regulations, and will be implemented starting on January 1, 2013 and fully phased in by January 1, 2019." G20 Seoul Summit Leaders' Declaration. G20 Leaders, Seoul, 12 November 2010. [accessed on 15 November 2018] <http://www.g20.utoronto.ca/2010/g20seoul-doc.pdf>.

[711] Basel Committee on Banking Supervision reforms – Basel III.

[712] Initially it was composed of co-chairs from Deutsche Bank, HSBC Holdings plc., PIMCO and 25 senior officials and experts representing financial institutions, investors and analysts, credit rating agencies, and external auditors. Formation of the Enhanced Disclosure Task Force. FSB, Basel, 10 May 2012 [accessed on 18 November 2018] <https://www.fsb.org/wp-content/uploads/pr_120510.pdf>.

[713] Enhancing the Risk Disclosures of Banks. Report. EDTF, 29 October 2012. [accessed on 18 November 2018] <https://www.fsb.org/wp-content/uploads/r_121029.pdf>.

[714] Review of the Pillar 3 disclosure requirements. Issued for comment by 26 September 2014. BCBS, Basel, June 2014. P. 3. [accessed on 18 November 2018]. <https://www.bis.org/publ/bcbs286.pdf>. Final Standards. Revised Pillar 3 disclosure

As we can see, Basel III Pillar III dedicated to market discipline is continuously strengthened and further harmonised.

In the EU, Basel III soft law requirements, including those linked to the market discipline, were incorporated into the EU financial law by adopting the CRD and the CRR. The latter explicitly states that for the purposes of strengthening market discipline and enhancing financial stability it is necessary to introduce more detailed requirements for disclosure of the form and nature of regulatory capital and prudential adjustments made in order to ensure that investors and depositors are sufficiently well informed about the solvency of institutions[715]. What is more, in order to improve market discipline and to facilitate the monitoring of institutions' corporate governance practices, the CRR set a requirement for banks to disclose their corporate governance arrangements publicly[716]. The CRR includes a dedicated part for harmonising legal provisions linked to disclosure by institutions[717]. As a result, this forms the first comprehensive approach to disclosure requirements imposed on banks across the Union.

As we can see, from the perspective of bank prudential supervision, a number of legal provisions (on the one hand harmonising disclosure requirements, on the other hand standardising the templates and for disclosure information reporting) have been introduced in recent years. This was done under the assumption that timely and reliable information will enable market participants to evaluate more precisely the financial performance of banks across the Member States and will enhance market discipline across the Union.

Worth to note that a famous Turner report questioned the theory of the efficient and rational market and the role of market discipline[718]. It

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requirements. BCBS, Basel, January 2015. [accessed on 18 November 2018] <https://www.bis.org/bcbs/publ/d309.pdf>.

[715] Recital 76 of the CRR.

[716] Recital 114 of the CRR.

[717] See: Part 8 (Art. 431 – 455) of the CRR. What is more, considering that the BCBS released a revised version of Basel III Pillar III framework in January 2015, the EBA has issued own-initiative Guidelines on disclosure requirements under Part Eight of the CRR to ensure harmonised and timely implementation of the revised Pillar III requirement in the EU.

[718] The criticism of efficient market theory includes the following statements: i) market efficiency does not imply market rationality; ii) individual rationality does not ensure collective rationality; iii) individual behaviour is not entirely rational; iv) allocative efficiency benefits have limits; v) empirical evidence illustrates large scale herd effects and market overshoots. See: The Turner Review. A regulatory response to the global banking crisis. Financial Services

acknowledged that in the past, an important school of thought has argued that market discipline can play a key role in incentivising banks to constrain capital and liquidity risk, however, considering the performed analysis it concluded that "<...> *a strong case can be made that the events of the last five years have illustrated the inadequacy of market discipline: indeed, they suggest that in some ways market prices and market pressures may have played positively harmful roles*"[719]. Finally, this report also noted that the challenge to efficient market theory has consequences for the extent to which we can rely on market discipline rather than regulatory action to constrain risks[720].

Furthermore, the crisis highlighted and academic research confirmed[721] that expectations of government support (for example, through the provision of explicit or implicit government guarantees, bailouts) may lead market participants to expect that authorities will keep banks (in particular, systemic) afloat[722] what as a result reduces bank creditors' incentives to use, scrutinise and demand information disclosure on bank conditions. Empirical data also shows that market participants usually took for granted that in case a bank, in particular a systemic one, will face difficulties it will benefit from the financial support and rating agencies were taking this into account when setting a better rating grade for such banks[723].

Authority, London, March 2009. P. 45. [accessed on 15 March 2018] <http://news.bbc.co.uk/1/shared/bsp/hi/pdfs/18_03_09_turner_review.pdf>.

[719] The Turner Review. A regulatory response to the global banking crisis. Financial Services Authority, London, March 2009. P. 45. [accessed on 15 March 2018] <http://news.bbc.co.uk/1/shared/bsp/hi/pdfs/18_03_09_turner_review.pdf>.

[720] The Turner Review. A regulatory response to the global banking crisis. Financial Services Authority, London, March 2009. P. 40 – 41. [accessed on 15 March 2018] <http://news.bbc.co.uk/1/shared/bsp/hi/pdfs/18_03_09_turner_review.pdf>.

[721] A large number of studies find evidence that perceived government guarantees for "too big to fail" institutions (which are typically assumed to include G-SIBs, but which are not necessarily limited to G-SIBs) significantly reduce these banks' debt funding costs. Assessing the economic costs and benefits of TLAC implementation. Report submitted to the Financial Stability Board by an Experts Group. Bank of International Settlements, Basel, November 2015. [accessed on 22 November 2018] <https://www.bis.org/publ/othp24.pdf>.
P. 35. [accessed on 22 November 2018] <https://www.bis.org/publ/othp24.pdf>.

[722] STEPHANOU, C. Rethinking Market Discipline in Banking. Lessons from the Financial Crisis. The World Bank, March 2010. P. 11. [accessed on 15 March 2018] <http://documents.worldbank.org/curated/en/570631468175760237/pdf/WPS5227.pdf>.

[723] For example, Moody's alerted investors to the fact that resolution plans would remove the necessity to support banks as banks would no longer be too interconnected or complex to fail. This could potentially result in ratings downgrades where ratings currently incorporate a high degree of government support. See Commission Staff Working Document. Impact Assessment. Accompanying the document Proposal for a Directive of the European Parliament and of the

All this was also acknowledged at the G20 level. As a result, on 15 November 2008, the Leaders of the G20 agreed that as a medium-term action: *"[n]ational and regional authorities should review resolution regimes and bankruptcy laws in light of recent experience to ensure that they permit an orderly wind-down of large complex cross-border financial institutions*"[724]. Following the meeting in London on April 2009, the Leaders of G20 issued the declaration and statement where it was declared that the financial system should be strengthened through strengthening the legal regulation and supervision[725] and the regulators and supervisors, among other things, should also support market discipline[726]. In 2010, the BCBS issued recommendations of the cross-border bank resolution group which stated that *"[a]n effective resolution regime would allow the authorities to act quickly to maintain financial stability, preserve continuity in critical functions and protect depositors. <…> [A]n effective regime would maintain market discipline by holding to account, where appropriate, senior managers and directors and imposing losses on shareholders and, where appropriate, other creditors*"[727]. In 2011, the G20 endorsed the FSB KA (for details see Chapter I) which stated

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Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010. SWD(2012) 166 final. European Commission, Brussels, 2012. P. 25. [accessed on 15 March 2018] <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012SC0166&from=EN>.

[724] Declaration of the Summit on Financial Markets and the World Economy. The Leaders of the Group of Twenty, Washington, November 2008. [accessed on 15 March 2018] <http://www.g20.utoronto.ca/2008/2008declaration1115.html>.

[725] For details see: Declaration on Strengthening the Financial System – London Summit, 2 April 2009. The Leaders of the G20, London, April 2009. [accessed on 15 March 2018] <http://www.g20.utoronto.ca/2009/2009ifi.pdf>.

[726] London G20 Summit – Leaders s' Statement. The Leaders of the Group of Twenty, London, 2 April 2009. Paragraph 14. [accessed on 15 March 2018] <http://www.g20.utoronto.ca/2009/2009communique0402.pdf>. Furthermore, in the G20 meeting in Washington it was also stated that "*Regulators must ensure that their actions support market discipline <…>*". See: Declaration of the Summit on Financial Markets and the World Economy. The Leaders of the Group of Twenty, Washington, November 2008. Paragraph 8. [accessed on 15 March 2018] <http://www.g20.utoronto.ca/2008/2008declaration1115.html>.

[727] Report and Recommendations of the Cross-border Bank Resolution Group. Basel Committee on Banking Supervision, Basel, March 2010. P. 4. [accessed on 15 March 2018] <https://www.bis.org/publ/bcbs169.pdf>.

that an effective resolution regime should be "*credible, and thereby enhance market discipline and provide incentives for market-based solutions*"[728].

In the EU, the EC, when performing the impact assessment for the suggested EU bank crisis management legal framework, noted that by clearly setting the rules for burden-sharing between public and private sector in bank crisis situation should increase market discipline[729]. Furthermore, the Bank of England, on the basis of research performed by B. Marques[730], highlighted that "*removing government support assumptions (as measured via ratings) could induce systemically important banks to change the riskiness of their business models in a way that would reduce their probability of default by individual banks by around 30%. For an average jurisdiction, this is predicted to reduce the probability of a crisis by slightly less than 30% (e.g. a reduction from 4% to 2.8%)*"[731]. In the subsequent analysis, the Bank of England stated that the legal requirements of MREL (to ensure an effective and credible applications of any resolution tool and, in particular, the bail-in tool), reduce the probability of a crisis by between 26% and 41%[732], as a result of impact to the market discipline and potential prevention of contagion.

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[728] Key Attributes of Effective Resolution Regimes for Financial Institutions. Financial Stability Board, Basel, 15 October 2014. P. 3. [accessed on 15 March 2018] <https://www.fsb.org/wp-content/uploads/r_141015.pdf>.

[729] Commission Staff Working Document. Impact Assessment. Accompanying the document Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010. SWD(2012) 166 final. European Commission, Brussels, 2012. P. 207. [accessed on 15 March 2018] <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012SC0166&from=EN>.

[730] MARQUES, L.B.B.; CORREA, R.; SAPRIZA, H. International evidence on government support and risk taking in the banking sector. Working Paper No. 13/94. IMF, Washington, 2 May 2013. [accessed on 21 November 2018] <https://www.imf.org/en/Publications/WP/Issues/2016/12/31/International-Evidence-on-Government-Support-and-Risk-Taking-in-the-Banking-Sector-40501>.

[731] BROOK, M.; et all. Measuring the macroeconomic costs and benefits of higher UK bank capital Requirements. Bank of England Financial Stability Paper No. 35, December 2015. [accessed on 20 November 2018] <https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-paper/2015/measuring-the-macroeconomic-costs-and-benefits-of.pdf?la=en&hash=9E3312E32D26EC1F02E25CB2F075356B484F0242>.

[732] The Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL). Consultation on a proposed Statement of Policy. Bank of England, London, December 2015. P. 43. [accessed on 23 November 2018] <https://www.bankofengland.co.uk/-/media/boe/files/financial-stability/resolution/boes-

As it was discussed, by setting legal disclosure requirements, the prudential supervision legal framework aims at contributing to the market discipline. In the field of bank recovery and resolution, the EU legal framework disclosure requirements are not so well developed. More specifically, originally the BRRD did not include any provisions which would have required authorities or banks to disclose information, for example, on MREL. Though, it is important to note that, for example, from the consumer protection perspective the MiFID II[733] requires investment firms and credit institutions[734] when selling financial instrument to provide information in such a manner that clients of potential clients are reasonably able to understand the nature and risk of the investment service and of the specific type of financial instrument that is being offered, in order to make a decision on an informed basis[735].

Furthermore, under the Commission Delegated Regulation (EU) 2017/565[736] supplementing MiFID II, investment firms (including credit institutions) are required, in good time before a client or potential client is bound by any agreement for the provision of investment services or ancillary services or before the provision of those services, whichever is the earlier to provide that client or potential client with the information on the terms of any such agreement. Even though these provisions do not explicitly refer to the BRRD, they are important as financial instruments, depending on their nature, are subject to the resolution regime and do fall under the bail-in. Therefore, the buyer of bail-inable financial instruments should also be informed whether the financial instrument he or she is buying does fall under the resolution regime and whether it is bail-inable. This point, from the perspective of consumers protection, was also recognised by the ESMA, which issued a statement encouraging investment firms and credit institution to adequately

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approach-to-setting-mrel-consultation.pdf?la=en&hash=F1602B73F5746DE4B9BBD55719FB8D9F056943C5>.

[733] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU Text with EEA relevance. OJ L 173, 12.6.2014, p. 349–496. (the '**MiFID II**').

[734] Art. 1 of the MiFID sets that the provisions of the Directive should also apply to credit institutions (banks) authorised under Directive 2013/36/EU, when providing one or more investment services and/or performing investment activities.

[735] Art. 24(5) of the MiFID II.

[736] Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (Text with EEA relevance). C/2016/2398. OJ L 87, 31.3.2017, p. 1–83.

inform financial instruments buyers[737]. This is a quite important point in particular which regard to retail investors, who may have a limited understanding whether the financial instrument they are buying could be subject to the legal resolution regime and bail-in, and what this could mean[738]. Though, it should also be acknowledged that the issue of retail clients' understanding of the risks related to holding financial instruments had already existed before the introduction of the bank recovery and resolution legal framework. The introductions of resolution did not by itself create a risk of potential losses of retail clients if their financial instrument is bail-ined because in the insolvency legal proceedings all creditors have to bear losses. Though, it should be mentioned that in 2019 the revised BRRD went further by introducing additional protection for retail clients buying subordinated eligible liabilities[739].

At the global level, the FSB in the adopted international standard on TLAC, considering that transparency and disclosure of relevant information contribute to the market discipline, also noted that "*investors, creditors, counterparties, customers and depositors should have clarity about the order in which they will absorb losses in a resolution*"[740]. Subsequently, the BSBC recognising the importance of ensuring that the disclosure requirements in the Pillar III legal framework continue to be relevant and meaningful, and

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[737] MiFID practices for firms selling financial instruments subject to the BRRD resolution regime. Statement ESMA/2016/902. ESMA, Paris, 2 June 2016. [accessed on 23 November 2018] <https://www.esma.europa.eu/sites/default/files/library/2016-902_statement_brrd.pdf>.

[738] This point is strengthened by the fact that as of Q3 2017, retail investors of the euro area held EUR 262.4 billion or 12.7% of the EU bank debt securities issued to euro area investors. Senior unsecured debt constituted 81% (or EUR 212.4 billion) of retail held debt securities, with the balance (19% or EUR50.0billion) represented by subordinated debt. As of Q3 2017, retail held debt issuance appears more significant in banks in a few countries: Italy has the largest amount (EUR 132.3 billion), followed by Germany (EUR 49.4 billion) and then France (EUR 31.7 billion). (Statement of the EBA and ESMA on the treatment of retail holdings of debt financial instruments subject to the Bank Recovery and Resolution Directive. EBA, London, 30 May 2018. Paragraph 17, 18).

[739] The revised BRRD requires an issuing bank to perform and document a suitability test to satisfy itself that the instrument is suitable for a retail client. Furthermore, where the financial instrument portfolio of a retail client does not exceed EUR 500 000, the issuer also has to ensure that the retail client does not invest an aggregate amount exceeding 10% of the client's financial instrument portfolio, and that the minimum initial investment is at least EUR 10 000. Art. 44a of the BRRD.

[740] Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution. Total Loss-absorbing Capacity (TLAC) Term Sheet. FSB, Basel, 9 November 2015. P. 7. <https://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf >.

considering policy developments in the field of bank recovery and resolution legal framework, suggested incorporating proposed disclosure requirements arising from the TLAC[741]. Furthermore, the FSB has started discussion on the approach with regard to the public disclosure on resolution planning and resolvability, as the FSB believes that such disclosures should help strengthen market discipline and public accountability and additional incentives for firms to remove any remaining barriers to resolvability as well as clarify and strengthen market confidence in the resolution actions of authorities[742].

In the EU, the CRR, following developments at the global, was recently amended by transposing international soft law standards[743]. These amendments also incorporate international TLAC standard into the EU financial law and include enhanced disclosure requirements, including requirements for the disclosure of TLAC[744]. More specifically, the CRRII requires banks to disclose their TLAC capacity on a quarterly basis[745], as part of their key metrics[746]. While the information on the composition of bank's own funds and eligible liabilities, their maturity and their main features, the ranking of eligible liabilities in the creditor hierarchy, the total amount of each issuance of eligible liabilities instruments as well as the total amount of excluded liabilities[747] should be disclosed semi-annual[748]. Furthermore, the EBA noted that disclosing the MREL requirements and capacity of banks

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[741] Pillar 3 disclosure requirements – consolidated and enhanced framework. Consultative Document. Bank of International Settlements, the BCBS, Basel, March 2016. P. 1. [accessed on 21 November 2018]. <https://www.bis.org/bcbs/publ/d356.pdf>.

[742] Currently, in the EU legal framework there is no such obligation. Public Disclosures on Resolution Planning and Resolvability. Discussion Paper for Public Consultation. FSB, Basel, 3 June 2019. P. 2. [accessed on 4 June 2019] <https://www.fsb.org/wp-content/uploads/P030619-2.pdf>.

[743] Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012 (Text with EEA relevance.)
PE/15/2019/REV/1. OJ L 150, 7.6.2019, p. 1–225. (the '**CRRII**').

[744] Art. 72a – 72j, 92a, 104a, 104b of the CRRII.

[745] Art. 433a(1)(c) of the CRRII.

[746] Art. 433a(1)(c)(ii) and Art. 447(1)(h) of the CRRII.

[747] Art. 437a of the CRRII.

[748] Art. 433a(3) of the CRRII.

would provide transparency to investors and thus support market discipline, decrease speculations about banks' health and facilitate appropriate pricing[749].

To sum up, the second resolution objective not only encourages to prevent the contagion (acknowledging that to a certain extent, it is unavoidable) but also puts emphasis on increased market discipline. The understanding of the efficient market theory and the role of market discipline within it has changed after the financial crisis. More emphasis has been put on regulators and supervisors to support it. This followed by strengthening the regulatory and supervisory regimes as well as an introduction of recovery and resolution legal frameworks across the jurisdictions and in the EU which is also seen as an instrument to strengthen the market discipline by introducing legal provisions (requiring banks to hold sufficient amounts and types of bail-inable instruments, develop credible recovery and resolution plans etc.) which should contribute to making banks resolvable and clearly state that in case bank faces difficulties and the decision is made to resolve it, shareholders and other creditors should bear the losses.

The EU bank recovery and resolution legal framework aims to change the way the market perceives risks and contributes to solving them, in particular by trying to eliminate a potential reliance of market participants on government supper in case a bank faces difficulties. It is expected that, ultimately, there should be more market discipline as, on the one hand, market participants (shareholders and unsecured creditors of the bank) should become more risk-sensitive as they will be more involved in bearing losses and therefore should be more encouraged to take care of the business, on the other hand, the legal framework should encourage banks to better control their risk and demonstrate that they are not taking excessive risk in order to attract shareholders and unsecured creditors. This is a paradigm-changing approach which should be acknowledged by market participants and authorities when applying and implementing the legal provisions of the BRRD in a way which would contribute to the achievement of this objective.

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[749] Report on the Implementation and Design of the MREL framework. EBA-Op-2016-21. European Banking Authority, London, 14 December 2016. P. 9. [accessed on 15 December 20117]
<https://eba.europa.eu/documents/10180/1695288/EBA+Final+MREL+Report+%28EBA-Op-2016-21%29.pdf>.

2.4. Protection of public funds by minimising reliance on extraordinary public financial support

In order to ensure a competitive and effective banking system, which supports growth, banks (as any other business) should be allowed to fail. However, it should also be recognised that by applying tools and instruments foreseen in the EU bank recovery and resolution legal framework, authorities are required to ensure that bank could be allowed to fail, though, in an orderly way and that losses (during bank's bankruptcy or resolution process) arising from bank failure would be imposed on shareholders and investors (subject to no creditor worse off principle[750]). As a result, this should help to protect the public funds from loss. Furthermore, it is argued that such legal mechanism should also reduce the risk of bank failures by encouraging more responsible risk-taking[751].

Therefore, the third legal resolution objective requires protecting public funds by minimising reliance on extraordinary public financial support[752]. This objective supplements the second objective by aiming to restrict reliance on government support and in this way, enhance market discipline. This is an important objective as overall, one of the key aims of the EU bank recovery and resolution legal framework is to limit the use of public funds when dealing with bank failures, and was an important political driver for reaching an agreement at the EU level on these rules as it worked as well as a good 'selling point' for voters.

It may seem that this objective is quite straight forward, though, as we will see from the analysis, there are a lot of complex elements, and there are

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[750] The '**no creditor worse off principle**' means that no creditor incurs greater losses than it would have incurred if the institution had been wound up under normal insolvency proceedings. Furthermore, the BRRD includes the legal provisions aimed at safeguarding that this principle is respected. Namely, for the purposes of assessing whether shareholders and creditors would have received better treatment if the institution under resolution had entered into normal insolvency proceedings, Member States are required to ensure that a valuation is carried out by an independent person as soon as possible after the resolution action or actions have been applied. Furthermore, Member states are required to ensure that if the valuation determines that any shareholder or creditor, or the deposit guarantee scheme, has incurred greater losses than it would have incurred in a winding up under normal insolvency proceedings, it is entitled to the payment of the difference from the resolution financing arrangements. Art. 34(1)(g), Art. 73 – 75 of the BRRD.

[751] The Bank of England's approach to assessing resolvability. A Policy Statement. Bank of England, London, July 2019. P. 4.

[752] Art. 31(2)(b) of the BRRD.

important legal provisions the context of which should be taken when interpreting the content of this resolution objective. The BRRD does not provide the definition of the public funds, though it defines the '*extraordinary public financial support*' as a "*State aid, or any other public financial support at supra-national level, which, if provided for at national level, would constitute State aid, that is provided in order to preserve or restore the viability, liquidity or solvency of a bank or of a group of which such a bank forms part*"[753].

The EU bank recovery and resolution legal framework include a number of legal provisions linked to the extraordinary public financial support. Namely, in the prevention and preparation stage, the legal provisions of the EU bank recovery and resolution legal framework are directly or indirectly support this objective. Namely, recovery and resolution plans should not assume access to extraordinary public financial support or expose taxpayers to the risk of loss[754]. What is more, a bank should be deemed resolvable without the assumption of any extraordinary public financial support (besides the use of the financing arrangements), any central bank emergency liquidity assistance and any central bank liquidity assistance provided under non-standard collateralisation, tenor and interest rate terms[755]. The MREL requirement should be determined without recourse to extraordinary public financial support other than contributions from resolution financing arrangements[756].

A valuation carried for the purposes of resolution should not assume any potential future provision of extraordinary public financial support or central bank emergency liquidity assistance or any central bank liquidity assistance provided under non-standard collateralisation, tenor and interest rate terms.

Furthermore, the requirement of an extraordinary public financial support could be an identification that the institution is failing or likely to fail. The legal framework sets that a bank should be considered to be failing or likely to fail not only when it infringes or is likely in the near future to infringe the requirements for continuing authorisation, when the assets of the institution are or are likely in the near future to be less than its liabilities when the institution is or is likely in the near future to be unable to pay its debts as they

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[753] Art. 2(1)(28) of the BRRD.
[754] Recital 31, Art. 3, Art. 10(3)(a), Art. 10(7)(i)(i), 12(3)(f) of the BRRD.
[755] Art. 15(1), Art. 16(1) of the BRRD.
[756] Art. 45c(5) of the BRRD.

fall due, but also when the institution requires extraordinary public financial support (except in the particular circumstances which will be discussed below)[757]. Though, the need for emergency liquidity assistance from a central bank should not, per se, be a condition that sufficiently demonstrates that an institution is or will be, in the near future, unable to pay its liabilities as they fall due.[758]

A need for the extraordinary public financial support (subject to certain exemptions) also forms part of the conditions for applying the resolution authorities power to write down or convert relevant capital instruments and eligible liabilities (into shares or other instruments of ownership of bank) either independently of resolution action or in combination with resolution actions where the conditions for resolution are met[759].

The extent to which the bank has previously benefited from extraordinary public financial support may impact the ex-ante contribution level to the resolution fund[760].

As we can see, there are a number of legal provisions with the BRRD which encourage to avoid the use of public funds and, in particular, extraordinary public financial support. However, in the recital, the BRRD also mentions that *"[i]n light of the consequences that the failure of an institution may have on the financial system and the economy of a Member State as well as the possible need to use public funds to resolve a crisis, the Ministries of Finance or other relevant ministries in the Member States should be closely involved, at an early stage, in the process of crisis management and resolution* <..>"[761]. Therefore, we could still raise a question to what extent, if at all, the use of public funds is still possible under the legal provisions of the BRRD and in line with the objective? Considering the legal provisions of the BRRD and a broader context, the of public funds could be discussed from a few perspectives, namely: i) the use of public funds in pre-resolution; and ii) the use of public funds in resolution. However, before going to this analysis, it is also important to discuss certain aspects of the state aid legal framework as they are relevant for both pre-resolution and resolution stages.

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[757] Recital 41, Art. 32(4)(d) of the BRRD.
[758] Ibid.
[759] Art. 59(3)(e) of the BRRD.
[760] Art. 103(7)(e) of the BRRD.
[761] Recital 16 of the BRRD.

2.4.1. Relevant state aid provisions

The Union '*State aid*' framework should be understood as established in Articles 107, 108 and 109 of the TFEU and all Union acts, including guidelines, communications and notices, made or adopted pursuant to Article 108(4) or Article 109 of the TFEU[762].

The EU state aid legal framework includes a general rules that *"<....> any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between the Member States, be incompatible with the internal market[763]*". However, the TFEU also foresees certain exemptions[764] to this general rule by stating, for example, that state aid should be allowed to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State. Furthermore, a Member State considering applying a state aid should inform and get approval from the EC[765].

The process of a notification to the EC as well as other procedural rules are defined in the Council Regulation (EU) 2015/1589[766], while notification forms, which shall be used for the notification of state aid to the EC, are set in the Commission Regulation (EU) 2015/2282[767].

Furthermore, it is important to highlight that with regard to the use of public funds through the state aid to the financial sector, the EC has introduced specific rules, namely, State aid rules to support measures in favour of banks

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[762] Consolidated version of the Treaty on the Functioning of the European Union - Protocols - Annexes - Declarations annexed to the Final Act of the Intergovernmental Conference which adopted the Treaty of Lisbon, signed on 13 December 2007. Official Journal C 326, 26/10/2012 P. 0001 – 0390. Art. 2(1)(53) of the BRRD.
[763] Art. 107(1) of the TFEU.
[764] Art. 107(2)(3) of the TFEU.
[765] Art. 108 of the TFEU.
[766] Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union (Text with EEA relevance). OJ L 248, 24.9.2015, p. 9–29.
[767] Commission Regulation (EU) 2015/2282 of 27 November 2015 amending Regulation (EC) No 794/2004 as regards the notification forms and information sheets (Text with EEA relevance). OJ L 325, 10.12.2015, p. 1–180.

in the context of financial crisis (the 'Banking Communication')[768]. The EC adopted those rules by stating that "*In its response to the financial crisis <…> financial stability has been the overarching objective for the Commission, whilst ensuring that State aid and distortions of competition between banks and across Member States are kept to the minimum. Financial stability implies the need to prevent major negative spill-over effects for the rest of the banking system which could flow from the failure of a credit institution as well as the need to ensure that the banking system as a whole continues to provide adequate lending to the real economy. Financial stability remains of central importance in the [EC's] assessment of State aid to the financial sector <…> [it] shall conduct its assessment taking account of the evolution of the crisis from one of acute and system-wide distress towards a situation of more fundamental economic difficulties in parts of the Union, with a correspondingly higher risk of fragmentation of the single market.*[769] Furthermore, more importantly the Banking Communication also states *"<…> That overarching objective is reflected not only in the possibility for banks in distress to access State aid when necessary for financial stability, but also in the way restructuring plans are assessed. In that respect it has to be underlined that financial stability cannot be ensured without a healthy financial sector*[770].

As a result, the Banking Communication also introduces the following tools[771]: i) recapitalisation and impaired assets rescue aid to address a capital

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[768] Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis (the 'Banking Communication'). Text with EEA relevance. OJ C 216, 30.7.2013, p. 1–15.

[769] Paragraph 7 of the Banking Communication.

[770] Paragraph 8 of the Banking Communication.

[771] As explained by the ECJ, the Banking Communication must be interpreted as meaning that it is not binding on the Member States. However, it also highlighted that the Banking Communication is not capable of imposing independent obligations on the Member States, but does no more than establish conditions, designed to ensure that State aid granted to the banks in the context of the financial crisis is compatible with the internal market, which the Commission must take into account in the exercise of the wide discretion that it enjoys under Article 107(3)(b) TFEU. See Paragraphs 44-45 of the Judgment of the Court (Grand Chamber), European Court of Justice, 19 July 2016. Tadej Kotnik and Others v Državni zbor Republike Slovenije.
Request for a preliminary ruling from the Ustavno sodišče Republike Slovenije. Reference for a preliminary ruling — Validity and interpretation of the Banking Communication from the Commission — Interpretation of Directives 2001/24/EC and 2012/30/EU — State aid to banks in the context of the financial crisis — Burden-sharing — Writing off equity capital, hybrid capital and subordinated debt — Principle of protection of

shortfall[772]; ii) guarantees and liquidity support outside the provision of central bank liquidity to temporarily stabilise the liability side of a bank's balance sheet[773]; iii) provision of liquidity by central banks and intervention of deposit guarantee schemes and resolution funds, which under certain circumstances may qualify as the State aid[774]; and iv) liquidation aid to encourage the exit of non-viable players in an orderly manner so as to preserve financial stability[775]. Application of these tools is subject to a burden-sharing rule, which means that losses firstly should be absorbed by equity (shareholders), contributions by hybrid capital holders and subordinated debt holders.

The Banking Communication and burden sharing rule (in case the tools foreseen in the Communication are applied) was introduced before the adoption of the EU bank recovery and resolution legal framework. At that time, it already raised shareholders' concerns that it infringes their property rights. Namely, the burden-sharing rule was assessed by the European Court of Justice (the 'ECJ') in its case Tadej Kotnik and Others v Državni zbor Republike Slovenije[776].

In 2013, five Slovenian banks, namely Nova Ljubljanska banka d.d., Nova Kreditna banka Maribor d.d., Abanka Vipa d.d., Probanka d.d. and Factor banka d.d., were showing capital shortfalls. Given the scale of those shortfalls, those banks did not have sufficient assets to satisfy their creditors and to cover the value of deposits. The Bank of Slovenia adopted decisions putting in place exceptional measures to affect the recapitalisation of the first two banks, the rescue of the third, and the winding up of the last two banks. Among other things, the court ruled out that the burden-sharing requirement does not

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legitimate expectations — Right to property — Protection of the interests of shareholders and others — Reorganisation and winding up of credit institutions. Case C-526/14.

[772] Part 3 of the Banking Communication.

[773] Part 4 of the Banking Communication.

[774] Paragraphs 62 – 64 of the Banking Communication.

[775] Part 6 of the Banking Communication.

[776] Judgment of the Court (Grand Chamber), European Court of Justice, 19 July 2016. Tadej Kotnik and Others v Državni zbor Republike Slovenije. Request for a preliminary ruling from the Ustavno sodišče Republike Slovenije. Reference for a preliminary ruling — Validity and interpretation of the Banking Communication from the Commission — Interpretation of Directives 2001/24/EC and 2012/30/EU — State aid to banks in the context of the financial crisis — Burden-sharing — Writing off equity capital, hybrid capital and subordinated debt — Principle of protection of legitimate expectations — Right to property — Protection of the interests of shareholders and others — Reorganisation and winding up of credit institutions. Case C-526/14.

infringe the principle of protection of legitimate expectations and the right to property of shareholders and subordinated creditors. The court made this conclusion based on the following arguments.

Firstly, the court noted that the objective of ensuring the stability of the financial system while avoiding excessive public spending and minimising distortions of competition constitutes an overriding public interest of that kind[777]. With regard to shareholders rights it highlighted that accordance with the general rules applicable to the status of shareholders of public limited liability companies, they must fully bear the risk of their investments[778]. Furthermore, considering that shareholders are liable for the debts of the bank up to the amount of its share capital, the court highlighted that a requirement, in order to overcome a bank's capital shortfall, prior to the grant of State aid, those shareholders should contribute to the absorption of the losses suffered by that bank to the same extent as if there were no State aid, cannot be regarded as adversely affecting their right to property[779].

As regards the subordinated creditors, the court kept the same reasoning and added that the '*no creditor worse off principle*' (which was also introduced in the BRRD) should be adhered to. In this context, this principle means that subordinated creditors should not receive less, in economic terms, than what their instrument would have been worth if no State aid were to be granted and the bank was put into the insolvency[780].

This court ruling is important as it confirms the legitimacy of the burden-sharing rule and no creditor worse of principle which are set not only in the Bank Communication but also in the BRRD (as the burden-sharing rules[781] and no creditor worse of principle[782] should be applied when the bail-in, write-down or conversion tools are applied, and when determining the amount of losses which could be imposed on shareholders and creditors).

In the following subchapters, the legal provisions linked to the use of public funds in pre-resolution and resolution stages will be discussed, as well as how the above-discussed state aid regime rules are linked to those legal provisions. Such analysis will provide a better understanding of the scope,

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[777] Paragraph 69 of the Case C-526/14.
[778] Paragraph 73 of the Case C-526/14.
[779] Paragraph 74 of the Case C-526/14.
[780] Paragraph 77 of the Case C-526/14.
[781] Art. 34(1)(a)(b) of the BRRD.
[782] Art. 34(1)(g) of the BRRD.

limits and implementation challenges of the legal objective – protection of public funds.

2.4.2. Remaining legal ways to use public funds in the recovery (pre-resolution) stage

As it was discussed, a need for the extraordinary public financial support is one of the conditions to consider that a bank is failing or likely to fail. However, the EU bank recovery and resolution legal framework also foresees an exception to the general rule by stating that the extraordinary public financial support could be used in order to remedy a serious disturbance in the economy of a Member State and preserve financial stability. In such case, extraordinary public financial support could take any of the following forms[783]; i) a state guarantee to back liquidity facilities provided by central banks according to the central banks' conditions; ii) a state guarantee of newly issued liabilities; or iii) precautionary recapitalisation.

With regard to liquidity facilities, the BRRD mentions that the need for emergency liquidity assistance from a central bank should not, per se, be a condition that sufficiently demonstrates that a bank is or will be, in the near future, unable to pay its liabilities as they fall due[784]. However, if that facility is guaranteed by a State, a bank accessing such a facility will be subject to the State aid framework[785]. Furthermore, the BRRD acknowledges that State guarantees on liquidity could be needed, in particular, in the case of a systemic liquidity shortage, or State guarantees of newly issued liabilities could be needed to remedy a serious disturbance in the economy of a Member State and therefore should not trigger resolution. While Member States guarantees for equity claims should be prohibited. When providing a guarantee for newly issued liabilities other than equity, a Member State should ensure that the guarantee is sufficiently remunerated by the institution[786].

The precautionary recapitalisation means an injection of own funds or purchase of capital instruments at prices and on terms that do not confer an advantage upon the bank, where neither the failing or likely to fail conditions (the bank does not and is not likely to, in the near future infringe the conditions

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[783] Art. 32(4)(d) of the BRRD.
[784] Recital 41 of the BRRD.
[785] *Ibid*.
[786] *Ibid.*

for authorisation, hold fewer assets than liabilities and fail to pay its debts as they fall due)[787] nor for the application of write down or conversion of capital instruments and eligible liabilities power[788] are met. A precautionary recapitalisation is limited to injections necessary to address capital shortfall established in the national, Union or SSM-wide stress tests, asset quality reviews or equivalent exercises conducted by the European Central Bank, EBA or national authorities, where applicable, confirmed by the competent authority. The important point is that these tools should be confined to solvent institutions and should be conditional on final approval under the Union *State aid legal framework*. What is more, these tools should be of a precautionary and temporary nature and should be proportionate to remedy the consequences of the serious disturbance and should not be used to offset losses that the bank has incurred or is likely to incur in the near future[789]. Finally, access to liquidity facilities, including emergency liquidity assistance by central banks may constitute State aid pursuant to the State aid framework.

Furthermore, the provision of extraordinary public financial support should not trigger resolution where, as a precautionary measure, a Member State takes an equity stake in a bank, including a bank which is publicly owned, which complies with its capital requirements[790]. This may be the case, for example, where a bank is required to raise new capital due to the outcome of a scenario-based stress test or of the equivalent exercise conducted by macroprudential authorities which includes a requirement that is set to maintain financial stability in the context of a systemic crisis, but the institution is unable to raise capital privately in markets. A bank should not be

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[787] As indicated in Art. 32(4)(a)(b)(c).

[788] Art. 59(3) of the BRRD.

[789] The EBA Guidelines further specify the main features of the types of tests, reviews or exercises that may lead to support measures. These features include a timeline, a scope, a time horizon and reference date, a quality review process, a common methodology and, where relevant, a macro-economic scenario and hurdle rates, as well as a timeframe to address the shortfall. These elements are designed to assist the supervisory authorities when they are conducting such tests, reviews and exercises where banks may not be able to address the capital shortfall resulting from the test, review or exercise and would, in that situation, be a potential candidate for resolution.
See Guidelines on the types of tests, reviews or exercises that may lead to support measures under Article 32(4)(d)(iii) of the Bank Recovery and Resolution Directive. EBA/GL/2014/09. EBA, London, 22 September 2014. [accessed on 10 December 2018] <https://eba.europa.eu/documents/10180/821335/EBA-GL-2014-09+%28Guidelines+on+Public+Support+Measures%29.pdf>.

[790] Recital 41 of the BRRD.

considered to be failing or likely to fail solely on the basis that extraordinary public financial support was provided before the entry into force of the EU bank recovery and resolution legal framework[791].

This exemption and tools introduce the possibility to use public funds in the pre-resolution stage. As a result, even though the conditions for the use of public funds through these tools are quite strict, a risk of the potential misuse, for example, by attempting to indirectly bail-out a bank in order to avoid its entering into resolution, remains. The precautionary recapitalisation tool, as it is foreseen in the BRRD, has already been used in the EU a few times in Greece and Italy. In Greece, the precautionary recapitalisation tool was applied with regard to Piraeus Bank and National Bank of Greece[792] for recapitalisations by the Hellenic Financial Stability Fund in 2015. In both cases, state aid was involved.

Recapitalisation with the State aid of EUR 2.72 billion was approved to Piraeus in the context of the third economic adjustment programme[793] for Greece[794]. The EC stated that "*additional public support and further implementation of bank's restructuring plan should enable it to return to [the] long-term viability and continue to support the recovery of the Greek economy*"[795]. In this case, also the burden-sharing rule set in the Banking Communication was applied as well. Considering this requirement and a big shortfall in capital, senior unsecured bondholders had to absorb losses as well[796]. Later in the year, on the same basis and conditions, a recapitalisation

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[791] Ibid.

[792] Recapitalisation of National Bank of Greece by the Hellenic Financial Stability Fund. State aid No SA.34824 (2012/C, ex 2012/NN) – Greece. EC, Brussels, 27 July 2012. [accessed on 12 December 2018] <https://ec.europa.eu/competition/state_aid/cases/245545/245545_1362474_28_2.pdf>.

[793] On the detailed analysis of the financial assistance programme for Greece see: ANGERER, J.; *et all*. Greece's financial assistance programme (March 2016). Directorate-General for Internal Policies. European Parliament, Brussels, 5 April 2016. [accessed on 15 November 2018] <http://www.europarl.europa.eu/RegData/etudes/IDAN/2016/574404/IPOL_IDA(2016)574404_EN.pdf>.

[794] Commission signs three-year ESM stability support programme for Greece. EC, Brussels, 20 August 2015. [accessed on 12 December 2018] <https://europa.eu/rapid/press-release_IP-15-5512_en.htm>.

[795] State aid: Commission approves aid for Piraeus Bank on the basis of an amended restructuring plan. EC, Brussels, 29 November 2015. [accessed on 12 December 2018] <https://europa.eu/rapid/press-release_IP-15-6193_en.htm>.

[796] DURAND, H. Piraeus debt holders face tough choice as recap gets underway. Reuters, London, 15 October 2015. [accessed on 14 November 2018] <

with the State aid of EUR 2.71 billion was also approved for National Bank of Greece[797]. These cases show that the EC acknowledges that when a bank is unable to raise capital privately in the market, public funds could be used for this purpose subject to the State aid provisions.

Precautionary recapitalisation instrument was also applied in Italy. Namely, on 4 July 2017, the EC announced the approval of the precautionary recapitalisation of Monte Dei Paschi di Siena bank[798] (the '**Monte Dei Paschi bank**') for a total amount of EUR 8.1 billion[799] on the basis of the restructuring plan. This was followed by a number of issues the bank was facing since 2008.

Already in 2009, the Monte Dei Paschi bank benefited from the Italian bank recapitalisation scheme[800] (Tremonti bonds for and amount of EUR 1.9 billion)[801] and the bank also benefited from liquidity support in the form of state guarantee. Though, in 2011, the stress test exercise performed by the EBA[802] identified the capital shortfall of EUR 3.3 billion. This followed by the state recapitalisation in the amount of EUR 4.1 billion in 'Monti bonds' (also reimbursing the Tremonti bonds) concluded in 2013[803]. In 2016 the bank share price fell more than 70% followed by information in media that the ECB requires substantially to reduce the bank's non-performing loans portfolio[804] as well as indication by the ECB that the bank's capital shortfall rise to EUR

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https://uk.reuters.com/article/piraeus-bank-bonds/update-2-piraeus-debt-holders-face-tough-choice-as-recap-gets-underway-idUKL8N12F1D020151015>.

[797] State aid: Commission approves aid for National Bank of Greece on the basis of an amended restructuring plan. EC. Brussels, 4 December 2015.

[798] State aid: Commission approves Italian recapitalisation scheme for financial institutions. IP/08/2019. EC, Brussels, 23 December 2008. [accessed on 17 November 2018] < https://europa.eu/rapid/press-release_IP-08-2059_en.htm?locale=en>.

[799] State aid No SA.36175 (2013/N) – Italy – Monte dei Paschi di Siena – Restructuring. C(2013) 8427 final. EC, Brussels, 27 November 2013.

[800] Ibid.

[801] Italy. Technical note on safety nets, bank resolution, and crisis management framework. IMF Country Report No. 13/350. IMF, Washington, June 2013. P. 21. [accessed on 17 November 2018] <https://www.imf.org/external/pubs/ft/scr/2013/cr13350.pdf>.

[802] 2016 EU wide Stress Test. Results. EBA, London, 29 July 2016 [accessed on 17 November 2018] <https://eba.europa.eu/documents/10180/1532819/2016-EU-wide-stress-test-Results.pdf>.

[803] Italy. Technical note on safety nets, bank resolution, and crisis management framework. IMF Country Report No. 13/350. IMF, Washington, June 2013. P. 21. [accessed on 17 November 2018] <https://www.imf.org/external/pubs/ft/scr/2013/cr13350.pdf>.

[804] BUCK, J. Italian Bank Stocks: No Rebound in Store. Barons, London, 16 July 2016. [accessed on 17 July 2018] < https://www.barrons.com/articles/italian-bank-stocks-no-rebound-in-store-1468641778>.

8.8 billion from 5 billion[805]. The same year the bank submitted request for liquidity support and the EC temporarily approved the aid (state guarantees for bonds issued by the bank) conditional upon the submission of a restructuring plan[806] (which was ultimately authorised on a definite basis). Finally, after banks failed private capital raising attempts to cover capital shortfall identified in the EBA stress test, in 2017 the EC approved the State aid amounting to EUR 5.4 billion[807] as a precautionary recapitalisation what means that it was considered that the bank surprisingly, did not meet failing or likely to fail conditions (as the EU bank recovery and resolution legal framework was already in force). Indeed, the EC noted that on 28 June 2017[808], the ECB sent a letter which stipulated that at 31 March 2017 – on a consolidated level – the Bank had a CET1-ratio of 6.46% and a total capital ratio of 8.89% the letter concluded that the Bank was solvent (at the day of sending the letter) from the point of view of compliance with the Pillar 1 minimum capital requirements[809]. However, the public version of the EC decision does not include a detailed analysis of all other failing or likely to fail conditions and, from the information provided in the decision it seems that the ECB did not refer to them in its letter as well. Interestingly, the ECB letter included a disclaimer that the bank was solvent at the day of sending the letter and from the point of view of compliance with the Pillar 1 minimum capital requirements. No information on the assessment of all failing or likely to fail conditions (even in the form of summary) is quite concerning, because as it

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[805] POLITI, J. Monte dei Paschi shortfall hits EUR 8bn, says ECB. Financial Times, Rome, December 2016. [accessed on 15 September 2018] <https://www.ft.com/content/60576ada-cbbd-11e6-864f-20dcb35cede2>.

[806] State Aid SA.47081 (2016/N) – Italy – Liquidity support to MPS bank. C(2016) 9032 final . EC, Brussels, 29 December 2016. [accessed on 18 November 2018] < https://ec.europa.eu/competition/state_aid/cases/267610/267610_1943800_75_2.pdf>.

[807] State Aid SA.47677 (2017/N) – Italy. New aid and amended restructuring plan of Banca Monte dei Paschi di Siena. C(2017) 4690 final. EC, Brussels, 4 July 2017. [accessed on 20 November 2018] < https://ec.europa.eu/competition/state_aid/cases/270037/270037_1951496_149_2.pdf>.

[808] While in on 23 December 2016, the Chair and the Vice-Chair of the Supervisory Board of the ECB sent a letter to the Italian authorities which said that at 30 September 2016 - on a consolidated level - the Bank had a Common Equity Tier 1 ratio of 11.49% and that the Bank was solvent at the day of sending the letter from the point of view of compliance with the minimum capital requirements. *Ibid.*, P.2.

[809] State Aid SA.47677 (2017/N) – Italy. New aid and amended restructuring plan of Banca Monte dei Paschi di Siena. C(2017) 4690 final. EC, Brussels, 4 July 2017. P. 6. [accessed on 20 November 2018] <https://ec.europa.eu/competition/state_aid/cases/270037/270037_1951496_149_2.pdf>.

was already mentioned, the BRRD explicitly says that it should be assessed whether those conditions are present at the time the public support is granted and if yes, precautionary recapitalisation could not be granted[810].

There was also a temptation to use precautionary recapitalisation for two other Italian banks, namely, Banca Popular di Vincenza and Veneto Banca in 2017. Initially, these banks made a request to the Italian State for a precautionary recapitalisation to address their capital shortfalls[811]. Ultimately, a precautionary recapitalisation via State aid was not issued as the ECB declared (on 23 June 2017) that both banks meet the conditions to be considered as failing or likely to fail[812]. However, interesting measures were applied before and after this decision.

On 11 April 2017, the Italian authorities submitted an individual notification to the EC asking to allow to grant liquidity aid to these two banks in the form of a State guarantee on newly issued liabilities[813]. The BRRD foresees that in order to remedy a serious disturbance in the economy of a Member State and preserve financial stability, the extraordinary public financial support could be provided in the form of a State guarantee of newly issued liabilities. Though, the following legal requirements should be met: i) the guarantee or equivalent measures should be confined to solvent bank; ii) it is conditional on final approval under the Union State aid framework; iii) such measure should be of a precautionary and temporary nature; iv) such measure should be proportionate to remedy the consequences of the serious disturbance; v) it should not be used to offset losses that the institution has incurred or is likely to incur in the near future[814].

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[810] Art. 32(4)(d)(iii) of the BRRD.

[811] State aid: Commission approves aid for market exit of Banca Popolare di Vicenza and Veneto Banca under Italian insolvency law, involving sale of some parts to Intesa Sanpaolo. EC, Brussels, 25 June 2017. [accessed on 20 November 2018] <https://europa.eu/rapid/press-release_IP-17-1791_en.htm>.

[812] 'Failing or Likely to Fail' Assessment of Veneto Banca Società per Azioni. ECB, Frankfurt, 23 June 2017. [accessed on 22 November 2018] <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.2017_FOLTF_ITVEN.en.pdf>. 'Failing or Likely to Fail' Assessment of Banca Popolare di Vicenza Società per Azioni. ECB, Frankfurt, 23 June 2017. [accessed on 22 November 2018] <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.2017_FOLTF_ITPVI.en.pdf>.

[813] State Aid SA. 47941 (2017/N) – Italy – Additional liquidity support to Veneto Banca. C(2017) 2559 final. EC, Brussels, 12 April 2017. P. 2. [accessed on 23 November 2018] <https://ec.europa.eu/competition/state_aid/cases/269148/269148_1978816_114_2.pdf>.

[814] Art. 32(4)(d) of the BRRD.

As regard, the solvency, on 30 March 2017, the SSM in its letter to the Italian authorities noted that Veneto Banca has a current Common Equity Tier 1 (CET1) capital of EUR 1.31 billion (ratio of 6.8%) and a total capital of EUR 1.67 billion (ratio of 8.7%) based on the latest CoREP data (available as of 31 December 2016). Considering this, the SSM stated that the Bank was solvent on the day of sending the letter from the point of view of compliance with the minimum capital requirements. Furthermore, the SSM letter also highlighted that the Bank reported a breach of capital requirements under Pillar 2 and the Combined Buffer Requirements is not yet restored[815]. It also highlighted that the Stress testing exercise of 2016 further revealed a significant depletion of the Bank's capital in the adverse scenario by the end of 2018 driving the Bank's CET1 ratio further below 8% (the capital shortfall in such scenario is EUR [2.5-5] billion)[816]. On the liquidity position, the SSM letter noted that it is rapidly deteriorating, driven mainly by important outflows occurred due to customers withdrawals between 7 and 21 March 2017[817]. To sum up, even though it was declared that the bank is solvent, its issues with the capital and liquidity were more than evident.

As regards the solvency of Banca Popolare di Vincenza, on 28 December 2016, the SSM letter set to the Italian authorities stated that on 30 September 2016 the Bank had a Common Equity Tier 1 ratio of 10.72% and that the Bank was solvent at the day of sending the letter from the point of view of compliance with the minimum capital requirements[818]. The letter stated that the Bank's consolidated capital fulfilled the requirements under Pillar 2 and the Combined Buffer Requirements[819]. As regards the SREP stress test, the letter confirmed that the Bank had no capital shortfall in the baseline scenario of the stress test, while having a capital shortfall in the adverse scenario (by the end of 2018) compared to a threshold of 8% CET1[820]. On the liquidity

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[815] State Aid SA. 47941 (2017/N) – Italy – Additional liquidity support to Veneto Banca. C(2017) 2559 final. EC, Brussels, 12 April 2017. Paragraph 10. [accessed on 23 November 2018]
<https://ec.europa.eu/competition/state_aid/cases/269148/269148_1978816_114_2.pdf>.
[816] *Ibid*., Paragraph 11.
[817] *Ibid*., Paragraph 12.
[818] State Aid SA.47149 (2016/N) – Italy – Liquidity support to Banca Popolare di Vicenza. C(2017) 331 final. EC, Brussels, 18 January 2017. Paragraph 6. [accessed on 23 November 2018]
<https://ec.europa.eu/competition/state_aid/cases/267517/267517_1978813_103_2.pdf>.
[819] *Ibid.*, Paragraph 6.
[820] Ibid.

position, the SSM noted that between 30 November and 21 December 2016 it rapidly deteriorated as evidenced by the significant drop of the counterbalancing capacity[821]. All this shows that compared with the Veneto Banca, the Banca Popolare di Vincenza with regard to its capital position was in a better situation.

Finally, with regard to the compliance with the above mentioned BRRD provisions the EC just noted that the requirements are met as the state aid is granted to the solvent banks, the guarantee granted is of temporary nature since its maturity is three years, and is of a precautionary nature, since it only covers newly issued liabilities, and it is proportionate to remedy the consequence of the serious disturbance[822] and is not meant to offset incurred or likely losses[823]. Based on this, on 18 January 2017, the EC made a decision that the liquidity support through the provisions of the State guarantee (amounting to EUR 10 billion) is, among other things, also compatible with the EU bank recovery and resolution legal framework requirements and approved it.

However, on 23 June 2017, the ECB declared that both discussed Italian banks met the conditions to be considered as failing or likely to fail. As a result, on 23 June 2017, the SRB, in its capacity as the EU resolution authority,

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[821] *Ibid.*, Paragraph 7.

[822] With regard proportionality to remedy the consequences of the serious disturbance in the case of Veneto Banca, the EC stated that the measure is appropriate to remedy a serious disturbance in the Italian economy. The objective of the measure is to strengthen the liquidity position of the Bank. The Commission observed that the Bank is facing a significant deterioration of its liquidity position since the beginning of March 2017. Hence, the provision of liquidity support to the Bank is an appropriate means to address the deterioration of the Bank's liquidity position, against the background of the assessment carried out by the SSM. State Aid SA. 47941 (2017/N) – Italy – Additional liquidity support to Veneto Banca. C(2017) 2559 final. EC, Brussels, 12 April 2017. Paragraph 36. [accessed on 23 November 2018] <https://ec.europa.eu/competition/state_aid/cases/269148/269148_1978816_114_2.pdf>.
With regard proportionality to remedy the consequences of the serious disturbance in the case of Banca Popolare, the EC noted the measure is appropriate to remedy a serious disturbance in the Italian economy. The objective of the measure is to strengthen the liquidity position of the Bank. The Commission observes that despite its capital position, the Bank is facing a significant deterioration of its liquidity position since November 2016. Hence, the provision of liquidity support to the Bank is an appropriate means to restore market confidence in the Bank. State Aid SA.47149 (2016/N) – Italy – Liquidity support to Banca Popolare di Vicenza. C(2017) 331 final. EC, Brussels, 18 January 2017. Paragraph 30. [accessed on 23 November 2018] <https://ec.europa.eu/competition/state_aid/cases/267517/267517_1978813_103_2.pdf>.

[823] State Aid SA.47149 (2016/N) – Italy – Liquidity support to Banca Popolare di Vicenza. C(2017) 331 final. EC, Brussels, 18 January 2017. Paragraph 44. [accessed on 23 November 2018]
<https://ec.europa.eu/competition/state_aid/cases/267517/267517_1978813_103_2.pdf>.

had to perform an analysis whether conditions for resolution were met, as the resolution authority could make a decision[824] to take resolution action only if it considers that all the conditions are met, namely: i) the determination that the bank is failing or is likely to fail[825]; ii) there are no alternative measures (e.g. private sector solutions, early intervention, the write-down or conversion of capital) what would prevent the failure of the bank within a reasonable timeframe[826]; and iii) a resolution action is necessary for the public interest[827]. Furthermore, when deciding on the application of resolution tools and powers, resolution authorities are obliged to have regard to the resolution objectives[828].

Following the ECB's failing or likely to fail assessment (which the ECB performed after consulting with the SRB), the SRB concluded that the banks are failing or likely to fail as there is material evidence to conclude that the banks infringe the requirements for continuing authorisation (in particular, the bank is in breach of capital requirements) in a way that would justify the withdrawal of the authorisation by the supervisory authority[829].

The SRB also concluded that there are no alternative measures, which could prevent the failure of the banks within a reasonable timeframe, there is no reasonable prospect that any alternative private sector measures could prevent the failure of the banks, there is no reasonable prospect that any supervisory action, including early intervention measures, could prevent the failure of the banks, the exercise of the power to write down or covert the

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[824] Decision of the Single Resolution Board in its Executive Session of 23 June 2017 concerning the assessment of the conditions for resolution in respect of Veneto Banca S.p.A (the 'Institution'), with the Legal Entity Identifier 549300W9STRUCJ2DLU64 addressed to Banca d'Italia in its capacity as National Resolution Authority. SRB/EES/2017/11. Non-confidential version. SRB, Brussels, 23 June 2017. Paragraph 3.1. [accessed on 22 November 2018] <https://srb.europa.eu/sites/srbsite/files/srb-ees-2017-11_non-confidential.pdf> (the '**SRB Decision on Veneto Banca**'); Decision of the Single Resolution Board in its Executive Session of 23 June 2017 concerning the assessment of the conditions for resolution in respect of Banca Popolare di Vicenza S.p.A. (the "Institution"), with the Legal Entity Identifier V3AFM0G2D3A6E0QWDG59, addressed to Banca d'Italia in its capacity as National Resolution Authority. SRB/EES/2017/12. Non-confidential version. SRB, Brussels, 23 June 2017. Paragraph 3.1. [accessed on 22 November 2018]. <https://srb.europa.eu/sites/srbsite/files/srb-ees-2017-12_non-confidential.pdf>. (the '**SRB Decision on Banca Popolare**').

[825] Art. 32(1)(a) of the BRRD, Art. 18(1)(a) of the BRRD.

[826] Art. 32(1)(b) of the BRRD, Art. 18(1)(b) of the BRRD.

[827] Art. 32(1)(c) of the BRRD, Art. 18(1)(c) of the BRRD.

[828] Art. 31(1) of the BRRD, Art. 17(1) of the SRM.

[829] Art. 2 of the SRB Decision on Veneto Banca, the SRB Decision on Banca Popolare. Art. 8(1)(a)(4) of the SRM and Art. 32(1)(a)(4) of the BRRD.

banks' capital instruments independently of any resolution action would not prevent the failure of the banks[830].

With regard to the third condition – public interest – it is worth to note that the EU bank recovery and resolution legal framework further specifies that a resolution action shall be treated as in the public interest if it is necessary for the achievement of and is proportionate to one or more of the resolution objectives (i.e. continuity of bank's critical functions, prevention of contagion and maintenance of market discipline, protection of public funds, protection of covered depositors and investors, and protection of client assets) and winding up of the bank under normal insolvency proceedings would not meet those resolution objectives to the same extent[831].

As regards the first resolution objective – continuity of critical functions – the SRB concluded that the functions performed by the banks (i.e. deposit-taking, lending, payment and cash services) are not critical since it is expected that a sudden disruption of those functions would not have a material negative impact on third parties, and neither would undermine the general confidence of market participants nor to give rise to contagion[832].

With regard to the second resolution objective, the SRB, after performing the analysis, concluded that considering the relatively low financial and operational interconnections with other financial institutions, an adverse impact (contagion) on other financial institutions and considerable spill-over effects to other intermediaries are regarded as highly unlikely; in particular, considering the minor importance of the banks for the Italian funding market, and the low score for interconnectedness[833]. Furthermore, the SRB also noted that a potentially adverse impact on retail customers and small and medium enterprises in certain regions cannot be excluded, though there should be no significant impact at national level as the market confidence is not likely to be affected given the already high visibility of the banks' difficulties and the decline in the banks' systemic relevance over the past years[834].

With regard to the third objective – protection of public funds by minimising reliance on extraordinary public finance support – the SRB noted

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[830] Art. 3 of the SRB Decision on Veneto Banca, the SRB Decision on Banca Popolare Art. 18(1)(b) of the SRM. Art. 32(1)(b) of the BRRD.
[831] Art. 32(5) of the BRRD, Art. 18(5) of the SRM.
[832] For further details see, Paragraphs 4.2.1 of the SRB Decision on Veneto Banca, the SRB Decision on Banca Popolare.
[833] Art. 4.2.2(c) of the SRB Decision on Veneto Banca, the SRB Decision on Banca Popolare.
[834] Art. 4.2.2.(d) of the SRB Decision on Veneto Banca, the SRB Decision on Banca Popolare.

that in case of normal insolvency proceedings, any pay-out by the DGS to the covered depositors would not qualify as an extraordinary public financial support. Though if any DGS funds are used to assist in the restructuring of the banks, including to finance the transfer of assets and liabilities to a purchaser in case of insolvency, these funds could qualify as a State aid and therefore, as extraordinary public financial support[835].

With regard to the fourth objective – protection of covered depositors and investors – the SRB concluded that national Italian insolvency proceedings could achieve this objective to the same extent as resolution. The same conclusion was made with regard to the fifth objective – protection of client funds.

Finally, the SRB concluded that while the conditions for resolution action with regard to determining that the banks are failing or likely to fail and that there are no alternative private measures and supervisory actions were met, the third condition – public interest – was not met as the resolution action is not necessary in the public interest, and stated that normal Italian insolvency proceedings would achieve the resolution objectives to the same extent as resolution since such proceedings would meet the resolution objectives to a comparable degree. Therefore, the SRB's decisions in respect of banks were addressed for implementation by Banca d'Italia in its capacity as a national resolution authority in order to wind-up banks under Italian insolvency proceedings.

As a result, Italy initiated the liquidation of the banks under the Italian Insolvency Law for Banks by applying compulsory administrative liquidation. Furthermore, Italy envisaged the use of State aid measures to allow the immediate sale out of the liquidation of assets and liabilities to Intesa Sanpaolo S.p.A., including staff and branches. What is more, Italy envisaged a State financed entity (asset management company) to purchase assets that were not included in the sale perimeter and left in the entities in insolvency[836]. In total, Italy requested state aid in the form of cash injections amounting to EUR 4.785 billion and state guarantee of a maximum of about EUR 12 billion.

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[835] Art. 4.2.2. of the SRB Decision on Veneto Banca and Art. 4.2.3 of the SRB Decision on Banca Popolare.

[836] State Aid SA. 45664 (2017/N) – Italy – Orderly liquidation of Banca Popolare di Vicenza and Veneto Banca - Liquidation aid. C(2017) 4501 final. EC, Brussels, 26 June 2017. Paragraph 7. [accessed on 22 November 2018] <https://ec.europa.eu/competition/state_aid/cases/264765/264765_1997498_221_2.pdf>.

Furthermore, Italian authorities noted that such aid is needed to avoid serious disturbance in the Italian economy. When requesting for such State aid, Italy relied on the Banking Communication, which foresees liquidation aid to encourage the exit of non-viable players in an orderly manner so as to preserve financial stability[837]. As a result, on 25 June 2017, Italy had to notify and request the EC's approval for the State aid.

Worth to note that Italian authorities argued that such aid is needed to avoid serious disturbance to the Italian economy and financial stability, which could be caused because of the failure of these banks. However, such reasoning seems to be contradictory to the SRB's assessment and conclusions. In particular, the SRB clearly concluded that banks do not perform critical functions which would be essential to the real economy and financial stability, an adverse impact (contagion) on other financial institutions and considerable spill-over effects to other intermediaries are regarded as highly unlikely, and that a potentially adverse impact on retail customers and small and medium enterprises in certain regions cannot be excluded, though there should be no significant impact at national level. Furthermore, according to the EC information as of 31 December 2016, Veneto Banca had around 400 branches and a market share in Italy of only around 1% in terms of both deposits and in loans, with EUR 28 bn of total assets. While the Banca Popolare had around 500 branches and a market share in Italy of only around 1% in terms of deposits and around 1.5% in terms of loans, with total assets of slightly below EUR 35 billion[838]. The EC acknowledged that these are small Italian commercial banks mainly operating in regional areas. Surprisingly, despite all the analysis performed by the EC and the SRB, the EC still authorised a State aid (public support) for the exit (!) from the market of these two banks[839].

The use of exceptions from the extraordinary public financial support restrictions in the form of a State guarantees, precautionary recapitalisation tool in the aftermath of the crisis to mop up losses at badly run banks or the

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[837] Part 6 of the Banking Communication.

[838] State aid: Commission approves aid for market exit of Banca Popolare di Vicenza and Veneto Banca under Italian insolvency law, involving sale of some parts to Intesa Sanpaolo. EC, Brussels, 25 June 2017. [accessed on 23 November 2018] < https://europa.eu/rapid/press-release_IP-17-1791_en.htm>.

[839] State Aid SA. 45664 (2017/N) – Italy – Orderly liquidation of Banca Popolare di Vicenza and Veneto Banca - Liquidation aid. C(2017) 4501 final. EC, Brussels, 26 June 2017. Paragraph 48. [accessed on 22 November 2018] <https://ec.europa.eu/competition/state_aid/cases/264765/264765_1997498_221_2.pdf>.

use national administrative liquidation proceedings relying on State aid even for the exit of failing banks from the market is quite concerning. In particular, considering the risk that these legal instrument and the State aid legal framework could potentially be used (in particular, under political pleasure) to justify the use of public funds when dealing with bank failures and may give wrong signals, undermine market discipline[840] as well as other ultimate objectives of the EU bank recovery and resolution legal framework.

Finally, the analysis of practical cases confirms that the use of public funds through the extraordinary financial support outside the resolution process is more flexible compared with the use of public funds in the actual resolution process.

2.4.3. Remaining legal ways to use public funds in the resolution stage

As we will see, the EU bank recovery and resolution legal framework acknowledge the use of funds from the Deposit Guarantee Schemes (the 'DGS') or resolution financing arrangements (resolution) funds in order to absorb losses that would have otherwise been suffered by covered depositors or discretionarily excluded creditors. It may be argued that the contributions to these funds are made by the private banks and, therefore, should not be considered to be public funds. However, here is important the EC position which highlighted that *"[w]hilst the funds in question may derive from the private sector, they may constitute aid to the extent that they come within the control of the State and the decision as to the funds' application is imputable to the State*"[841]. In that respect, the use of extraordinary public financial support, resolution financing arrangements (resolution funds) or DGSs to assist in the restructuring of failing bank in the resolution should comply with the relevant State aid provisions[842]. Considering the complexity of the legal framework, it is worth to discuss a bit more the legal provisions linked to the use of public funds.

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[840] This is also supported by the fact, that, for example, Italian Veneto banks' bonds rise on hopes that a state bailout deal is close by granting through the state aid which they have requested to stay in business. UPDATE 1-Veneto banks' bonds rise on hopes state bailout deal is close. Reuters, London, 4 April 2017. [accessed on 20 November 2018] <https://uk.reuters.com/article/italy-veneto-banks-bonds-idUKL5N1HC204>.

[841] Point 63 of the Banking Communication.

[842] Recital 55 of the BRRD.

The legal framework requires to establish financing arrangements (known as resolution funds) financed by the contributions from the banks which are authorised in the territory of the Member State. The funds from the financing arrangements could be used for the following purposes: i) to guarantee the assets or the liabilities of the bank under resolution, its subsidiaries, a bridge institution or an asset management vehicle; ii) to make loans to the bank under resolution, its subsidiaries, a bridge institution[843] or an asset management vehicle[844]; iii) to purchase assets of the bank under resolution; iv) to make contributions to a bridge institution and an asset management vehicle; v) to pay compensation to shareholders or creditors in case the final valuation shows that the principle of no creditor worse off was not respected and that shareholders or creditors have incurred greater losses compared to what they have incurred if the bank was wound-up under normal insolvency proceedings; vi) to make a contribution to the institution under resolution in lieu of the write-down or conversion of liabilities of certain creditors when the bail-in tool is applied, and the resolution authority decides to exclude certain creditors from the scope of bail-in; vii) to lend to other financing arrangements on a voluntary basis; and viii) to take any combination of the above-mentioned actions[845]. Furthermore, it is mandatory to use financing arrangements in accordance with the resolution objectives[846].

In particular, it is worth discussing a bit more the possibility to use financing arrangement when the bail-in tool is applied (as in general the idea of this tool is to avoid use of the public funds and ensure that losses are absorbed by the shareholders and other unsecured creditors of the bank), and the resolution authority decides to exclude certain creditors from the scope of bail-in. Firstly, it should be noted that strict conditions apply for such exclusions to be made by resolution authorities[847]. Secondly, the resolution

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[843] Art. 40(2)(a) of the BRRD.
[844] Art. 42(2)(a) of the BRRD.
[845] Art. 101 of the BRRD.
[846] Art. 100(1) of the BRRD.
[847] A resolution authority are allowed to make such exclusions only in exceptional circumstances, where the bail-in tool is applied, and where: i) it is not possible to bail-in that liability within a reasonable time notwithstanding the good faith efforts of the resolution authority; ii) the exclusion is strictly necessary and is proportionate to achieve the continuity of critical functions and core business lines in a manner that maintains the ability of the institution under resolution to continue key operations, services and transactions; iii) the exclusion is strictly necessary and proportionate to avoid giving rise to widespread contagion, in particular as regards eligible deposits held by natural persons and micro, small and medium sized

financing arrangement may make a contribution only when the losses that would have been borne by excluded liabilities have not been passed on fully to other creditors. Though in all cases such contribution could be made only when: a) a contribution to loss absorption and recapitalisation equal to an amount not less than 8 % of the total liabilities including own funds of the bank under resolution, measured at the time of resolution action in accordance with the provided valuation[848], has been made by the shareholders and the holders of other instruments of ownership, the holders of relevant capital instruments and other bail-inable liabilities through write down, conversion or otherwise[849]; and b) the contribution of the resolution financing arrangement does not exceed 5 % of the total liabilities including own funds of the institution under resolution, measured at the time of resolution action in accordance with the provided valuation[850]. The legal framework also foresees that in extraordinary circumstances, the contribution of the resolution financing arrangements could exceed 5 % limit, but only if all unsecured, non-preferred liabilities, other than eligible deposits, have been written down or converted in full[851].

If all the above-mentioned conditions are met, a contribution could be made to: i) cover any losses which have not been absorbed by bail-inable liabilities and restore the net asset value of the institution under resolution to zero; and/or ii) purchase shares or other instruments of ownership or capital instruments in the institution under resolution, in order to recapitalise the bank[852].

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enterprises, which would severely disrupt the functioning of financial markets, including of financial market infrastructures, in a manner that could cause a serious disturbance to the economy of a Member State or of the Union; or iv) the application of the bail-in tool to those liabilities would cause a destruction in value such that the losses borne by other creditors would be higher than if those liabilities were excluded from bail-in. With regard to the details for interpretation and application of these provisions see: Commission Delegated Regulation (EU) 2016/860 of 4 February 2016 specifying further the circumstances where exclusion from the application of write-down or conversion powers is necessary under Article 44(3) of 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. C/2016/0379. OJ L 144, 1.6.2016, p. 11–20; prepared on the basis of BALCIUNAS, L.; *et all*. Technical advice on the delegated acts on the circumstances when exclusions from the bail-in tool are necessary. EBA/op/2015/07. EBA, London, 6 March 2015.

[848] Under Article 36 of the BRRD.

[849] Art. 44(5)(a) of the BRRD.

[850] Art. 44(5)(b) of the BRRD.

[851] Art. 44(7) of the BRRD.

[852] Art. 44(4) of the BRRD.

Finally, it is worth to note that where the exclusion would require a contribution by the resolution financing arrangement or an alternative financing source, the EC may, within 24 hours of receipt of such a notification, or a longer period with the agreement of the resolution authority, prohibit or require amendments to the proposed exclusion if the requirements are not met in order to protect the integrity of the internal market (this is without prejudice to the application by the EC of the Union State aid framework)[853].

As it can be seen, the conditions for the use of the resolution financing arrangements are quite strict under the EU bank recovery and resolution legal framework, and, in particular, strict with regard to the use of such arrangements when the exclusion of certain liabilities from the bail-in has been made.

Another aspect, which should be discussed is to what extent the use of funds from the DGSs is allowed to be used in the resolution. Firstly, it is worth highlighting that paragraph 63 of the Banking Communication states that *"[i]nterventions by [DGSs] to reimburse depositors in accordance with Member States' obligations under Directive <...> on deposit-guarantee schemes do not constitute State aid. However, the use of those or similar funds to assist in the restructuring of credit institutions [recovery stage] may constitute State aid*". Therefore, before the envisaged use of the DGS funds, it should be communicated to the EC in order to clear out the possible State aid issue.

The EU legal framework mentions that the DGSs funds could be used when: i) the bail-in tool is applied, to the amount by which covered deposits would have been written down in order to absorb the losses in the bank, had covered deposits been included within the scope of bail-in and been written down to the same extent as creditors with the same level of priority under the national law governing normal insolvency proceedings[854]; or ii) when one or more resolution tools other than the bail-in tool is applied, to the amount of losses that covered depositors would have suffered, had covered depositors suffered losses in proportion to the losses suffered by creditors with the same level of priority under the national law governing normal insolvency proceedings[855].

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[853] Art. 44(12) of the BRRD and Paragraph 64 of the Banking Communication.
[854] Art. 109(1)(a) of the BRRD.
[855] Art. 109(1)(b) of the BRRD.

In all cases, the liability of the deposit guarantee scheme shall not be greater than the amount of losses that it would have had to bear had the institution been wound up under normal insolvency proceedings[856]. If after the valuation it is determined that the DGS contribution to resolution was greater than the net losses it would have incurred had the institution been wound up under normal insolvency proceedings, the deposit guarantee scheme should be entitled to the payment of the difference from the resolution financing arrangement[857]. What is more, is worth to note that where a DGS makes payments in the context of resolution proceedings, including the application of resolution tools or the exercise of resolution powers[858], the DGS has a right to put a claim against the relevant credit institution for an amount equal to its payments[859]. In such case, a claim should be ranked at the same level as covered deposits under national law governing normal insolvency proceedings[860].

The EU bank recovery and resolution legal framework in the resolution stage foresees a possibility to provide extraordinary public financial support through the government financial stabilisation tools (though these measures are foreseen only outside the Banking Union) which include; i) public equity support tool; and ii) temporary public ownership tool. These tools were not foreseen in the initial draft of the BRRD issued by the EC[861] and were added by the European Parliament. The Council was quite concerned with the introduction of these tools arguing that without strict conditions such instruments open the doors for continuous use of bailouts. Finally, an agreement was reached between the European Parliament, the Council (represented Lithuanian Presidency to the European Council team[862]) and the EC during the political trilogues[863] after agreeing how to strengthen the

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856 Art. 109(1) of the BRRD.
857 Art. 109(1) last paragraph of the BRRD.
858 As foreseen under Art. 11 of the DGSD and Art. 109 of the BRRD.
859 Art. 9(1) of the DGSD.
860 *Ibid.*
861 Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010. COM/2012/0280 final - 2012/0150 (COD).
862 Author worked as a Senior Legal Expert before and during the negotiations.
863 Deal reached on bank "bail-in directive". Press Release. EP, Brussels, 12 December 2013. [accessed on 15 September 2016] <http://www.europarl.europa.eu/news/en/press-room/20131212IPR30702/deal-reached-on-bank-bail-in-directive>; Some publicly disclosed

safeguards for the use of these tools only as a last resort. Namely, it was agreed that these tools could be used only in the very extraordinary situation of a systemic crisis and when the following conditions are met: i) a contribution to loss absorption and recapitalisation equal to an amount not less than 8 % of total liabilities including own funds of the institution under resolution, measured at the time of resolution action in accordance with the provided valuation[864], has been made by the shareholders and the holders of other instruments of ownership, the holders of relevant capital instruments and other bail-inable liabilities through write down, conversion or otherwise[865]; ii) the use of extraordinary public financial support through these tools is conditional on prior and final approval under the Union State aid legal framework[866].

This analysis shows that the use of DGS funds in resolution is quite limited, what contributes to the idea that the main source of public support available in resolution should be the resolution financing arrangements (resolution fund). The conditions for the use of funds from the resolution financing arrangements (in particular, in bail-in) is quite strict. However, it is also worth to note that in case other types of public indirect financial support schemes (which are not explicitly mentioned in the EU bank recovery and resolution legal framework) would be designed, for example, the transfer of assets to a publicly funded asset management company (has been applied in Italy) or bridge bank at a price above market value - such measures should be subject to requirements and procedures for compliance with the Union State aid rules.

On the basis of the performed analysis, it could be concluded that the use of public funds either before the resolution or during the resolution process is not completely eliminated from the BRRD and has already been applied in practice. It is worth noting that the legal rules linked to the application of the public fund in the resolution are more restrictive (in particular, with regard to the level of burden-sharing) compared to the legal provisions allowing the use of public funds before the resolution. Furthermore, subject to certain legal restrictions outside the Banking Union, public funds could be used through

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information on the actual the issues faced during the negotiations see: Dutch banking revolt: Dijsselbloem vs Borg round II. FT, London, 16 December 2013. [accessed on 21 November 2018] <https://www.ft.com/content/47523d56-d8c7-3f2a-a923-abd020ecd1b2>.

[864] Under Art. 36 of the BRRD.

[865] Art. 37(10)(a) of the BRRD.

[866] Art. 37(10)(b) of the BRRD.

the extraordinary public financial support. Finally, it is important to keep in mind that the use of the public funds through the extraordinary public financial support, the DGSs and/or the resolution financing arrangements should usually be compliant with the Union State aid legal framework.

2.5. Protection of covered deposits and investors

The fourth resolution objective[867] is to protect depositors *covered* by deposit guarantee schemes under Directive 2014/49/EU (the '**DGS**') [868] and investors covered by Directive 97/9/EC (the '**ICSD**') [869].

2.5.1. Protection of covered deposits

It is worth noting that the DGS schemes work not only as an instrument for the protection of depositors' deposits by providing pay-outs up to the insured amount in case the bank is put into insolvency. Being one of the financial safety-net elements, the DGS schemes aim to prevent runs on individual banks by depositors as well as to disincentivise them from withdrawing deposits when banks face turbulent times. What is more, in the academic literature it is also argued that the DGS schemes limit losses to depositors in the event of bank failure and reduces the risk that a run on one bank might undermine confidence in others through a contagion effect[870].

The first part of the objectives is linked to the protection of '*covered depositors'*. According to the DGS, the '*depositor*' is understood as the holder or, in the case of a joint account, each of the holders, of a deposit[871]. The '*deposit*' means a credit balance which results from funds left in an account or from temporary situations deriving from normal banking transactions and which a credit institution is required to repay under the legal and contractual conditions applicable, including a fixed-term deposit and a savings deposit

[867] Art. 31(2)(c) of the BRRD2.
[868] Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes Text with EEA relevance. OJ L 173, 12.6.2014, p. 149–178.
[869] Directive 97/9/EC of the European Parliament and of the Council of 3 March 1997 on investor-compensation schemes. OJ L 84, 26.3.1997, p. 22–31.
[870] BERGER, A.; MOLYNEUX, P.; WILSON, J. The Oxford Handbook of Banking. Second Edition. Oxford University Press, Oxford, 2015, P. 15.
[871] Art. 2(1)(6) of the DGS.

subject to certain restrictions[872]. As a general rule, the *maximum coverage level*[873] for the aggregate deposits of each depositor is restricted to EUR 100 000[874] in the EU. It is important to note that this is a maximum harmonisation legal provision which restricts the Member States from introducing unlimited or different coverage[875]. This was not the case under the first DGSD[876] which was a minimum harmonisation directive and only required Member States to have a deposit guarantee scheme for at least 90% of the deposited amount, up to at least EUR 20 000 per person[877]. As a result, in the recent financial crisis, uncoordinated increases in coverage across the EU have in some cases led to depositors transferring money to credit institutions in countries where deposit guarantees were higher and drained liquidity from banks in times of stress. In times of stability, it is possible that different coverage leads to depositors choosing the highest deposit protection rather than the deposit product best suits them, resulting in competitive distortions in the Single Market. Therefore, when adopting the new DGSD, it was decided to ensure a harmonised level of deposit protection by all recognised DGSs, regardless of where the deposits are located in the EU[878]. As regards the maximum coverage

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[872] This excludes credit balance where: i) its existence can only be proven by a financial instrument as defined in Article 4(17) of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ L 145, 30.4.2004, p. 1.), unless it is a savings product which is evidenced by a certificate of deposit made out to a named person and which exists in a Member State on 2 July 2014; ii) its principal is not repayable at par; and iii) its principal is only repayable at par under a particular guarantee or agreement provided by the credit institution or a third party. See Art. 2(1)(3) of the DGS.

[873] Art. 6(1) of the DGSD.

[874] Though, the DGSD also foresees that certain types of deposits should be protected above EUR 100 000 for at least three months and no longer than 12 months. Namely, this applies to deposits resulting from real estate transactions relating to private residential property, deposits that serve social purposes laid down in national law and are linked to particular life events of a depositor such as marriage, divorce, retirement, dismissal, redundancy, invalidity or death; deposits that serve purposes laid down in national law and are based on the payment of insurance benefits or compensation for criminal injuries or wrongful conviction. See Art. 6(2) of the DGSD.

[875] The recent financial crisis illustrates that a flawed deposit insurance system might cause more harm than good, if moral hazard created by the insurance results in excessive risk-taking or recklessness on the part of banks. BERGER, A.; MOLYNEUX, P.; WILSON, J. Oxford Handbook of Banking, Second Edition. Oxford University Press, Oxford, 2015, P. 16.

[876] Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes. OJ L 135, 31.5.1994, p. 5–14.

[877] Art. 7 of the first DGSD.

[878] See recital 19 of the DGSD.

amount, it was calculated that the EU expanded coverage limit to EUR 100 000 is estimated to cover 98% of all depositors and 60% of the value of all deposits. For example, in the U.S. where the coverage limit was raised from USD 100 000 dollars to USD 250 000 dollars, it was calculated that 99.8% of depositors and 78% of the value of deposits would be provided protection[879] and, therefore, should limit intention to withdraw deposits during the banking crisis.

As can be seen, deposits exceeding the covered limit of EUR 100 000 are not a relevant consideration for the purpose of determining whether this objective is met. However, with regard to depositors' protection, it is important to note that eligible deposits above the covered level do have special treatment under the BRRD - they do benefit from the priority ranking and may be excluded from the application of the bail-in tool in exceptional circumstances[880]. The '*priority ranking*' means that eligible deposits from natural persons and micro, small and medium-sized enterprises (the 'SMEs') which exceeds the coverage level of EUR 100 000, and deposits from natural persons and the SMEs that would be eligible for protection were they not made through branches located outside the EU, should have a higher ranking than the claims of ordinary unsecured creditors[881]. What is more, 'covered deposits' and deposit guarantee schemes benefit from even higher ranking than the mentioned eligible deposits[882]. Such ranking of deposits means that the majority of depositors will not be ranked *pari-passu* with senior creditors, as a result of which the senior creditors may be required to absorb losses without imposing them on the depositors. Furthermore, as a result of such special treatment in resolution, uncovered but eligible depositors' recoveries may be increased substantially.

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[879] Handlining of Systemic Cries. Research Paper. International Association of Deposit Insurers. October 2012. P. 23. [accessed on 16 March 2018] <https://www.iadi.org/en/assets/File/Papers/Approved%20Research%20-%20Discussion%20Papers/IADI_Research_Paper-Handling_of_Systemic_Crises-Final_201210(2012-12_to_IADI).pdf>; HOELSCHER, David S. Deposit Insurance Policies and the Financial Crisis. Paper presented at 2011 IADI Research Conference, Basel, June 2011.

[880] Art. 44(3)(c) of the BRRD and BALČIUNAS, L; at all. Technical advice on the delegated acts on the circumstances when exclusions from the bail-in tool are necessary. European Banking Authority, London, 6 March 2015. [accessed on 2 March 2018] <https://eba.europa.eu/documents/10180/983359/EBA-Op-2015-07+Tehcnical+Advice+on+exclusion+from+the+bail-in+tool.pdf>

[881] Art. 48(1)(e) and 108 of the BRRD.

[882] Art. 108(1)(b) of the BRRD.

2.5.2. Protection of covered investors

The second part of the objective is linked to the protection of '*covered investors'*. The '*investor*' is defined by the ICSD as any person who has entrusted money or instrument to an investment firm in connection with investment business[883]. The idea of the ICSD is to provide for investors receiving investment services from investment firms (including credit institutions) a right of compensation in specific circumstances where the firm is unable to return money or financial instruments that it holds on the client's behalf. With regard to the compensation limits, the situation is more complex across the EU compared with the DGSD case. According to the ICSD, Member States should ensure that investor protection schemes provide for a cover of not less than EUR 20 000 for each investor[884]. As a result, a maximum compensation amount varies across the Member States, from the maximum of EUR 20 000 compensation in most Member States (e.g. Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, Germany, Hungary, Ireland, Italy, Latvia, Luxembourg, Malta, Netherlands, Romania) to a few (Lithuania, Poland, Slovenia up to EUR 22 000, Portugal up to EUR 25 000, Greece up to EUR 30 000, Sweden up to SEK 250 000) with a compensation slightly in excess of the minimum compensation level set in the ICSD[885]. Three Members States (the UK gradually increased up to GBP 85 000[886], France up to EUR 70 000, Spain has increased, as a result of the financial crisis, the coverage level of investor-compensation from EUR 20 000 to EUR 100 000 in October 2008) provides for significantly higher coverage[887]. Finally, one Member States (Slovakia) provides a scheme which

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[883] Art. 1(4) of the ICSD.
[884] Art. 4 of the ICSD.
[885] Commission Staff Working Document. Impact Assessment. Accompanying document to the Proposal for a Directive of the European Parliament and of the Council amending Directive 1997/9/EC on investor-compensation schemes. COM(2010)371. P. 101. [accessed on 25 March 2017] <https://ec.europa.eu/smart-regulation/impact/ia_carried_out/docs/ia_2010/sec_2010_0845_en.pdf>
[886] See the Financial Conduct Authority information [accessed on 28 April 2018] <https://www.fscs.org.uk/what-we-cover/>
[887] Commission Staff Working Document. Impact Assessment. Accompanying document to the Proposal for a Directive of the European Parliament and of the Council amending Directive 1997/9/EC on investor-compensation schemes. COM(2010)371. P. 101. [accessed on 25 March 2017] <https://ec.europa.eu/smart-regulation/impact/ia_carried_out/docs/ia_2010/sec_2010_0845_en.pdf>

compensates for 100% of the value of the client's assets[888]. Contrary to the DGSD case, these divergences across the EU have not been resolved yet.

To sum up, the fourth resolution objective aims to ensure public confidence of covered depositors and investors by stating that they are protected in resolution as if they were protected in case the institution was put into insolvency. Though contrary to the insolvency proceedings where such protection is ensured through the fast pay-out to covered depositors and investors, in the case of resolution this protections is ensured by the continuity of bank's critical functions and, for example, transfer of eligible deposits to private sector purchaser (for example, by applying the sale of business tool or using other resolution actions). What is more, even though this objective talks only about the *covered* depositors and investors, as it can be seen the BRRD introduces special ranking of eligible depositors and deposit guarantee schemes, which, as a result, may increase their chances to recover the amounts above the covered level. Such special treatment does not apply to the investors, and their maximum protection is harmonised by the EU legal framework to a limited extent and varies greatly across the Member States.

2.6. Protection of client funds and client assets

The fifth legal resolution objective requires to protect client funds and assets[889]. The FSB KA 4.1 states that the legal framework governing the segregation of client assets should be clear, transparent and enforceable during a crisis or resolution of firms and should not hamper the effective implementation of resolution measures. Annex III to the FSB KA further notes that effective resolution regimes should allow for the rapid return of segregated client assets or the transfer to a performing third party or bridge institution of the client asset holdings[890]. The FSB also acknowledges that

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[888] Commission Staff Working Document. Impact Assessment. Accompanying document to the Proposal for a Directive of the European Parliament and of the Council amending Directive 1997/9/EC on investor-compensation schemes. COM(2010)371. P. 101. [accessed on 25 March 2017] <https://ec.europa.eu/smart-regulation/impact/ia_carried_out/docs/ia_2010/sec_2010_0845_en.pdf>

[889] Art. 31(2)(e) of the BRRD.

[890] Client Asset Protection in Resolution. II-Annex 3. Excerpt from Key Attributes of Effective Resolution Regimes for Financial Institutions. FSB, Basel, 2014. [accessed on 5 January 2019] <https://www.fsb.org/wp-content/uploads/II-Annex-3-Protection-of-Client-Assets-in-Resolution.pdf>.

national regimes for client asset protection vary significantly across the jurisdictions[891].

The EU bank recovery and resolution legal framework does not include a definition of client assets or funds. Though, client assets and funds are excluded from bail-in. More specifically, the BRRD explicitly provides that the write-down or conversion powers should not be provided to any liability that arises by virtue of the holding by the institution of client assets or client money including client assets or client money held on behalf of UCITS[892] or of AIFs[893], as such a client is it any case protected under the insolvency law. In particular, here are relevant the provisions of Directive 2014/65/EU (the '**MiFID II**')[894] as it sets that an investment firm should, when holding financial instruments belonging to clients, make adequate arrangements so as to safeguard the ownership rights of clients, especially in the event of the investment firm's insolvency, and to prevent the use of a client's financial instruments on own account except with the client's express consent[895]. What is more, an investment firm, when holding funds belonging to clients, should make adequate arrangements to safeguard the rights of clients and, except in the case of credit institutions, prevent the use of client funds for its own

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[891] The FSB notes that client asset protection regimes fall into a number of broad categories which have been classified by IOSCO as 'custodial regimes', 'trust regimes' and 'agency regimes, based on the legal nature of the relationship between the firm and its clients with respect to client assets. Those differences are likely to affect the legal nature of the client's rights to its assets, the way in which those rights are protected by the regime and the treatment in insolvency. Moreover, the definition of a 'client asset' that is subject to a particular form of protection and rights for the client varies across jurisdictions. See Introduction to the Final Report of the IOSCO Technical Committee on Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets. IOSCO, March 2011; Client Asset Protection in Resolution. II-Annex 3. Excerpt from Key Attributes of Effective Resolution Regimes for Financial Institutions. FSB, Basel, 2014. [accessed on 5 January 2019] <https://www.fsb.org/wp-content/uploads/II-Annex-3-Protection-of-Client-Assets-in-Resolution.pdf>.

[892] as defined in Article 1(2) of Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (Text with EEA relevance). *OJ L 302, 17.11.2009, p. 32–96.*

[893] as defined in point (a) of Article 4(1) of Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 Text with EEA relevance.

[894] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU Text with EEA relevance. OJ L 173, 12.6.2014, p. 349–496.

[895] Art. 16(8) of the MiFID.

account[896]. Moreover, an investment firm should not conclude title transfer financial collateral arrangements with retail clients for the purpose of securing or covering present or future, actual or contingent or prospective obligations of clients[897]. Finally, the MiFID allows the Member States to impose additional requirements on investment firms concerning the safeguarding of client assets[898]. Investment firms do fall under the scope of the BRRD, and therefore these legal provisions are relevant to them.

Another important aspect for the analysis of this legal framework objective is that it has to be read in the context of the legal distinction made throughout the BRRD between covered deposits, deposits that exceed the coverage level (uncovered deposits) and other types of liabilities that arise by virtue of the holding by a bank of 'client assets or client money'[899] and the broader financial regulatory regime what stipulates that deposits exceeding the covered deposit limit do not qualify as client funds or assets as this is a different legal category. Accordingly, the impact of insolvency on deposits above the covered deposit limit is not a relevant consideration for the purpose of determining whether the client assets objective is met.

To sum up, the fourth legal resolution objective – to protect client funds and client assets – should be considered and applied not only keeping in mind the BRRD provisions but also taking into account the legal provisions of the broader financial regulatory regime, in particular, the MiFID II that protects assets and funds belonging to clients in connection with investment business. Finally, important to note that the uncovered deposits do not fall under this objective and are not relevant for the consideration of this objective.

2.7. An Overview and Conclusions of the Second Part

The EU bank recovery and resolution legal framework lists five legal resolution objectives: i) to ensure the continuity of critical functions; ii) to avoid a significant adverse effect on the financial system, in particular by preventing contagion, including to market infrastructures, and by maintaining market discipline; iii) to protect public funds by minimising reliance on

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[896] Art. 16(9) of the MiFID.
[897] Art. 16(10) of the MiFID.
[898] Art. 16(11) of the MiFID.
[899] See recital (111), Article 44(2)(a) and (c), as well as the last but one subparagraph of the same Article, and Article 108 of the BRRD.

extraordinary public financial support; iv) to protect covered depositors and investors; and v) to protect client funds and client assets.

However, even though the resolution objectives do play a vital role in the BRRD and explain the aims of the whole legal framework, their content is not further specified in the BRRD. What is more, a literal reading of the legal framework may wrongly stipulate that these objectives are linked only to the stage of resolution (i.e. determination of resolution conditions and application of resolution actions). Logic-systemic analysis of legal provisions and the content of those objectives allows arguing that such an approach would be too narrow. The BRRD different stages are all interlinked to each other, and if the provisions linked to recovery and resolution planning, resolvability assessment, early intervention measures, determination of MREL would not be considered taking into account the resolution objectives, this may question how at all they could be achieved. Only by looking into the whole legal framework and linking the legal norms with the resolution objectives, we can better understand their content and the whole system. Furthermore, the EU bank recovery and resolution legal framework does have links with other parts of the financial safety-net elements. Therefore, in order to achieve the objectives of the legal framework, other participants of the financial safety-net should also take due regard of them that relevant policies and procedures would not undermine but rather help to achieve them and vice versa.

The legal framework states that the resolution objectives are of equal significance, though subject to different provisions of the BRRD and resolution authorities are obliged to balance them as appropriate to the nature and circumstances of each case. The in-depth analysis allows arguing that the first objective – to ensure the continuity of critical functions – is one of the most important and complex. Other objectives are linked to it and support this objective. The first legal resolution objective – the continuity of critical functions (which are essential to the real economy and financial stability) – cannot be assessed without understanding the legal concept of critical functions which plays a crucial role in the EU bank recovery and resolution legal framework. Namely, each step, whether it was recovery planning, resolution planning, identification of resolution objectives or application of resolution tools and powers, relates to the legal concept of critical functions and therefore the provisions of the EU bank recovery and resolution legal framework should be applied keeping in mind this concept.

Furthermore, the legal concept of critical functions has to be assessed together with other interlinked key elements such as core business lines,

critical services, critical FMI services and operational continuity arrangements. This concept at the global level is defined by the global standards (i.e. Key Attributes and FSB relevant Guidance), at the EU level by the BRRD, the SRM and the second level legal acts (i.e. Commission Delegated Regulations). However, not all of these elements (such as critical FMI services and operational continuity arrangements) which are defined at the global level are defined in the EU binding level one or level two legal acts. Such a situation creates a risk of potential inconsistencies when implementing the legal framework in the Single Market. Therefore, the EU legislators should consider their actual incorporation into the EU binding legal framework in order to ensure greater harmonisation across the EU in future.

The second legal resolution objective – prevention of contagion and maintenance of market discipline – is linked to the first objective as, the discontinuation of critical functions (and protection of market infrastructure which is essential for the continuity of bank's critical functions) may give rise to contagion and have significant adverse effect on the financial system. The first resolution objective and the BRRD requirements linked to the identification, mapping, protection and continuity of bank's critical functions should ensure that authorities do have a better understanding of individual bank's critical functions, their importance to the real economy and financial stability, and are able to limit the potential risk of contagion by being ready to ensure the continuity of such functions during the resolution. With regard to the prevention of contagion, it should also be noted that the contagion to a certain extent is unavoidable as the BRRD requires in resolution shareholders and other creditors always to bear losses. Ultimately, not only authorities but also market participants should get used to the new game rules and new 'standard' situation. Though challenges are expected during the transitional stage.

The third resolution objective – protection of public funds – encourages to minimise the use of public funds for the achievement of continuity of the bank's critical functions. Though in this context worth to note that on the basis of the performed analysis, it could be concluded that the use of public funds either before the resolution or during the resolution process is not entirely eliminated from the BRRD and has already been applied in practice. It is worth noting that the legal rules linked to the application of the public fund in the resolution are more restrictive (in particular, with regard to the level of burden-sharing) compared to the legal provisions allowing the use of public funds before the resolution. Furthermore, subject to certain legal restrictions

outside the Banking Union, public funds could be used through the extraordinary public financial support. Finally, it is essential to keep in mind that the use of the public funds through the extraordinary public financial support, the DGSs and/or the resolution financing arrangements should usually be compliant with the Union State aid legal framework.

The fourth resolution objective – protection of covered depositors and investors – is linked to the deposit-taking activity, which could be considered as a critical function. As a result, this objective aims to ensure public confidence of covered depositors and investors by stating that they are protected in resolution as if they were protected in case the institution was put into insolvency. Though contrary to the insolvency proceedings where such protection is ensured through the fast pay-out to covered depositors and investors, in the case of resolution this protections are ensured by the continuity of bank's critical functions and, for example, transfer of eligible deposits to private sector purchaser (for example, by applying the sale of business tool or using other resolution actions). What is more, even though this objective captures only the *covered (insured)* depositors and investors, there are other provisions in the BRRD which introduce special ranking of eligible depositors and deposit guarantee schemes, which, as a result, may increase their chances to recover the amounts above the covered level. However, such special treatment does not apply to the investors, and their maximum protection is harmonised by the EU legal framework to a limited extent and varies significantly across the Member States.

The fifth legal resolution objective – to protect client funds and client assets (which is linked to a capital markets and investment activities which could be considered as a critical functions) – should be considered and applied not only keeping in mind the BRRD provisions but also taking into account the legal provisions of the broader financial regulatory regime, in particular, the MiFID II that protects assets and funds belonging to clients in connection with investment business. Finally, it is important to note that the uncovered deposits do not fall under this objective and are not relevant for the consideration of this objective.

The EU bank recovery and resolution legal framework resolution objectives should work as a safeguard for the public interest, which among other things also requires to ensure a stable and sustainable banking sector. These objectives also aim to encourage market-oriented incentives and greater responsibility of bank's owners, senior management, creditors and investors in its debt. However, performed analysis of their complex legal structure and

case studies indicate that in practice achievement and implementation of these objectives is not straightforward.

Finally, considering assigned different roles for supervisory, resolution authorities (both at a national and the EU level) by the legal framework on the one hand, and business interests of banks, on the other hand, divergent views or conflicting interests should be expected during the implementation of the legal provisions linked to resolution objectives when performing recovery, resolution planning and resolvability assessment, or assessing whether resolution conditions are met. Cooperation and collaboration between supervisory, resolution authorities (both at the EU and national level) and banks will play an essential role that common approach would be reached (in particular, this is important for the cross-border resolutions), and the legal framework would be implemented in a consistent way. Issuance of level two technical guidance could be considered at the EU level as well.

III. OPPORTUNITIES AND CHALLENGES FOR THE IMPLEMENTATION OF THE EU BANK RECOVERY AND RESOLUTION LEGAL FRAMEWORK OBJECTIVES IN THE ERA OF FINTECH

3.1. Introduction

"The pace of change has never been this fast, and yet it will never be this slow again."[900]

"By enabling technologies and managing risks,
we can help create a new financial system for a new age…
under the same sun[?][901]*"*

As it was discussed in the previous Parts, the new EU bank recovery and resolution legal framework (e.g. EU Bank Recovery and Resolution Directive; Single Resolution Mechanism Regulation; national implementing measures transposing the provisions of the Directive) is aiming to ensure greater preparation as well as to deal with the '*too big to fail*' problem by introducing legal instruments which should help to reach a paradigm-changing legal objective – to resolve failing bank by ensuring the continuity of bank's critical functions which are essential to the real economy and financial stability[902]. The legal framework aims to reach this objective by requiring supervisory and resolution authorities, among other things, to ensure bank's resolvability through the preparation of recovery and resolution plans where critical functions and core business lines should be mapped, checking how non-critical services could be separated from critical etc.

However, the traditional banking industry is in the throes of a revolution. Just like the hospitality, telecom and media industries, the lending sector is grappling with the phenomenon that is digital disruption. FinTech solutions

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[900] Justin Trudeau, Prime Minister of Canada, the World Economic Forum, Davos, 2018.

[901] CARNEY, M. The Promise of FinTech – Something New Under the Sun? Speech by the Chair of the Financial Stability Board. Deutsche Bundesbank G20 conference on "Digitising finance, financial inclusion and financial literacy". Wiesbaden, 25 January 2017. P.14. [accessed on 15 September 2018] <http://www.fsb.org/wp-content/uploads/The-Promise-of-FinTech-–-Something-New-Under-the-Sun.pdf>

[902] See more on the legal concept of critical functions the second part of this work and BALČIŪNAS, L. The Legal Concept of Bank's Critical Functions, Implementation Challenges and the Role in the EU Bank Recovery and Resolution Framework. In *Teisės viršenybės link*. Vilnius University, Faculty of Law. Vilnius, 2019.

are some of the developments that are also impacting access and provisions of critical functions (e.g. credit supply, payments, etc.) and the way financial institutions operate. Moreover, in recent years we have seen unprecedented growth of investment in the financial technologies (the '**FinTech**'). For example, FinTech firms around the world have raised a record $39.57 billions of investment from venture capital firms in 2018, an increase of 120% from 2017[903]. Partnerships and collaboration between FinTech and incumbent banks have been increasing, and a new generation FinTech banks are evolving as well. This raises the questions what kind of opportunities and challenges such collaboration could bring to the application and implementation of the EU bank recovery and resolution legal framework provisions and ensuring one of the key '*after crisis*' bank recovery and resolution legal framework objectives – to ensure the continuity of bank's critical functions (see Part II) which are essential to the real economy and financial stability.

This Part consists of three Chapters. The first Chapter discusses trends and the drivers for collaboration between FinTech firms and banks. The second Chapter provides an overview of reactions from regulators and public authorities at the global and the EU levels. The third Chapter discusses specific opportunities and challenges which such collaboration could bring for the implementation of one of the key the EU bank recovery and resolution legal framework objective – to the continuity of bank's critical functions, and aspects which should be considered by banks, supervisory and resolution authorities to adjust to changing reality when applying the legal provisions of the bank recovery and resolution legal framework. Finally, based on the performed analysis, the conclusions are provided.

3.2. Clarification of certain definitions: financial technology (FinTech) and financial innovation

New technologies could create new markets servicing new needs or completely transform established markets by meeting existing needs in entirely new ways[904]. Banking is dependent on technological solutions, as well.

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[903] Banking Tech. 4 February 2019. [accessed on 4 February 2019] <https://www.bankingtech.com/2019/02/fintech-investment-in-2018-soars-to-record-40bn/>

[904] GEROSKI, Paul. The Evolution of New Markets. Oxford University Press, Oxford, 2013. P. 21.

The use of financial technology and financial innovation in banking and financial services is not a new thing. It has been used for years. In the academic literature, even the analysis of waves of technological disruption in finance and banking could be found[905]. Though, the use of technology in banking and financial services was never so high as it is now. Artificial intelligence (AI)[906],

[905] It is argued that the first wave of technology in finance (could be named as 1.0) was prompted by the completion of the first transatlantic telegraph cable in 1866. As a result, finance started gradually to shift from analogue to digital. This was followed by a second wave of technological innovations in financial services (could be named as 2.0), starting with the advent of the automated teller machine (known as the ATM) in the UK in 1967. Emergence of smartphones and networked environment leads us to a third wave of increasing technological pervasiveness in finance, coupled with the emergence of new actors and channels for the provision of finance and banking (could be named as 3.0). See: ARNER, D; BARBERIS, J.; BUCKLEY, R. The evolution of fintech: a new post-crisis paradigm? In *University of Hong Kong Faculty of Law Research Papers*, No 2015/047, 2015.

[906] **Artificial Intelligence (AI)** – refers to systems that display intelligent behaviour by analysing their environment and taking actions – with some degree of autonomy – to achieve specific goals. AI-based systems can be purely software-based, acting in the virtual world (e.g. voice assistants, image analysis software, search engines, speech and face recognition systems) or AI can be embedded in hardware devices (e.g. advanced robots, autonomous cars, drones or Internet of Things applications). Many AI technologies require data to improve their performance. Once they perform well, they can help improve and automate decision making in the same domain. For example, an AI system will be trained and then used to spot cyber- attacks on the basis of data from the concerned network or system. Currently, many AI applications, particularly in the financial sector, are 'augmented intelligence' solutions, i.e. solutions focusing on a limited number of intelligent tasks and used to support humans in the decision-making process. Currently, many AI applications, particularly in the financial sector, are 'augmented intelligence' solutions, i.e. solutions focusing on a limited number of intelligent tasks and used to support humans in the decision-making process. Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions. Artificial Intelligence for Europe. European Commission, Brussels, 25.4.2018, COM(2018) 237 final. P. 1. [accessed on 26 May 2018] <https://ec.europa.eu/transparency/regdoc/rep/1/2018/EN/COM-2018-237-F1-EN-MAIN-PART-1.PDF>. Report - A definition of Artificial Intelligence: main capabilities and scientific disciplines. Independent High-Level Expert Group on Artificial Intelligence set up by the European Commission, Brussels, 8 April 2019. P. 1.

machine learning[907], Big Data[908], advanced analytics[909], cloud computing[910], distributed ledger technology (DLT)[911] , as well as mobile and digital social networks, have given rise to new delivery channels and business models not only for new entrants (FinTech firms) but also established banks. According

[907] **Machine learning** – refers to a process using algorithms rather than procedural coding that enables learning from existing data in order to predict future outcomes. ISO/IEC 38505-1:2017(en). Information technology — Governance of IT — Governance of data. Paragraph 3.7. [accessed on 27 May 2018] <https://www.iso.org/obp/ui/#iso:std:iso-iec:38505:-1:ed-1:v1:en>.

[908] **Big Data** – refers to processing of data sets with characteristics (e.g. volume, velocity, variety, variability, veracity, etc.) that for a particular problem domain at a given point in time cannot be efficiently processed using current/existing/established/traditional technologies and techniques in order to extract value. Though it is also argued that a fast-evolving phenomenon such as Big Data requires the definition to remain flexible to accommodate the inevitable need for future adjustments. Joint Committee Final Report on Big Data. ESMA, EBA, EIOPA, 15 March 2018. P. 8. [accessed on 15 March 2018] <https://www.esma.europa.eu/sites/default/files/library/jc-2018-04_joint_committee_final_report_on_big_data.pdf>; ISO/IEC 38505-1:2017(en). Information technology — Governance of IT — Governance of data. Paragraph 3.2. [accessed on 27 May 2018] <https://www.iso.org/obp/ui/#iso:std:iso-iec:38505:-1:ed-1:v1:en>.

[909] **Advanced analytics** – is the autonomous or semi-autonomous examination of data or content using sophisticated techniques and tools, typically beyond those of traditional business intelligence (BI), to discover deeper insights, make predictions, or generate recommendations. Advanced analytic techniques include those such as data/text mining, machine learning, pattern matching, forecasting, visualization, semantic analysis, sentiment analysis, network and cluster analysis, multivariate statistics, graph analysis, simulation, complex event processing, neural networks. Information Technology Gartner Glossary. [accessed on 28 June 2017] < https://www.gartner.com/en/information-technology/glossary/advanced-analytics>.

[910] **Cloud computing** – an innovation in computing that allows for the use of an online network ("cloud") of hosting processors so as to increase the scale and flexibility of computing capacity. Cloud computing has made possible the analysis of very large datasets (big data), and a number of specific FinTech applications. Financial Stability Implications from FinTech. Supervisory and Regulatory Issues that Merit Authorities' Attention. Financial Stability Board, Basel, 27 June 2017. P. 33. [accessed on 28 June 2017] <http://www.fsb.org/wp-content/uploads/R270617.pdf>

[911] **Distributed Ledger Technology –** refers to a novel and fast-evolving approach to recording and sharing data across multiple data stores (or ledgers). This technology allows for transactions and data to be recorded, shared, and synchronized across a distributed network of different network participants. A 'blockchain' is a particular type of data structure used in some distributed ledgers which stores and transmits data in packages called "blocks" that are connected to each other in a digital 'chain'. Blockchains employ cryptographic and algorithmic methods to record and synchronize data across a network in an immutable manner. Distributed Ledger Technology (DLT) and Blockchain. FinTech Note, No. 1. International Bank for Reconstruction and Development, the World Bank, Washington, 2017. P. IV. [accessed on 17 June 2017] <http://documents.worldbank.org/curated/en/177911513714062215/pdf/122140-WP-PUBLIC-Distributed-Ledger-Technology-and-Blockchain-Fintech-Notes.pdf>.

to statistical data, in 2017, digitally active consumers using FinTech solutions reached 33 % globally, compared with 16 % in 2015[912].

Even though technology has always been important in banking and financial services, the term 'FinTech' is relatively new (or better to say the combination of words '*financial*' and '*technology*'). In 2016, according to Google, the question '*what is FinTech*' ranked eighth in the most often asked questions related to FinTech[913]. The Oxford Dictionary[914] defines FinTech as computer programs and other technology used to support or enable banking and financial services. R.S. Freedman states that financial technology is concerned with building systems that model, value, and process financial products such as bonds, stocks, contracts, and money[915]. Quite a significant research has been done by professor P. Schueffel who, after performing an extensive analysis, concluded that FinTech might be defined as a new financial industry that applies technology to improve financial activities[916]. Though, P. Schueffel also acknowledged that in the academic literature, there are variations and no one single definition of FinTech exists.

In 2017, FinTech definition also caught the attention of international standard setters, namely, the FSB. After discussions, the FSB concluded that the term FinTech could be defined as "*technologically enabled innovation in financial services that could result in new business models, applications, processes or products with an associated material effect on financial markets and institutions and the provision of financial services*" [917].

To sum up, as can be seen, in the academic literature there are some variations in the FinTech definition. However, all of them link FinTech term with the technology which has an impact on financial activities or provisions of services, while the definition set by the FSB at the global level is the latest

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[912] EY FinTech Adoption Index 2017. The rapid emergence of FinTech. EY, London, 2017, P. 6 – 7. [accessed on 26 March 2019] < https://www.ey.com/Publication/vwLUAssets/ey-fintech-adoption-index-2017/$FILE/ey-fintech-adoption-index-2017.pdf>.

[913] SCHUEFFEL, P. Taming the Beast. A Scientific Definition of FinTech. In *Journal of Innovation Management*, 2016, No 4(4), pp. 32 – 54, P. 33.

[914] The Oxford Dictionary. Term 'FinTech'. [Accessed on 15 August 2018] <https://en.oxforddictionaries.com/definition/fintech>.

[915] FREEDMAN, R.S. Introduction to Financial Technology. Elsevier, 2006, P.1.

[916] SCHUEFFEL, P. Taming the Beast. A Scientific Definition of FinTech. In *Journal of Innovation Management*, 2016, No 4(4), pp. 32 – 54, P. 45.

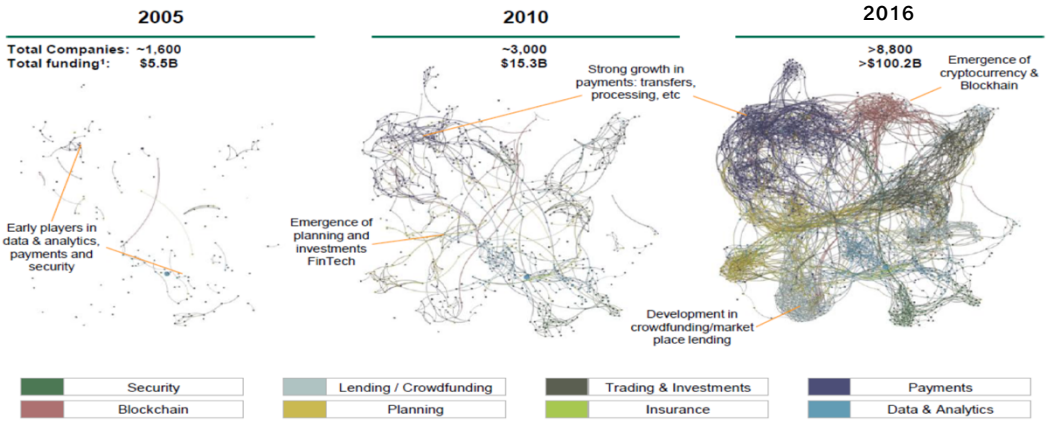
[917] Financial Stability Implications from FinTech. Supervisory and Regulatory Issues that Merit Authorities' Attention. Financial Stability Board, Basel, 27 June 2017. P.33. [accessed on 26 March 2019] <http://www.fsb.org/wp-content/uploads/R270617.pdf>

one, and is also used by the EU institutions[918] when preparing relevant policy papers or suggestions for legislative amendments. Therefore, it is also used for the purposes of this research.

3.3. Drivers for collaboration between FinTech firms and banks

Since 2000 investments in FinTech have grown dramatically (see scheme 20), and it is expected that such a trend will remain strong with the continuous growth of investors' interest[919]. The customer-first approach that FinTech's have, continue to facilitate and advance financial inclusion, and are re-imagining products and propositions tailored to changing needs. So, will banks disappear? No, but they will be different.

Scheme 20. FinTech Investment Growth 2000 – 2016[920]



Customer habits and needs are changing as they get used to Google, Amazon, Apple and other user-friendly interfaces and are looking for something similar in banking. The adoption and use of internet-connected devices, computer and mobile-savvy millennials drives need for speed and convenience in financial services. However, banks' platforms are far from

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[918] E.g. The EBA's FinTech Roadmap. Conclusions from the Consultation on the EBA's Approach to Financial Technology (FinTech). EBA, London, 15 March 2018. P. 3.

[919] The pulse of FinTech – Q4 2017. KPMG, 2018. [accessed on 10 February 2019] <https://assets.kpmg.com/content/dam/kpmg/xx/pdf/2018/02/pulse_of_fintech_q4_2017.pdf>

[920] IOSCO Research Report on Financial Technologies (FinTech). International Organisation of Securities Commission (IOSCO), February 2017. P. 5. [accessed on 10 February 2019] <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD554.pdf>

such experience as usually they are based on outdated, inflexible and legacy IT systems. FinTech firms aim to directly or indirectly fill this gap by providing various innovative solutions. Furthermore, data confirms that most investments in FinTech (usually developing products and solutions based on technologies such as – cloud computing, big data, advanced analytics, artificial intelligence[921], machine learning, and distributed ledger technology) are targeting namely retail banking[922].

Moreover, policymakers around the globe are also encouraging FinTech developments by giving specific additional roles for public authorities. In particular, worth to mention the example of the UK as it has one of the leading financial centres in the world and, for example, investors put more money into the UK FinTech sector than any other European country in 2018[923]. The UK supervisory authority – the Financial Conduct Authority (the '**FCA**') which was established in 2013[924] – has been given a specific mandate *to promote competition[925] in* the field of financial services in the interest of consumers[926]

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[921] "*More profound than fire or electricity. AI is one of the most profound things we're working on as humanity*" – Google's chief executive officer speech, Davos, Switzerland, 22 January 2020. According to Financial Times survey, of 18 major banks surveyed, 17 reported using AI in the front office. Eight reported AI in the front office, middle office, back office and data analytics. Of six which gave details of AI spending, the sums ranged from EUR 5m to EUR 15m, with one institution planning to increase spending from below $3m to $50m a year. Eight were involved in joint ventures, while four had made investments in AI-related companies. AI in banking: the reality behind the hype. Financial Times, London 12 April 2018. [accessed on 12 April 2018] < https://www.ft.com/content/b497a134-2d21-11e8-a34a-7e7563b0b0f4>.

[922] As a matter of fact, McKinsey already in 2016 estimated that 52% of FinTech investments will focus on retail banking. Impact of FinTech on Retail Banking. McKinsey & Company, Brussels, 2016. Presentation slide 5. [accessed on 15 March 2018] <https://www.financialforum.be/sites/financialforum.be/files/media/1695-3-marc-niederkorn.pdf>

[923] UK FinTech. State of the Nation. Department for International Trade, HR Treasury, London, 2019. P. 11. [accessed on 5 January 2019] <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/801277/UK-fintech-state-of-the-nation.pdf>.

[924] It took over responsibility for the conduct and relevant prudential regulation from the Financial Services Authority after implementing in the UK so-called twin peaks supervision model. See: BALČIŪNAS, Laurynas. Financial Market Supervision Models and Trends of Legal Regulation. In *Teisė*, 99, pp. 64 – 82, Vilnius, 2014. [interactive, accessed on 1 December 2018] <http://www.journals.vu.lt/teise/article/view/3372/2440>.

[925] Part 1A, Chapter 1, 1B (3)(c) of the Financial Services Act 2012 (as amended).

[926] The matters to which the FCA may have regard in considering the effectiveness of competition in the market include: (a) the needs of different consumers who use or may use those services, including their need for information that enables them to make informed choices; (b) the ease with which consumers who may wish to use those services, including consumers in areas affected by social or economic deprivation, can access them; (c) the ease with which

and in this way to encourage banks to become more productive, with lower transaction costs, greater capital efficiency and stronger operation resilience etc. As a result, the FCA launched Project Innovate (the component of which are being gradually developed)[927] to foster competition and growth in financial services by supporting both small and large businesses that are developing products that could genuinely improve services for customers. More specifically, the FCA uses its convening powers to bring participants together and explore innovative ways of improving market effectiveness, such as developing FinTech – using technology to deliver financial services – to reduce the cost of financial services or to extend access to vulnerable consumers[928]. Furthermore, by using specific tools such as Innovation Hub (introduced in 2014)[929] and Regulatory Sandbox[930] (introduced in 2015)[931], the FCA aims to help the newly established business to bring innovative financial

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consumers who obtain those services can change the person from whom they obtain them; (d) the ease with which new entrants can enter the market, and (e) how far competition is encouraging innovation. Part 1A, Chapter 1, 1E Financial Services Act 2012 (as amended).

[927] For more details see Project Innovate. Financial Conduct Authority. [accessed on 12 December 2018] < https://www.fca.org.uk/firms/fca-innovate>.

[928] Our Mission 2017. How we regulate financial services. Financial Conduct Authority, London, 2017. P. 7. [accessed on 5 June 2018] <https://www.fca.org.uk/publication/corporate/our-mission-2017.pdf>.

[929] Innovation Hub is focused on encouraging innovation in financial services in the interests of consumers by supporting innovator businesses with a range of services. For more details see: Innovation Hub. Financial Conduct Authority. [accessed on 12 December 2018] <https://www.fca.org.uk/firms/innovate-innovation-hub/objectives>.

[930] A '**regulatory sandbox**' is a 'safe space' in which businesses can test innovative products, services, business models and delivery mechanisms without immediately incurring all the normal regulatory consequences of engaging in the activity in question. This idea is not completely new. A similar approach is used in other industries such as clinical trials. What is more, well known law professor E. Posner in 2012 raised an idea that financial markets should be regulated as drugs comparing financial products to prescription drugs that can do a lot of good but used improperly they can be deadly. See: POSNER, E.; WEYL, G. E. An FDA for Financial Innovation: Applying the Insurable Interest Doctrine to 21st Century Financial Markets. In *Northwestern University Law Review*, No 107, 1307, 2013, pp. 1307 – 1357; Regulatory sandbox. Financial Conduct Authority, London, November 2015. P. 2. [accessed on 15 November 2018] < https://www.fca.org.uk/publication/research/regulatory-sandbox.pdf>.

[931] Following recommendations by the Government Office for Science, the FCA was asked by Her Majesty's Treasury (HMT) to investigate the feasibility of developing a regulatory sandbox for financial services. See: FinTech Futures. The UK as a World Leader in Financial Technologies. A report by the UK Government Chief Scientific Adviser. P. 37. [accessed on 15 November 2018] < https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/413095/gs-15-3-fintech-futures.pdf>.

services and products to the market[932]. Such an approach also encourages the proactiveness of supervisory authorities. Rather than 'hiding' behind the narrow interpretation of the supervisory authorities mandate, financial law provisions, drawing a line what does fall or not under the mandate of the supervisory authority, or aiming to prevent new entrants from entering the financial market, a new approach emerged that the supervisory authority should help natural and legal entities to get regulated or even push the business to the next step, what as a result should also help to deal with the shadow banking risks. This is the trend which is being followed by other jurisdictions around the globe (e.g. Singapore, Honk Kong) and the EU Member States, including the Republic of Lithuania and which is one of a few EU Member States which are members of the FCA's Global Financial Innovation Network supporting financial innovation in the interests of consumers[933]. In this context, it is worth to mention that advanced supervisors and regulators from the supportive regulatory response to FinTech developments are entering a much trickier phase which requires to assess and respond to the risks and benefits posed by FinTech developments to banks, financial stability and consumers.

Application of financial technology in the field of banking is not new. As history confirms, different technologies come and go in waves and not all of them prove. Researcher Gartner has developed the so-called hype cycle chart (see scheme 21) which shows a visual representation of the fact that the effect of new technology tends to be overestimated in the short term and underestimated in the long term[934].

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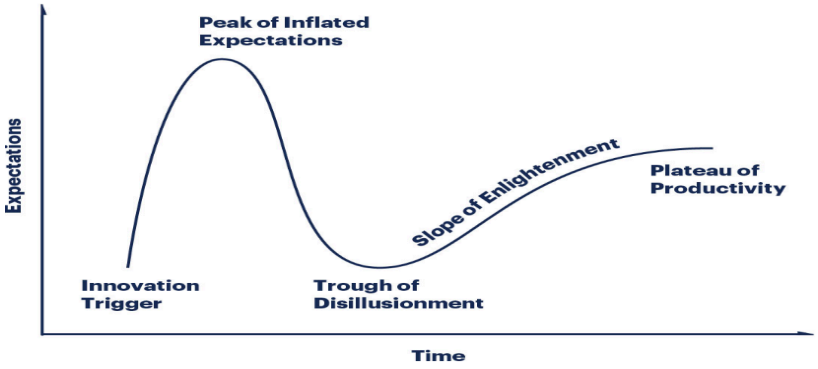
[932] Our Mission 2017. How we regulate financial services. Financial Conduct Authority, London, 2017. P. 7. [accessed on 12 December 2018] <https://www.fca.org.uk/publication/corporate/our-mission-2017.pdf>.

[933] Terms of Reference for Membership and Governance of the Global Financial Innovation Network. GFIN, London, August 2019. [accessed on 2 September 2019] <https://www.fca.org.uk/publication/mou/gfin-terms-of-reference.pdf>.

[934] FENN, J.; BLOSCH, M. Understanding Gartner's Hype Cycle. Gartner, 20 August 2018 [accessed on 20 August 2018] < https://www.gartner.com/en/documents/3887767/understanding-gartner-s-hype-cycles>.

Scheme 21. Interpreting Technology Hype[935]



Of course, it is difficult to say with certainty where we are at the moment in the hype cycle[936]. However, it is clear that in the long term FinTech will have a great impact on the provisions of financial services and banking. What is more, an important trend is emerging. According to certain empirical researches, around 75% of FinTech firms cite collaboration with incumbent banks as their primary business objective[937]. This is driven by the fact that banks and FinTech firms start to understand that they not only have their own strengths but also that there are shared mutuality beneficial interests (see scheme 22).

[935] Source: GARTNER. Gartner Hype Cycle. Interpreting technology hype. 2019 Gartner. [accessed on 1 January 2019] <https://www.gartner.com/en/research/methodologies/gartner-hype-cycle>.

[936] On the role of research for the innovation see LERNER, J. The Architecture of Innovation. The Economics of Creative Organisations. Oxford University Press, Oxford, 2016.

[937] For example, The World FinTech report 2018. P. 41. [accessed on 15 March 2018] <https://www.capgemini.com/wp-content/uploads/2018/02/world-fintech-report-wftr-2018.pdf>; 81% of banking executives see working with partners as the best path to digital transformation. Business Insider, London, 2 October 2019. [accessed on 3 October 2019] < https://www.businessinsider.com/banks-see-partners-as-best-path-to-digital-transformation-2019-10?r=US&IR=T>.

Scheme 22. Own and shared strengths of banks and FinTech firms[938]

Banks Own Strengths	Shared Potential Strengths	FinTech Firms Own Strengths
• Brand and Name recognition • Large customer base • Wide range of products offerings • Comprehensive customer data • Robust infrastructure • Advanced underwriting capabilities • Risk management experience • Access to capital • Licensed to provide regulated financial services	• Scale and innovative solutions • Deeper and analytical-driven customer engagement • Enhanced risk mitigation • Improved products efficiency • More accessible products	• Culture of Innovation • Nimble • Agility and speed to market • Outside of the box mindset • Lean set-up and an absence of legacy systems • Technological experience • Customer data analytics • Specialised solutions • Modern IT systems

What is more, FinTech firms are aiming to collaborate with the well-known brand bank as this enhances their visibility, allows to achieve economies of scale, gain customer trust, access to capital, expertise in regulations, expertise in risk management and other[939]. On the other hand, collaboration is also expected to be a priority for banks[940]. It is increasingly

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[938] Source: How Financial Institutions and FinTechs Are Partnering for Inclusion: Lessons from the Frontlines. A joint report from the Center for Financial Inclusion at Action and the Institute of International Finance, London, July 2017. [accessed on 12 December 2018] <https://content.centerforfinancialinclusion.org/wp-content/uploads/sites/2/2018/08/IIF-CFI_FI-Fintech_Partnerships_Final.pdf>.

[939] *Ibid.*

[940] For some time, for example, banks in Baltic states were sceptical regarding the partnership and collaboration with the FinTech firms. Though now they argue that this is a must thing in order to adjust to changing needs of customers and to find innovative solutions for making payments and using financial services. See: SEB plėtros vadovas: per ateinančius penkerius metus bankui būtina pasikeisti. Robert Pehrson. Head of Business Development at SEB, 14 November 2019. [accessed on 14 November 2019] <https://www.delfi.lt/verslas/verslas/seb-pletros-vadovas-per-ateinancius-penkerius-metus-bankui-butina-pasikeisti.d?id=82782439>; Luminor bank collaborate with a FinTech partner Ondato. Fully digitalised opening of a bank account is available from anywhere in the world now. Luminor Bank, 12 February 2020.

expected that moving forward banks will become product and service 'aggregators', retaining the interface with clients, but combing their products and services with those of other market participants[941]. Banks are aiming to partner with FinTech firms[942] as this is reducing cost and inefficiencies, improving client servicing, increasing revenue, maintaining business completeness, agility and catching up with the speed of the market and changing customer needs[943]. Banks are also embracing new technologies to accelerate the commoditization of cost drivers[944]. They also understand that firms which miss a transition or fail to innovate may quickly found themselves out of business[945].

Partnership and collaboration work as an alternative for banks to building out their own costly internal technology projects and helps to unlock the technical capabilities without necessarily requiring the technical know-how[946].

[accessed on 12 February 2020] < https://www.luminor.lv/en/news/fully-digitised-opening-bank-account-available-anywhere-world-now>.

[941] Technology and Innovation in Global Capital Markets. Current trends in technology and innovation and their impact on the Investment Bank of the Future. Global Financial Markets Association and Pwc, March 2019. P. 5. [accessed on 10 March 2019] <https://www.afme.eu/globalassets/downloads/publications/afme-technology-and-innovation-in-global-capital-markets.pdf>.

[942] The EBA identified as well that for banks the predominant way is partnership with new entrant FinTech firms and other firms that aim to actively follow and embrace FinTech developments. See: EBA Report on the Impact of FinTech on Incumbent Credit Institutions' Business Models. European Banking Authority, London, 3 July 2018. P. 25. [accessed on 3 July 2018] <https://eba.europa.eu/documents/10180/2270909/Report+on+the+impact+of+Fintech+on+incumbent+credit+institutions%27%20business+models.pdf>

[943] Technology and Innovation in Global Capital Markets. Current trends in technology and innovation and their impact on the Investment Bank of the Future. Global Financial Markets Association and Pwc, March 2019. P. 7. [accessed on 10 March 2019] <https://www.afme.eu/globalassets/downloads/publications/afme-technology-and-innovation-in-global-capital-markets.pdf>

[944] European Central Bank. Guide to assessment of fintech credit institution licence applications. Frankfurt, March 2018. [accessed on 10 August 2019] <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.201803_guide_assessment_fintech_credit_inst_licensing.en.pdf>

[945] As noted by Ch. O'Reilly and M. Rushman, fifty years ago, the average life expectancy of a firm in the Standard and Poor's 500 was fifty years – today it is closer to twelve, therefore, managers do not have the luxury of time to react slowly to change. O'REILLY, Ch.; TUSHMAN, M. Lead and Disruption. How to solve the innovator's dilemma. Stanford University Press, Stanford, California, 2016. ix- x.

[946] See: As Facebook and Apple encroach on finance, top banks are teaming up with younger rivals. CNBC, 27 September 2019. [accessed on 27 September 2019] < https://www.cnbc.com/2019/09/26/sibos-banks-partner-with-fintechs-amid-challenge-from-facebook-apple.html>.

Banks also want to understand better and use data they have as it argued that if you have access to large pools of data, you are straddling the twenty-first century's oil field[947]. As a result, a new trend is emerging as big banks not only aim to partner with the FinTech firms to provide bespoke solutions for their consumers (e.g. Goldman Sachs bank partnered with the FinTech firms to launch its consumer-friendly retail lending business under the brand Marcus[948]) but also with the BigTech firms[949] (e.g. Goldman Sachs bank partnered with Apple to provide a joint credit card[950]; Citigroup Inc. is partnering with Google to allow users to access their bank accounts through the Google Pay app[951]). BigTech firms also operate in the EU and therefore, it could be expected they will try to build partnership links with the EU banks as well.

Finally, considering that such collaboration brings business benefits for both sides, and even greater symbiosis between FinTech firms and banks could be expected in the future. Such a trend will be stimulated by existing

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[947] It is quite an extraordinary fact that 90 percent of the world's data has been in the last five years and that humankind now produces in two days the same amount of data it took us from the dawn of civilisation until 2003 to generate. SAUTOY, Marcus. The Creativity Code. Art and Innovation in the Age of AI. The Belknap Press of Harvard University Press, Cambrdige, Massachusetts, 2019. P. 62.

[948] Apple and Goldman Sachs partnering on a credit card for the iPhone, WSJ says. CNBC, 21 February 2019. [accessed on 21 February 2019] <https://www.cnbc.com/2019/02/21/apple-and-goldman-sachs-partnering-on-a-credit-card-for-the-iphone-wsj-says.html>.

[949] **BigTech firms** – large companies with established technology platforms – are playing an increasingly prominent role in the financial system and have begun to provide financial services. A non-exhaustive list of BigTech firms include Alibaba, Amazon, Apple, Baidu, eBay, Facebook, Google, Microsoft, Tencent etc. BigTech in finance. Market developments and potential financial stability implications. Financial Stability Board, Basel, 9 December 2019. P. 1. [accessed on 10 December 2019] <https://www.fsb.org/wp-content/uploads/P091219-1.pdf>.

[950] As Facebook and Apple encroach on finance, top banks are teaming up with younger rivals. CNBC, 27 September 2019. [accessed on 27 September 2019] <https://www.cnbc.com/2019/09/26/sibos-banks-partner-with-fintechs-amid-challenge-from-facebook-apple.html>.

[951] Google Partners with Citigroup to Offer Customers Checking Accounts**.** [accessed on 13 November 2019] < https://www.bloomberg.com/news/articles/2019-11-13/google-partners-with-citi-to-offer-customers-checking-accounts>.

banks as well as emerging[952] FinTech banks (e.g., Revolut[953], Monzo[954], Starling[955], N26[956] , etc.)[957]. It could be expected that such partnerships and collaboration will result in the emergence of new value creation systems[958].

However, such collaboration brings not only new business models and opportunities for FinTech firms and banks themselves, but also raises questions how such collaboration may impact the existing prudential supervision, in particular, bank recovery and resolution legal framework, it's one of the key objectives (continuity of critical functions which are essential for the real economy and financial stability) and financial stability in general,

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[952] For example, in the UK the Bank of England has been receiving interest from a range of FinTech firms seeking authorisation in the UK as a bank. 6 firms with business models focused on providing banking services to customers digitally have already been authorised as banks since 2015. A further 16 FinTech firms are at pre-application or live application stage, compared with 26 non-FinTech firms. See: What are the business models of new FinTech firms in the UK? Bank of England, London, 29 March 2019. [accessed on 29 March 2019] <https://www.bankofengland.co.uk/bank-overground/2019/what-are-the-business-models-of-new-fintech-firms-in-the-uk?sf100451385=1>

[953] Revolut Ltd is a UK financial technology company that offers banking services including a prepaid debit card, fee free currency exchange, commission free stock trading, cryptocurrency exchange and peer-to-peer payments. Revolut has been granted a European banking license. The license allows the London-based fintech company to offer services typically provided by traditional banks, including full current accounts, consumer and business lending and overdrafts throughout the EU. U.K. Fintech Revolut Gets European Banking License. Bloomberg, 13 December 2018. [13 December 2018] < https://www.bloomberg.com/news/articles/2018-12-13/u-k-fintech-revolut-gets-european-banking-license-via-lithuania>.

[954] Monzo Bank Ltd, is a digital, mobile-only bank based in the United Kingdom. It has been operating through a mobile app and a prepaid debit card since April 2017 when their UK banking licence restrictions were lifted, enabling them to offer a current account. [accessed on 18 December 2018] <https://monzo.com>.

[955] Starling Bank is a digital, mobile-only challenger bank based in the United Kingdom, operating current accounts, and business banking. [accessed on 18 December 2018] <https://www.starlingbank.com>.

[956] N26 is a German direct bank, headquartered in Berlin, Germany. N26 offers its services throughout most of the Eurozone, UK, Switzerland and US. [accessed on 15 March 2019] <https://n26.com/en-eu>.

[957] **FinTech bank** is a business model in which the production and delivery of banking products and services are based on technology-enabled innovation. See: Guide to assessment of FinTech credit institution licence applications. European Central Bank, Frankfurt, March 2018. P. 3. [accessed on 10 August 2018] <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.201803_guide_assessment_fintech_credit_inst_licensing.en.pdf>

[958] As indicated by professor Rafael Ramirez, value creating systems are systems where value is created not only by one party in the offering but by all parties in the offering, as opposed to the conventional view of value creation, where a supplier only produces and 'offers' and a client only buys and 'uses'. The so-called users are taken to have more than one role, and centrally are also seen as value creators. RAMIREZ, R.; MANNERVIK, U. Strategy for a Networked World. Imperial London College Press, London, 2016. P. 5.

and what are the reactions of regulators and public authorities both at the global and the EU levels.

3.4. Analysis of reactions of public authorities at the global and the EU levels

3.4.1. Reactions at the global level

At the global level, the Financial Stability Board (FSB) has the mandate to promote international financial stability; therefore, has a role to play as FinTech continues to evolve. Already in 2016, the FSB has highlighted that for regulators is essential to understand what FinTech developments will change the way financial markets operate[959]. In 2017, M. Carney, Chair of the FSB (and the Governor of the Bank of England), stated that *"[b]y enabling technologies and managing risks, we can help create a new financial system for a new age… under the same sun*[960]". Though, the Chair also highlighted that as risks form FinTech emerge, "*authorities can be expected to pursue a more intense focus on the regulatory perimeter, more dynamic setting of prudential requirements, a broader commitment to resolution [legal] regimes <…>*"[961]. The same year the FSB also issued a more specific analysis focusing on financial stability implications from FinTech and highlighting supervisory and regulatory issues that merit authorities' attention[962]. In 2019, the FSB issued the report assessing FinTech market developments in the financial system and the potential implications for financial stability[963].

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[959] ANDERSEN, S. Chatham House Banking Revolution Conference Global Regulatory Developments and their Industry Impact. Financial Stability Board, Basel, 3 November 2016. P.3. [accessed on 12 February 2019] <http://www.fsb.org/wp-content/uploads/Chatham-House-The-Banking-Revolution-Conference.pdf>

[960] CARNEY, M. The Promise of FinTech – Something New Under the Sun? Speech given by the Chair of the Financial Stability Board. Deutsche Bundesbank G20 conference on "Digitising finance, financial inclusion and financial literacy". Wiesbaden, 25 January 2017. P.1. [accessed on 15 September 2018] <http://www.fsb.org/wp-content/uploads/The-Promise-of-FinTech-–-Something-New-Under-the-Sun.pdf>

[961] *Ibid*., P.14.

[962] Financial Stability Implications from FinTech. Supervisory and Regulatory Issues that Merit Authorities' Attention. Financial Stability Board, Basel, 27 June 2017. [accessed on 28 June 2017] < http://www.fsb.org/wp-content/uploads/R270617.pdf>

[963] FinTech and Market Structure in Financial Services: Market Developments and Potential Financial Stability Implications. Financial Stability Board, Basel, 14 February 2019. [accessed on 14 February 2019] <http://www.fsb.org/wp-content/uploads/P140219.pdf>

The Basel Committee also has performed some work linked to FinTech and bank supervision, not to mention that the Basel Committee's Core Principles[964] are relevant for assessing innovation in banking and the interaction between banks and FinTech firms. Furthermore, in 2018, the Basel Committee issued the document summarising its main findings and conclusions on sound practices and implications of FinTech developments for banks and bank supervisors[965]. Though, the most recent analysis focused on policy responses to FinTech[966] rather than opportunities or risk and existing legal framework challenges emerging from the partnership between the banks and FinTech firms.

3.4.2. Reactions at the EU level

At the European Union (EU) level, in 2017 the European Commission (EC) published the Consumer Financial Services Action Plan[967] including some actions aimed at supporting the development of an innovative digital world in retail financial services[968]. Subsequently, in 2017 the European Parliament adopted the Report on FinTech[969] which among other things also highlighted that the legislation, regulation and supervision have to adapt to

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[964] Core principles for effective banking supervision. Basel Committee on Banking Supervision, Basel, September 2012. [accessed on 2 October 2012] <https://www.bis.org/publ/bcbs230.pdf>
[965] Sound Practices. Implications of FinTech Developments for Banks and Bank Supervisors. Basel Committee on Banking Supervision, Bank for International Settlements, Basel, February 2018. [accessed on 1 March 2018] <https://www.bis.org/bcbs/publ/d431.pdf>
[966] Policy responses to FinTech: a cross-country overview. Financial Stability Institute, BIS, Basel, January 2020. [accessed on 30 January 2020] <https://www.bis.org/fsi/publ/insights23.pdf>.
[967] Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions. Consumer Financial Action Plan: Better Products, More Choice. European Commission, Brussels, 2017. [accessed on 4 April 2017] <https://eur-lex.europa.eu/resource.html?uri=cellar:055353bd-0fba-11e7-8a35-01aa75ed71a1.0003.02/DOC_1&format=PDF>
[968] See Annex to Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions. Consumer Financial Action Plan: Better Products, More Choice. European Commission, Brussels, 2017. [accessed on 4 April 2017] <https://eur-lex.europa.eu/resource.html?uri=cellar:055353bd-0fba-11e7-8a35-01aa75ed71a1.0003.02/DOC_1&format=PDF>
[969] Report on FinTech: The Influence of Technology on the Future of the Financial Sector. Committee on Economic and Monetary Affairs, European Parliament, Brussels, 2017. [accessed on 2 May 2017] <http://www.europarl.europa.eu/doceo/document/A-8-2017-0176_EN.pdf>

innovation and strike the right balance between incentives to innovative consumer and investor protection and financial stability[970]. In 2017, the European Banking Authority (EBA) published a Discussion Paper[971] on its approach to FinTech[972]. This paper also raised questions concerning the impact of FinTech on the resolution of banks[973]. In 2018, as a follow-up to this paper, the EBA's FinTech roadmap was issued providing conclusions from the consultation on the EBA's approach to FinTech[974] which, among other things noted, that although resolution requirements are not typical for FinTech firms, there is a need to consider the interaction between FinTech firms and banks[975].

The Banking Union authorities, the European Central Bank (ECB) as a supervisory authority and the Single Resolution Board (SRB) as a resolution authority, are also progressively recognising the developments in the field of FinTech banking. In 2018, the ECB issued its guide to assessments of FinTech credit institution license applications[976]. The SRB noted that the

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[970] Report on FinTech: the Influence of Technology on the Future of the Financial Sector. Committee on Economic and Monetary Affairs, European Parliament, Brussels, 2017. P. 5. [accessed on 2 May 2017] <http://www.europarl.europa.eu/doceo/document/A-8-2017-0176_EN.pdf>

[971] Discussion Paper on the EBA's approach to financial technology (FinTech). European Banking Authority, London, 4 August 2017. [accessed on 4 August 2017] <https://eba.europa.eu/documents/10180/1919160/EBA+Discussion+Paper+on+Fintech+%28EBA-DP-2017-02%29.pdf>

[972] Considering the EBA's statutory objective, which, among other things, requires the EBA to promote a sound, effective and consistent level of regulation and supervision, prevent regulatory arbitrage and promoting equal competition, contribute to enhancing consumer protection, and its duty to monitor new and existing financial activities. Articles 1(5) and 2(2) of Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC. OJ L 331, 15.12.2010.

[973] Discussion Paper on the EBA's approach to financial technology (FinTech). European Banking Authority, London, 4 August 2017. P. 54 [accessed on 4 August 2017] <https://eba.europa.eu/documents/10180/1919160/EBA+Discussion+Paper+on+Fintech+%28EBA-DP-2017-02%29.pdf>

[974] The EBA's FinTech Roadmap. Conclusions from the Consultation on the EBA's Approach to Financial Technology (FinTech). European Banking Authority, London, 15 March 2018. [accessed on 15 March 2018] <https://eba.europa.eu/documents/10180/1919160/EBA+FinTech+Roadmap.pdf>.

[975] The EBA's FinTech Roadmap. Conclusions from the Consultation on the EBA's Approach to Financial Technology (FinTech). European Banking Authority, London, 15 March 2018. P. 33.

[976] Guide to Assessments of FinTech Credit Institutions License Applications. European Central Bank, Frankfurt, March 2018. [accessed on 2 April 2018]

transformation and digitalisation of financial services and the influence of FinTech firms on bank resolution would need to be considered and assessed in the Banking Union[977]. Though, nothing linked to FinTech was mentioned neither in the SRB's 2019[978] nor 2020 programmes[979].

As can be seen, both at the global and the EU levels FinTech topic is progressively getting more attention from regulators and public authorities. However, even though there is some attention and work done concerning potential general opportunities and challenges to financial stability stemming from FinTech, there is no or minimal specific analysis on how collaboration between FinTech firms and banks could impact the application of the legal provisions and the objectives of the EU bank recovery and resolution legal framework. In particular, what are opportunities and challenges from such collaboration for the implementation of relevant EU bank recovery and resolution statutory framework provisions and fulfilment of one of the key objectives – the continuity of bank's critical functions which are essential to the real economy and financial stability.

3.5. General considerations of opportunities and challenges for the EU bank recovery and resolution legal framework objectives

"FinTech [firms] are no longer going to disrupt the banks, they are going to power the banks."[980]

As it was discussed in Chapters I and II, in line with international standards, under the EU bank recovery and resolution legal framework banks

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<https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.201803_guide_assessment_fintech_credit_inst_licensing.en.pdf>

[977] SRB Multi-Annual Planning and Work Programme 2018 – 2020. Single Resolution Board, Brussels, 2018. P. 14. [accessed on 12 September 2018] <https://srb.europa.eu/en/content/work-programme>

[978] Single Resolution Board Work Programme 2019. SRB, Brussels, 2018. [accessed on 12 February 2018] < https://srb.europa.eu/sites/srbsite/files/wp2019_final.pdf>.

[979] Single Resolution Board Work Programme 2020. SRB, Brussels, 2019. [accessed on 12 February 2019] <https://srb.europa.eu/sites/srbsite/files/srb.2019.4871_wp_2020_final_version_web.pdf>.

[980] Closing the gap in FinTech collaboration. Overcoming obstacles to symbiotic relationship. Deloitte Centre for Financial Services, 2018. P. 2. [accessed on 15 May 2018] <https://www2.deloitte.com/content/dam/Deloitte/us/Documents/financial-services/us-fsi-dcfs-fintech-collaboration.pdf>.

are required to have in place adequate operational arrangements to ensure the continuity of the critical services, as well as the access to operational assets, staff that are necessary for preserving critical functions and supporting the achievement of the other resolution objectives (which are supporting the continuity of critical functions) upon entry into resolution and to allow post-resolution restructuring. Considering that greater collaboration and partnership between the FinTech firms and banks may result in an increased number of critical services being provided by the banks, a discussion of relevant provisions becomes important. Partnership models could bring both opportunities and challenges from the perspective of the EU bank recovery and resolution legal framework objectives.

From the perspective of opportunities, it could be argued that decentralisation and diversification across critical services and functions providers may dampen the effects of financial shocks in some circumstances as the failure of a single bank may less likely to shut down a market as there would be an increased number of other providers of critical services and critical functions. Furthermore, technological solutions provided by FinTech firms may increase efficiency in bank's operations, improve bank's ability to manage risk and in this way support the stable business model of the bank which subsequently would contribute to overall efficiency gains in the financial system and the real economy. It is also argued that diversity and competition among market participants could be considered as critical factors contributing to financial stability[981].

FinTech firms could also help to improve bank's ability to extract and aggregate specific information, as well as monitoring and reporting processes and systems what would, as a result, help to deal with the operational continuity issues. Smart management information systems could ensure that the resolution authorities are able to gather precise and complete information about the bank's core business lines, critical services, operations supporting critical functions what would facilitate making informed and rapid decisions. Ability to instantly extract accurate information on financial contracts[982], or the assets (their place and eligibility as collateral) and liabilities of the bank

[981] Report on FinTech: the influence of technology on the future of the financial sector (2016/2243(INI)). European Parliament, Brussels, 24 March 2017. Paragraph 50. [accessed on 25 March 2017] <https://www.europarl.europa.eu/doceo/document/A-8-2017-0176_EN.pdf>.
[982] As defined in Art. 2(1)(100), Art. 71(7)(8) of the BRRD.

could speed-up, for example, valuation exercise or decision to provide liquidity support.

However, such collaboration brings not only opportunities for the application and implementation of bank recovery and resolution framework legal norms and objectives, but it also brings direct and indirect challenges. As noted by the Bank of England, it is possible that FinTech firms could ultimately become critical links in systemically important chains (e.g. payment chains[983]) without being subject to commensurate financial stability regulatory standards, what, if not adequately considered, might create dark spots in the assessment of bank's resolvability or 'too big to fail' might relocate to different parts of the chain[984]. Increasing collaboration between FinTech firms and banks may result in an increased number of critical services which will be provided by FinTech firms to banks and which are needed to provide one or more critical functions which are essential to the real economy and financial stability. This brings to the question whether the resolution authorities will be able to use their resolution powers effectively (e.g. stay power) and tools (e.g. sale of business, asset separation, bail-in, bridge bank) as the role of third parties providing crucial specialised services to banks will increase. What is more, banks reliance on third-party service providers raises questions whether they will be able to ensure business and operation continuity once faced with the difficulties as technological solutions (e.g. based on distributed ledger technology[985]) may not be in their control. This will regularly require discussing and thinking how legal provisions set

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[983] Payment chains are becoming more complex what as a result poses challenges to regulators. For example, traditionally card payment activities (as a critical function) were performed by banks and core payment systems, however, this is being changed by the application of new FinTech solutions and innovation what introduces more actors in the processing of each transaction. As a result, some payment chains are becoming unbundled, with a wider range of FinTech firms providing each link (critical service) in the payment chain what ultimately creates a situation that the whole chain could potentially be disrupted by issues in any one of these links what as a result could create serious issues for each participant (or their groups) in the chain. What is more, given the speed of innovation, FinTech firms providing payment services can quickly become critical links in systemic chains. See: Financial Stability Report. Financial Policy Committee, Bank of England, December 2019. P. 83. [accessed on 10 December 2019] <https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-report/2019/december-2019.pdf>.

[984] *Ibid.,* P. 84.

[985] See more on the DLT: Technological Innovation. Distributed Ledger Technology: Challenges and Opportunities for Financial Market Infrastructures. European Central Bank, Frankfurt, 2016. [accessed on 7 May 2017] <https://www.ecb.europa.eu/pub/annual/special-features/2016/html/index.en.html>.

expectations for the way banks should engage third parties, in order to mitigate operational resilience and continuity issues which could be stemming from the increased interconnectedness and/or technological complexity of banks. Another point is that third parties offering services to regulated banks may not be subject to the same level of oversight, scrutiny of their governance and business process to which regulated banks are subject.

Moreover, increased digitalisation and technological solutions in the field of payments, FinTech banking solutions and instant access to the bank account, progressively allow clients to move funds across accounts easier and speedier. This could also allow depositors to speed-up outflows of deposits from the bank which faces difficulties and could create additional complications for authorities to stabilise the financial situation of the bank or to determine when the bank meets resolution conditions (e.g. whether failing or likely to fail moment is reached).

Finally, such collaboration could increase overall complexity of bank's corporate structure what would, as a result, make it more complicated to resolve it or to segregate critical functions, core business lines, critical services from each other or the legal entity, what ultimately would complicate and/or make it impossible to achieve the continuity of those critical functions. It also worth to note that already in 2010, the BCBS noted that interdependency among the various legal entities belonging to a financial institution is a major impediment to resolving such financial institutions in the event of their failure[986]. Increasing reliance on third parties may add another layer of complexity. While bank failures already identified practical issues such as the challenges created by complex corporate structures, information technology systems that may not provide timely or complete information, and the identification and retention of critical staff[987]. What is more, as noted by the FSB "*network effects and scalability of new technologies may in the future give rise to third-party dependencies [what] <…> could[,] in turn[,] lead to*

[986] Report and Recommendations of the Cross-border Bank Resolution Group. Basel Committee on Banking Supervision, Basel, March 2010. P. 29 – 30. [accessed on 12 November 2018] <https://www.bis.org/publ/bcbs169.pdf>.

[987] Report and Recommendations of the Cross-border Bank Resolution Group. Basel Committee on Banking Supervision, Basel, March 2010. Paragraph 10. [accessed on 12 November 2018] <https://www.bis.org/publ/bcbs169.pdf>.

the emergence of new systemically important players that could fall outside the regulatory perimeter"[988].

As we can see, FinTech solutions and increasing collaboration between FinTech firms and banks could not only provide direct as well as indirect opportunities and benefits linked to the implementation of the EU bank recovery and resolution legal framework and its legal objectives but also potentially will raise challenges, in particular, with regard to continuity of bank's critical functions. FinTech innovation may disrupt the ideas and justifications offered in support of regulatory intervention. However, in this context of rapid technological change, interlink between different sectoral legal frameworks, the contours of new legal and regulatory action are not obvious, nor are the frames for analysis. Furthermore, regulations cannot be changed each time when a new technology emerges as, on the one hand, to pass or to amend a legal act takes a lot of time, on the other hand, the applicability and spread of the technology in the field of financial services is not always immediately clear. Therefore, such a situation raises complex theoretical and practical questions of how relevant provisions of the financial law which were and, in most cases, are designed keeping in mind traditional banking business models, could be applied by supervisory and resolution authorities in the era of FinTech revolution and increasing synergy between the banks and FinTech firms. In this context it is also important to discuss relevant EU legal framework provisions (such as requirements to outsourcing and third-party arrangements) and how they could be (re)applied or fixed to deal with emerging risks and challenges for achieving and ensuring the EU bank recovery and resolution legal framework objectives, in particular, the continuity of critical functions.

3.5.1. Relevant EU outsourcing legal framework aspects and implementation challenges

Already in 2016, it was acknowledged that financial services outsourcing market is estimated to be worth 130 billion dollars and should grow by an

[988] Artificial intelligence and machine learning in financial services. Market developments and financial stability implications. Financial Stability Board, Basel, 1 November 2017. P. 1.

annual rate of 7.46 per cent between 2016 and 2020[989]. As it was noted, FinTech firms are good candidates to contribute to this trend. Therefore, for the purposes of this research, it is also important to take into account a broader legal framework in order to identify what kind requirements banks should be compliant with when they are aiming to receive critical services from third-party service providers (i.e. FinTech firms) and how this may impact bank's resolvability which (as it is required by the EU legal framework) has to be assessed by resolution authorities and which are also important for the fulfilment of resolution objectives. These aspects are also important from the perspective of the FinTech firms because if they are not adequately addressed, they could be an obstacle for their partnership and cooperation with banks, while in case banks apply light approach to those provisions this could be a serious obstacle for public authorities, in case, they need to apply recovery options or selected resolution strategy when bank faces difficulties. Finally, banks acknowledge that besides technical know-how, they are more interested in FinTech firms which are better positioned to meet the regulatory requirements of banks[990]. All this is also relevant for the Republic of Lithuanian market where FinTech firms are active as well and which are exploring ways how to partner with banks (in Lithuania and other EU Member States) and *vice versa*.

In this context the EU legal provisions linked to outsourcing become important[991] as well, because the contract negotiated between the bank and third-party providing critical service (i.e. FinTech firm) which are essential for the continuity of critical functions (one of the EU bank recovery and resolution legal framework objective) may be subject to the EU outsourcing requirements as well. The importance of this analysis is also justified by the fact that more and more banks (in particular, newly established so-called

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[989] SEB plėtros vadovas: per ateinančius penkerius metus bankui būtina pasikeisti. DELFI, Vilnius, 2019. [accessed on 14 November 2019] <https://www.delfi.lt/verslas/verslas/seb-pletros-vadovas-per-ateinancius-penkerius-metus-bankui-butina-pasikeisti.d?id=82782439>.

[990] Closing the gap in FinTech collaboration. Overcoming obstacles to symbiotic relationship. Deloitte Centre for Financial Services, 2018. P. 9. [accessed on 15 May 2018] <https://www2.deloitte.com/content/dam/Deloitte/us/Documents/financial-services/us-fsi-dcfs-fintech-collaboration.pdf>.

[991] Already in 2016 it was acknowledged that financial services outsourcing market is estimated to be worth 130 billion dollars and should grow by an annual rate of 7.46 proc. between 2016 and 2020. McCAHERY, Joseph; ROODE, F. Alexander. Governance of Financial Services Outsourcing: Managing Misconduct and Third-Party Risk. In ECGI Working Paper Series in Law, N 417/2018, September 2018, pp. 1 – 36, P. 2.

digital banks) are relying on services outsourced from third party FinTech firms.

At the EU level, the first-time outsourcing guidelines for banks were published by CEBS (predecessor of the EBA) in 2006[992], when the EU bank recovery and resolution legal framework did not exist. These guidelines were only updated in 2019, though certain separate steps with regard to cloud outsourcing were done in 2017. Worth to note that other ESAs acknowledged that the use of cloud outsourcing is a practice common to all financial undertakings and not only banks as credit institutions, and therefore initiated the development of their sectoral Guidelines[993]. Though, it should be mentioned that in 2018, the EC's FinTech action plan already noted that the issue deserves attention beyond the scope of existing initiatives, highlighting that additional certainty could be achieved if supervisory expectations were expressed in the form of formal guidelines of all ESAs[994]. Furthermore, stakeholders responding to the Commission consultation raised concerns that uncertainties over competent authorities' expectations were limiting the use of cloud computing services, highlighting that such uncertainties are due in particular to the absence of harmonisation of national rules and different interpretations of outsourcing rules[995]. All this significantly influenced the preparation of the EBA recommendations.

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[992] Guidelines on Outsourcing. Committee of European Banking Supervisors, London, 14 December 2006. [accessed on 12 November 2018] <https://eba.europa.eu/sites/default/documents/files/documents/10180/104404/6300a204-2d64-494f-b81e-fd3e235a74bb/GL02OutsourcingGuidelines.pdf.pdf?retry=1>.

[993] E.g. Outsourcing to cloud services is also part of EIOPA's mandate in the InsurTech area. As a result, the EIOPA issued a Consultation paper on the proposal for Guidelines on outsourcing to cloud service providers. EIOPA, Frankfurt, 1 July 2019. [accessed on 2 July 2019] https://eiopa.europa.eu/Publications/Consultations/2019-07-01%20ConsultationDraftGuidelinesOutsourcingCloudServiceProviders.pdf>; On 31 July 2018 ESMA sent a letter to all its supervised entities setting out its expectations for cloud based outsourcing and is working to promote supervisory convergence by intensifying dialogue among national competent authorities (Letter FinTech Action Plan – ICT / cybersecurity topics and cloud outsourcing. ESMA, Paris, 10 April 2019 [accessed on 11 April 2019] < https://www.esma.europa.eu/sites/default/files/library/esma50-164-2193_letter_eu_comm_fintech_action_plan_deliverables_cyber_cloud.pdf>).

[994] Communication from the Commission to the European Parliament, the Council, the European Central Bank the European Economic and social Committee and the Committee of the Regions. FinTech Action plan: For a more competitive and innovative European financial sector. The European Commission, Brussels, 8 March 2018. P. 11. [accessed on 10 March 2018] <https://ec.europa.eu/transparency/regdoc/rep/1/2018/EN/COM-2018-109-F1-EN-MAIN-PART-1.PDF>.

[995] *Ibid*, P. 11.

Namely, the EBA issued recommendations which aimed at clarifying the EU-wide supervisory expectations if banks intend to outsource to cloud service providers[996]. These recommendations are also important to form the FinTech perspective as cloud computing[997] is an important aspect enabling technology leveraged by banks to deliver innovative financial products and services. The banks are attracted by cloud computing as it also provides the ability to scale computing resources up or down depending on the needs what makes it appealing for banks to host and run their applications in the cloud instead of hosting and running in their own data centres. This also allows banks to save costs as they have to pay only for the capacity and tools they use. Furthermore, at the global level, the FSB acknowledged that cloud computing could provide greater security than some existing and dated on-premises infrastructures that operate behind firewalls[998]. Though also noted that cloud computing services are provided by a limited number of parties, which could have significant implications for a range of cloud-based financial services in the event of operational issues[999]. Indeed, when Amazon's cloud service rippled through the internet in 2017, everyone (from news sites to government services and financial institutions) whose data was held using this service experienced widespread glitches[1000].

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[996] Recommendations on outsourcing to cloud service providers. Final Report. EBA, London, 20 December 2013. EBA/REC/2017/03. [accessed on 14 November 2018]. < https://eba.europa.eu/sites/default/documents/files/documents/10180/2170121/5fa5cdde-3219-4e95-946d-0c0d05494362/Final%20draft%20Recommendations%20on%20Cloud%20Outsourcing%20(EBA-Rec-2017-03).pdf>.

[997] **Cloud computing** – an innovation in computing that allows for the use of an online network ("cloud") of hosting processors so as to increase the scale and flexibility of computing capacity. Cloud computing has made possible the analysis of very large datasets (big data), and a number of specific FinTech applications. Financial Stability Implications from FinTech. Supervisory and Regulatory Issues that Merit Authorities' Attention. Financial Stability Board, Basel, 27 June 2017. P. 33. [accessed on 28 June 2017] < http://www.fsb.org/wp-content/uploads/R270617.pdf>

[998] Financial Stability Implications from FinTech. Supervisory and Regulatory Issues that Merit Authorities' Attention. Financial Stability Board, Basel, 27 June 2017. P. 22 [accessed on 28 June 2017] < http://www.fsb.org/wp-content/uploads/R270617.pdf>.

[999] Financial Stability Implications from FinTech. Supervisory and Regulatory Issues that Merit Authorities' Attention. Financial Stability Board, Basel, 27 June 2017. P. 19 [accessed on 28 June 2017] < http://www.fsb.org/wp-content/uploads/R270617.pdf>.

[1000] Disruption in Amazon's cloud service ripples through the internet. Reuters, 28 February 2017. [accessed on 28 February 2017] < https://www.reuters.com/article/us-amazon-com-aws-outages-idUSKBN1672E2>.

In the EU, the EBA's Recommendations aimed to deal with the risk of banks becoming too reliant on one provider or being unable to change them should the situation deteriorate. They set specific directions on how to assess the materiality of cloud outsourcing[1001] as well as specific guidance on the process that banks should follow in informing their supervisory authorities about material cloud outsourcing and the information to be provided. Furthermore, with regard to continuity arrangements, it was set that "*the outsourcing contract should include termination and exit management clause that allows the activities being provided by the outsourcing service provider to be transferred to another outsourcing service provider or to be reincorporated into the outsourcing institution*"[1002]. What is more, a requirement for banks to ensure that they are able to exit cloud outsourcing arrangements including the requirement to include indicators that can trigger the exit plan in ongoing service monitoring and oversight of the services provided by the cloud service provider were also set[1003]. Moreover, the Recommendations introduced a requirement to ensure in written contractual arrangements with the service provider bank's unrestricted access and audit rights (including such right to competent authority supervising the outsourcing bank)[1004]. Worth to note that the Commission is also working on the development of standard contractual clauses for cloud outsourcing with financial sector entities[1005]. The rationale behind the development of such standard clauses is that it could be too difficult for financial institutions (in particular, smaller ones) to negotiate terms which are required by the prudential and resolution legal frameworks as big suppliers may use their dominant position.

Finally, it is important to note that even though it was not explicitly mentioned in those recommendations, introduced provisions were also important from the perspective of the EU bank recovery, and resolution legal framework as cloud computing most likely would be considered as a critical service which is essential for the continuity of bank's core business lines and critical functions.

[1001] *Ibid,* Paragraph 4.1.
[1002] *Ibid,* Paragraph 26.
[1003] Ibid, Paragraphs 26 – 29.
[1004] Paragraph 4.3 of the EBA Recommendations.
[1005] Consultation Document – Digital Operational Resilience Framework for financial services: Making the EU financial sector more secure. European Commission, Brussels, 2019. P. 5.

In 2019, when the EU bank recovery and resolution legal framework was already in place, the EBA issued Guidelines developed according to Article 74(3) of the CRD which mandated the EBA to further harmonise institutions' governance arrangements – while outsourcing[1006] is one of the specific aspects of banks' governance arrangements (the "**EBA GL on outsourcing arrangements**")[1007]. These GL not only integrated the discussed recommendation on outsourcing to cloud service providers but went further focused on third-party service providers. A number of provisions linked to the assessment of outsourcing arrangements[1008], governance arrangements, outsourcing policy, business continuity plans, documentation requirements, pre-outsourcing analysis, supervisory conditions for outsourcing[1009], risk assessment of outsourcing arrangements[1010], contractual requirements[1011], sub-outsourcing[1012], security of data and systems[1013], termination rights[1014], oversight of outsourced functions[1015], exit strategies[1016] and specific guidelines addressed to competent authorities[1017] were introduced.

Worth to note that sectoral provisions linked to outsourcing could also be found in other EU legal acts. For example, MiFID II[1018] contains explicit provisions regarding the outsourcing of important operations functions in the field of investment services and activities[1019], while the PSD2[1020] sets out

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[1006] Outsourcing – means an arrangement of any form between an institution, a payment institution or an electronic money institution and a service provider by which that service provider performs a process, a service or an activity that would otherwise be undertaken by the institution, the payment institution or the electronic money institution itself. Paragraph 12 of the EBA Guidelines on outsourcing.

[1007] Final Report on EBA Guidelines on outsourcing arrangements. EBA/GL/2019/02. EBA, London, 25 February 2019.

[1008] Title II of the Guidelines.

[1009] Paragraphs 62 – 63 of the EBA GL on outsourcing.

[1010] Paragraphs 64 – 68 of the EBA GL on outsourcing.

[1011] Paragraphs 74 – 75 of the EBA GL on outsourcing.

[1012] Paragraphs 76 – 80 of the EBA GL on outsourcing.

[1013] Paragraphs 81 – 84 of the EBA GL on outsourcing.

[1014] Paragraphs 98 – 99 of the EBA GL on outsourcing.

[1015] Paragraphs 100 – 105 of the EBA GL on outsourcing.

[1016] Paragraphs 106 – 108 of the EBA GL on outsourcing.

[1017] Paragraphs 109 – 119 of the EBA GL on outsourcing.

[1018] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU. OJ L 173, 12.6.2014, p. 349.

[1019] Art. 16(5), 40(1)(b) of the MiFiD II.

[1020] Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money

requirements for the outsourcing of important operational functions by payment institutions[1021]. The BRRD does not use a term of outsourcing, however, as it was discussed in Chapter II, a number of legal provisions are linked to the continuity of critical functions, while their continuity is not possible without the continuity of critical services supporting those functions and which could be performed by one or more entities (separate legal entity, internal unit, etc.) within the group or be outsourced to an external provider. Discussed GL also acknowledge the importance of outsourcing arrangements in the field of recovery and resolution and notes that a business decision to outsource certain function should not create impediments to the resolvability of the bank[1022].

Considering this, these GL state that they aim to embrace all existing legislation and to ensure a level playing field for credit institutions, investment firms, payment institutions and electronic money institutions[1023]. However, this is not exactly the case as these GL also introduce ambiguities and questions with regard to their alignment with the broader legal framework. Namely, the GL notes that the term '*critical or important functions*' is based on the wording of the MiFID II and the Commission Delegated Regulation 2017/565 supplementing the MiFID II. Indeed, Article 16(5) of the MiFID II includes legal provisions linked to '*important operational functions*', though it does not mention critical operational functions. The term is further elaborated in Commission Delegated Regulation (EU) 2017/565 which specified that an operational function *"[should] be regarded as critical or important where a defect or failure in its performance would materially impair the continuing compliance of an investment firm with the conditions and obligations of its authorisation or its other obligations under the MiFID II, or its financial performance, or the soundness or the continuity of its investment services and activities*"[1024]. What is more, it also notes that the following functions should not be considered as critical or important for the

institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC (Text with EEA relevance). OJ L 267, 10.10.2009, p. 7–17.

[1021] Art. 19(6) of the PSD2.

[1022] Paragraph 9 of the EBA GL on outsourcing.

[1023] P. 9 of the EBA GL on outsourcing.

[1024] Art. 30(1) of Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (Text with EEA relevance) C/2016/2398. OJ L 87, 31.3.2017, p. 1–83.

above-mentioned purpose: i) the provision to the firm of advisory services, and other services which do not form part of the investment business of the firm, including the provision of legal advice to the firm, the training of personnel of the firm, billing services and the security of the firm's premises and personnel; and ii) the purchase of standardised services, including market information services and the provision of price feeds[1025]. The Solvency II, in the context of outsourcing, also uses the term '*critical or important functions or activities'*[1026]. What is more, even though it is not mentioned in the GL, it is worth to note that the V Anti-Money Laundering Directive[1027] regulates performance by third parties[1028] upon whom obliged entities are permitted to rely on third parties to meet the customer due diligence requirements, though making clear that the ultimate responsibility remains with the obliged entity[1029]. It is also worth to note that Article 22 of the General Data Protection Regulation[1030] also states that everyone should have the right not to be subject to a decision based solely on automated processing and the right to be given meaningful information about the logic involved.

The GL note that in order to embrace all existing legislation and to ensure a level playing field for credit institutions, investment firms, payment institutions and electronic money institutions, the wording used under the MiFID II is used within the guidelines. However, there is some ambiguity with regard to the link between the definitions of '*critical or important function*s', and the definitions of '*critical functions*' and 'critical services' (which can be outsourced to an external provider) which are essential with regard to credit

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[1025] Ibid, Art. 30(2).

[1026] Art. 49(2)(3) of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (recast) (Text with EEA relevance). Text with EEA relevance. OJ L 335, 17.12.2009, p. 1–155. (the '**Solvency II**').

[1027] Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC (Text with EEA relevance). OJ L 141, 5.6.2015, p. 73–117.

[1028] Section 4 of the V Anti-Money Laundering Directive.

[1029] Art. 25 of the V Anti-Money Laundering Directive.

[1030] Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC. OJ L 119, 4.5.2016, p. 1–88.

institutions (to which these guidelines are applied as well) and are used in the EU bank recovery and resolution legal framework.

The GL define '*critical or important functions*' as means any function that is considered critical or important and notes that the wording critical or important functions' is not related to the definition of 'critical functions' for the purposes of the recovery and resolution framework as defined under Art. 2(1)(35) of the BRRD. However, despite this confusing definition, it should be kept in mind that under Title II of these GL it is stated that "*in the case of [banks], particular attention should be given to the assessment of the criticality or importance of functions if the outsourcing concerns functions related to core business lines and critical functions as defined in Article 2(1)(35) and 2(1)(36) of Directive 2014/59/EU36 and identified by institutions using the criteria set out in Articles 6 and 7 of Commission Delegated Regulation (EU) 2016/778. Functions that are necessary to perform activities of core business lines or critical functions should be considered as critical or important functions for the purpose of these guidelines unless the institution's assessment establishes that a failure to provide the outsourced function or the inappropriate provision of the outsourced function would not have an adverse impact on the operational continuity of the core business line or critical function*. Under the rational and objective part of the GL, it is noted that "*[o]utsourcing arrangements also need to be considered in the context of [banks'] recovery planning and resolution planning; the operational continuity of critical functions must be ensured even when in financial distress or during financial restructuring or resolution[;] A business decision to outsource a function should not in any way impede the resolvability of the institution*"[1031]. Furthermore, in part explaining the background of the GL it is explicitly acknowledged that "*functions that are considered critical under a resolution perspective may also be outsourced <…> [and] outsourcing arrangements should not create impediments to the resolvability of the [bank]*"[1032]. However, in this context, it is also worth to note that under this paragraph, the regulator most likely had in mind outsourcing of critical services which are supporting critical functions.

As it can be seen, the GL include a provision which tries to link discussed '*critical or important functions*' with the legal concept of critical functions

[1031] Paragraph 35 of the EBA GL on outsourcing.
[1032] Paragraph 9 of the EBA GL on outsourcing.

and interlinked elements (as discussed in Chapter II), though such clarity is not ensured throughout the GL. The wording definitely needs to be improved. In order to avoid ambiguities, it should be clearly stated that critical activities, processes or services directly applicable to core business lines and critical functions should be considered as critical or important for the purposes of these guidelines.

What is more, even though the GL episodically mentions the concept of '*operational continuity*' it avoids further consideration and explanation of the interlinkages between these GL and the work done on operational continuity in recovery and resolution planning and the link between the operational continuity arrangements which are supporting critical services which are essential for the continuity of critical functions (for details see Chapter II). What is more, unfortunately, the GL avoided an opportunity to ensure the EU legal framework greater consistency with the FSB Guidance on arrangements to support operational continuity in resolution (see Chapters I and II) which, considering practices applied by industry, distinguishes between three different service delivery models that banks typically adopt for the provision of service. Namely, i) provision of services by a division within a regulated legal entity, ii) provision of services by an intra-group service company and iii) provision of services by a third-party service provider. Even though the Guidance acknowledges that these three models are not mutually exclusive and many firms employ a mixed service delivery model that combines different models, it identifies service model specific (e.g. when services are provided by a third-party service provider) and general operational continuity elements which are important for bank's resolvability and continuity of critical functions. Therefore, they are relevant in the context of the GL.

The GL include other provisions which are relevant from the perspective of the EU bank recovery and resolution legal framework, though they are not straightforward and should be discussed further. For example, the GL set that when assessing whether an outsourcing arrangement relates *to a function that is critical or important*, banks and payment institutions should take into account, the factors which should include the potential impact of any disruption to the "*outsourced function or failure of the service provider to provide the service at the agreed service levels on a continuous basis on their <…>[,] where applicable, recovery and resolution planning, resolvability and operational continuity in early intervention, recovery or resolution*

situation[1033] ". This is a very broad provision which tries to impose a requirement on institutions by mixing a number of different elements what creates ambiguity (e.g. it is not clear what regulator had in mind by referring to 'operational continuity in an early intervention'. Does this mean the application of early intervention measures as they are defined under the BRRD or other stages; how 'recovery situation' should be understood etc.). This raises questions of how exactly the regulator expects these requirements to be consistently implemented in practice.

What is more, the GL require the outsourcing agreement, among other things, to include also other elements which are important from the perspective of the EU bank recovery and resolution legal framework. Namely:

i) Require ensuring that the data that are wound by the bank or payment institution can be accessed in the case of the insolvency, resolution or discontinuation of business operations of the service provider[1034];

ii) the obligation of the service provider to cooperate with the competent authorities and resolution authorities of the institution or payment institution, including other persons appointed by them[1035];

iii) for banks, a clear reference to the national resolution authority's powers, especially to Articles 68[1036] and 71[1037] of the BRRD, and in particular a description of the 'substantive obligations' of the contract in the sense of Article 68 of the BRRD[1038].

In particular, the third requirement should be discussed further as it may have significant implications both for banks and FinTech firms. In line with the international standards, the EU bank recovery and resolution legal framework sets that a crisis prevention measure or a crisis management measure taken in relation to an entity in accordance with the BRRD, including the occurrence of any event directly linked to the application of such a measure, shall not, per se, under a contract entered into by the entity, be deemed to be an enforcement event within the meaning of Directive

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[1033] Art. 31(b)(v) of the EBA GL on outsourcing.
[1034] Paragraph 75(m) of the EBA GL on outsourcing.
[1035] Paragraph 75(n) of the EBA GL on outsourcing.
[1036] Execution of certain contractual terms in early intervention and resolution.
[1037] Power to temporarily suspend termination rights.
[1038] Paragraph 75(o) of the EBA GL on outsourcing.

2002/47/EC[1039] or as insolvency proceedings within the meaning of Directive 98/26/EC[1040]. However, this is subject to the condition that the substantive obligations under the contract, including payment and delivery obligations and the provision of collateral, continue to be performed. Even though the definition of '*substantive obligations*' is not provided under the BRRD, the analysis of the discussed provisions shows that this at least includes continuous payment and delivery obligations, the provision of collateral. Furthermore, parties should be aware that these rules would also apply in case a 'moratorium tool'[1041] is applied provided that the substantive obligations under the contract, which include payment and delivery obligations, and provisions of collateral, continue to be performed[1042]. However, it is also important to note that the BRRD also requires (subject to certain exemptions[1043]) the Member States to ensure that resolution authorities have the power to suspend the termination rights of any party to a contract with a bank under resolution from the publication of the notice[1044] until midnight in the Member State of the resolution authority of the institution under resolution at the end of the business day following that publication, provided that the payment and delivery obligations and the provision of collateral continue to be performed. Finally, it is important to be aware that these provisions are considered to be overriding mandatory provisions within the meaning of Article 9 of Rome I Regulation[1045].

[1039] Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements. OJ L 168, 27.6.2002, p. 43–50.

[1040] Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems. OJ L 166, 11.6.1998, p. 45–50.

[1041] Art. 33a of the BRRD.

[1042] Art. 33a, 68(3) of the BRRD.

[1043] In order not to disrupt functioning of financial market infrastructures, such power does not apply: i) to systems or operators of systems designated for the purposes of Directive 98/26/EC; ii) central counterparties authorised in the Union pursuant to Article 14 of Regulation (EU) No 648/2012 and third-country central counterparties recognised by ESMA pursuant to Article 25 of Regulation (EU) No 648/2012; and iii) central banks. Art. 71(3) of the BRRD.

[1044] Subject to rules set in Art. 83(4) of the BRRD.

[1045] Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I). OJ L 177, 4.7.2008, p. 6–16.
1. Overriding mandatory provisions are provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract under this Regulation.
2. Nothing in this Regulation shall restrict the application of the overriding mandatory provisions of the law of the forum.

These aspects are important because according to the BRRD legal provisions, banks are expected to develop capabilities which would help to implement preferred resolution strategy (which best allows achieving legal resolution objectives) defined in the resolution plan or accordingly modified if the situation has changed. This means that in case, for example, a resolution strategy is to transfer assets and liabilities to a bridge institution, an asset management vehicle or to another party (through the sale of business tool), there should be not only operational but also contractual and financial arrangements which would ensure the continuity of critical services that the recipient would be able to continue the performance of critical functions, management of transferred assets and liabilities. In case resolution strategy requires open bail-in, banks are also expected to have in place arrangements which would support rapid restructuring. Though it is not explained in the GL, from the perspective of the EU bank recovery and resolution legal framework perspective when setting outsourcing arrangements banks should calculate and keep in mind financial resources and costs at which relevant critical services will continue to be provided in case the bank is put under resolution. Furthermore, in order to avoid misunderstandings, such potential scenario of resolution and potential legal consequences should be known to FinTech firms as well that they would be ready to facilitate the continuation of critical services essential for the continuity of critical functions. In particular, this might be relevant when banks sign outsourcing contracts with the FinTech firm from outside the EU. In this context, it is also worth to recall the FBS Guidance on operational continuity in resolution (see Chapter II) which require to ensure that contractual agreements would contain clauses that allow the service provider to alter the provision of services to a bank solely as a result of it entering into a period of stress or resolution. Furthermore, it sets an important requirement that services received from third-party should be well documented and clear parameters against which service providers can be measured should be set[1046] - in order to assess whether the contractual

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3. Effect may be given to the overriding mandatory provisions of the law of the country where the obligations arising out of the contract have to be or have been performed, in so far as those overriding mandatory provisions render the performance of the contract unlawful. In considering whether to give effect to those provisions, regard shall be had to their nature and purpose and to the consequences of their application or non-application.

[1046] P. 13 of the FSB Guidance on operational continuity in resolution.

provisions of the services meet the operation continuity objective. This aspect was not clarified in the GL as well.

Another important point is the definition of '*outsourcing*'. The EBA Guidelines define outsourcing as "*an arrangement of any form between an institution, a payment institution or an electronic money institution and a service provider by which that service provider performs a process, a service or an activity that would otherwise be undertaken by the institution, the payment institution or the electronic money institution*"[1047]. A '*service provider*' is defined as "*a third-party entity that is undertaking an outsourced process, service or activity, or parts thereof, under an outsourcing arrangement*"[1048]. Collaboration and partnership between the banks and FinTech firms fall under this definition. However, this definition should be read together with the provision set in paragraph 28 of the GL, which lists services and activities which should not be considered as outsourcing[1049]. What is more, considering the scope of definition, it could be argued that some arrangements between banks and FinTech firms such as the sharing of data with third parties (e.g. through application programming interfaces – APIs), the purchase of third-party hardware or software (e.g. artificial intelligence or machine learning models, open-source software and machine learning libraries developed by third-party providers) which may be important for the continuity of bank's critical functions may fall outside the definition of '*outsourcing*' defined in the EBA guidelines on outsourcing and may not be subject to specific outsourcing requirements.

What is more, these GL note that banks are responsible for assessing the *materiality* of outsourcing arrangements, though it does not define the criteria

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[1047] Paragraph 12 of the EBA Guidelines on outsourcing.
[1048] *Ibid.*
[1049] Namely: a) a function that is legally required to be performed by a service provider, e.g. statutory audit; b) market information services (e.g. provision of data by Bloomberg, Moody's, Standard & Poor's, Fitch); c) global network infrastructures (e.g. Visa, MasterCard); d) clearing and settlement arrangements between clearing houses, central counterparties and settlement institutions and their members; e) global financial messaging infrastructures that are subject to oversight by relevant authorities; f) correspondent banking services; and g) the acquisition of services that would otherwise not be undertaken by the institution or payment institution (e.g. advice from an architect, providing legal opinion and representation in front of the court and administrative bodies, cleaning, gardening and maintenance of the institution's or payment institution's premises, medical services, servicing of company cars, catering, vending machine services, clerical services, travel services, post-room services, receptionists, secretaries and switchboard operators), goods (e.g. plastic cards, card readers, office supplies, personal computers, furniture) or utilities (e.g. electricity, gas, water, telephone line).

for the assessment of such materiality nor how it should be understood. On the one hand, such provisions provide flexibility, on the other hand, they encode inconsistencies in their assessment criteria and conclusions across the Member States (in particular, outside the Banking Union) and will require revision in future. Furthermore, the Guidelines require banks to inform in a '*timely manner*' of material changes and/or severe events regarding their outsourcing arrangement that could have a material impact on the continuing provision of the banks' business activities[1050]. Such general provision not only raises a question what the term '*timely manner*' should mean but could create situations when the supervisors are notified of material outsourcing arrangements too late in order to meaningfully assess and discuss the arrangement and consider if additional steps were appropriate.

Another aspect which should be highlighted is a liability. Outsourcing to third-party service providers still means that bank's management body remains responsible for all outsourced functions as other bank's activities at all times, and the management body is required to ensure that sufficient resources are available to manage the outsourcing arrangements[1051]. Banks cannot transfer the accountability for the risks to third parties and cannot become so-called "empty-shells". As a result, this means that banks have to know FinTech firms they are planning to work with, which risks they are exposed to and whether they are able to monitor as well as to control these risks on an ongoing basis.

Outsourcing could also generate concentration risk. Monitoring of potential concentration risk is also important. Multiple banks may outsource critical services to a single dominant third party or have multiple outsourcing arrangements with the same service provider or closely connected service providers. In case such third party faces difficulties, it could result in discontinuity of critical services to several banks at the same time what may undermine confidence in the financial sector or create financial stability issues, in particular, if critical functions (e.g. payments) are affected. Therefore, in this context analysis of concentration risk becomes an important point not only for supervisory authorities (as it is set in the GL[1052]) but also by

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[1050] Paragraph 59 of the EBA GL on outsourcing.
[1051] *Ibid,* P. 4., Paragraph 100.
[1052] The EBA GL on outsourcing set an obligation only for competent authorities to monitor the development of concentration risks, though this aspect is also important for resolution

resolution authorities as it may have serious implications for operation continuity of critical functions. What is more, considering the role of resolution authorities in the resolvability assessment they may have a bigger picture of what is happening and where potential risks are building-up and could have negative externalities for the bank's resolvability.

Furthermore, worth to note that the EBA GL require banks to be able, upon request, to make available to the competent authority either the full register of all existing outsourcing arrangements or sections[1053]. Such a register could also be a good source for national supervisory authorities for the analysis of where potential concentrations risks are emerging. Subsequently, on the basis of the analysis performed by national authorities, for example, the EBA could aggregate the results and check the trends from the EU perspective. In the EU it was already acknowledged that the Commission should regularly monitor the extent and structure of outsourcing of critical services by banks and assess the appropriateness of tools in place to mitigate concentration risks, operational risks and systemic risk[1054]. Ultimately, coordinated international intervention and approach[1055] could be needed in particular if empirical data will start to show that third party service providers are becoming systemically important or even too big to fail. This may also require thinking about the legal framework for the supervisions of such systemic third parties[1056]. For example, at the EU level, a recommendation was already issued to establish an oversight framework for monitoring the critical third-party providers in the context of information and communication technology (the ICT)[1057]. Such concept won't

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authorities as it may impact bank's resolvability and continuity of critical functions in case such risks emerge.

[1053] As specified in Paragraph 54 of the EBA GL on outsourcing.

[1054] 30 Recommendations on Regulation, Innovation and Finance. Expert Group on Regulatory Obstacles to Financial Innovation. Final Report to the European Commission, Brussels, December 2019. P. 15 [accessed on 18 December 2019] < https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/191113-report-expert-group-regulatory-obstacles-financial-innovation_en.pdf>.

[1055] The IMF already highlighted that it is important to monitor FinTech developments and further analyse the macro-critical implications and risks at the country and global levels. FinTech: The Experience So Far. International Monetary Fund, Washington, 2019. P. 4. [accessed on 28 June 2019] <https://www.imf.org/en/Publications/Policy-Papers/Issues/2019/06/27/Fintech-The-Experience-So-Far-47056>.

[1056] Such practice is applied, for example, in the field of financial market infrastructures. In

[1057] Joint Advice of the European Supervisory Authorities to the European Commission on the need for legislative improvements relating to ICT risk management requirements in the EU financial sector. EIOPA, EBA, ESMA, 10April 2019. Paragraph 8. [accessed on 29 April 2019] <https://eba.europa.eu/sites/default/documents/files/documents/10180/2551996/4d2ad5e2-

be completely new, as central bank oversight of systemically important systems is applied, for example, in the field of financial market infrastructures (FMIs). More specifically, in April 2012, the Committee on Payment and Settlement Systems (the CPSS) of the Bank for International Settlements and the Technical Committee of the International Organisation of Securities Commissions (the IOSCO) jointly published the Principles for financial market infrastructures[1058]. The Committee on Payments and Market Infrastructures, the successor of the CPSS, and IOSCO subsequently jointly published guidance[1059] on these principles. The European Central Bank (ECB) implemented the CPSS-IOSCO principles and subsequent guidance insofar as they relate to systemically important payment systems.[1060]

To sum up, discussed EBA Guidelines on outsourcing are important EU legal acts and should become even more important in future, considering that both banks and FinTech firms are increasingly looking for opportunities to partner by establishing outsourcing arrangements. These Guidelines introduce a number of provisions linked to the assessment of outsourcing arrangements and requirements which should increase consistency of legal provisions across the Member States. They also aim to "*embrace all existing legislation and to ensure a level playing field*". However, the analysis shows that in order to ensure greater consistency across different legal acts, the interlink between the definition of '*critical or important functions*' and the legal concept of critical functions and supporting elements (e.g. critical services, operational continuity arrangements) could be further clarified. Moreover, considering the ambiguity of the terminology and norms, it could be challenging for banks and/or supervisory authorities to make relevant links between the provisions of different legal acts (i.e. the EU prudential legal framework and the EU bank recovery and resolution legal framework concepts) and to strike a right

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1570-48bd-819a-7cd9b4e8b157/JC%202019%2026%20(Joint%20ESAs%20Advice%20on%20ICT%20legislative%20improvements).pdf>.

[1058] Principles for financial market infrastructures. Bank for International Settlements, OICD-IOSCO, Basel, April 2012. [accessed on 2 May 2016] <https://www.bis.org/cpmi/publ/d101a.pdf>.

[1059] Recovery of financial market infrastructures. Bank for International Settlements, OICD-IOSCO, October 2014 (revised July 2017). [accessed on 1 August 2017] <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD569.pdf>.

[1060] Under Regulation of the European Central Bank (EU) No 795/2014 of 3 July 2014 on oversight requirements for systemically important payment systems (ECB/2014/28). OJ L 217, 23.7.2014, p. 16–30.

balance. This neither provides clarity for banks when applying and navigating between different legal acts, nor supervisory and resolution authorities when monitoring their implementation in practice.

Furthermore, the analysis of the 'outsourcing' definition stipulates that there could be third party arrangements (in particular, FinTech solutions) which may fall outside this definition and therefore may not be subject to specific outsourcing requirements. Therefore, it will be important for supervisory and resolution authorities to keep in mind such potential 'grey' areas and from time to time to clarify with the banks how they understand which arrangements fall under the outsourcing definition and requirements in order to avoid potential obstacles for the bank's resolvability. The complexity and jigsaw of legal requirements which have to be considered and respected by banks when relying on third-party service providers, in practice, will also create challenges for FinTech firms as not all of them may have sufficient professional knowledge to fulfil these requirements and piece together the regulatory landscape[1061] as it continuously develops.

3.6. An Overview and Conclusions of the Third Part

In recent years, the speed and scale of investments to FinTech has increased rapidly. Collaboration between FinTech firms and banks is expected to grow significantly as both parties could benefit from it. On the one hand, such collaboration brings new opportunities for customers and new business models for FinTech firms and banks themselves, on the other hand, it also impacts the application of existing bank prudential supervision, recovery and resolution legal framework and fulfilment of its legal objectives.

Both at the global and the EU levels FinTech topic is progressively getting more attention from regulators and public authorities. However, even though there is some attention and work done concerning potential opportunities and challenges to supervision and financial stability stemming from FinTech,

[1061] Besides the discussed legal framework, it is worth noting that the European Commission is working on a number of new regulatory initiatives. For example, development of a digital operational resilience testing framework across all financial sectors, providing for a mechanism to anticipate threats and impotence the digital operational readiness of financial actors and authorities. Consultation Document. Digital Operational Resilience Framework for financial services: Making the EU financial sector more secure. European Commission, Brussels, 2019. [accessed on 15 December 2019] <https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/2019-financial-services-digital-resilience-consultation-document_en.pdf>.

there is no or very limited specific analysis on how collaboration between FinTech firms and banks could impact the application of legal provisions and the objectives of the bank recovery and resolution legal framework.

The analysis shows that collaboration between FinTech firms and banks could create opportunities (e.g. improved data and risk management etc.) and challenges (e.g. bank's critical functions dependence on critical services supplied by FinTech firms etc.) in ensuring the continuity of bank's critical functions. Therefore, more attention from banks, supervisory (competent) and resolution authorities will be needed in order to balance those opportunities and challenges when applying and implementing the provisions of the EU bank recovery and resolution legal framework and ensuring that banks would not become 'too technologically interconnected and complex' to be resolved.

When preparing recovery plans, banks will need to consider their critical functions dependence from critical services supplied by FinTech firms, while supervisors, when reviewing those plans, will need progressively to draw more attention whether this aspect is adequately captured. When preparing the resolution plans, resolution authorities will need gradually to draw more attention to this aspect as well, as such collaboration could not only bring opportunities which could help to improve bank's resolvability, but also could bring challenges and potential impediments for bank's resolvability. Finally, if not adequately balanced, such collaboration may ultimately complicate the fulfilment of one of the vital resolution objectives – the continuity of bank's critical functions which are essential to the real economy and financial stability.

In this context, the EU legal framework with regard to outsourcing is important as well, because the contract negotiated between the bank and third-party providing critical service (i.e. FinTech firm) which are essential for the continuity of critical functions (one of the EU bank recovery and resolution legal framework objectives) may be subject to the EU outsourcing requirements as well. Continuously, this evolving regulatory area will require more concentrated efforts (from banks, FinTech firms, supervisory and resolution authorities) to map and oversee complex balance of risks surrounding flow of critical services and third-party dependencies and ensuring that banks are able to deliver critical functions and core business lines during disruptions. The analysis also shows that future review of discussed EU GL on outsourcing will require more significant consideration of the FSB international standards and the EU bank recovery and resolution legal framework provisions, objectives in order to ensure greater consistency and a

logic-systemic link between different parts of the EU bank prudential and resolution legal framework provisions.

Finally, considering banks' critical outsourcing dependencies on FinTech and BigTech solutions is increasing, global regulators should intensify reassessment of the regulatory perimeter to address these dependencies and growing so-called shadow infrastructures which are becoming part of the financial infrastructure but mostly fall outside the supervisory scope. The amendments of the prudential supervision legal framework should also take into account that these aspects are essential for ensuring one of the most important bank recovery and resolution legal framework objectives – the continuity of bank's critical functions which are essential to the real economy and financial stability.

CONCLUSIONS

1. In the market-based economy, we cannot avoid bank failures, but we can manage them better. Therefore, dynamic not a static approach is important concerning the legal framework in the field of banking supervision, crisis prevention and management, to adjust financial safety-net elements and legal instruments designed to deal with the challenges coming from the future, rather than just fixing what has not worked previously. The EU's recent reforms are the move forward, though they were made *post factum*. Namely, the research allows to identify four key waves of legal framework substantial developments and harmonisation, which ultimately lead to the adoption of the EU bank recovery and resolution legal framework. The first attempts to ensure greater harmonisation of the legal framework for dealing with the failing banks can be traced back to the creation of the EEC. However, the fourth wave, and the most significant one, was taken only after the financial crisis. Global agenda and the international standard of the Financial Stability Board have greatly influenced the development of the EU bank recovery and resolution legal framework as a new paradigm.
2. To be effective, the EU bank recovery and recovery legal framework – a paradigm-changing reform – requires a permanent mindset change not only from banks but also from national supervisory and resolution authorities, and governments. A better understanding of the content of the legal resolution objectives could contribute to this. The EU bank recovery and resolution legal framework lists five legal resolution objectives. The in-depth analysis allows arguing that the first objective – to ensure the continuity of bank's critical functions (not all banks do have such functions) – is one of the most important and complex. Other objectives are linked to it and support this objective. The first legal resolution objective – the continuity of critical functions (that are essential to the real economy and financial stability) – cannot be assessed without understanding the legal definition and concept of critical functions which play a crucial role in the EU bank recovery and resolution legal framework.
3. The EU bank recovery and resolution legal framework resolution objectives should work as a safeguard for the public interest, which among other things also requires to ensure a stable and sustainable banking sector. These objectives also aim to encourage market-oriented

incentives and greater responsibility of bank's owners, senior management, creditors and investors in its debt. However, their legal structure complexity indicates that in practice achievement and implementation of these objectives is not straightforward. This research contributes to a greater understanding of these objectives.

4. FinTech developments create not only opportunities but also challenges for the implementation and achievement of the EU bank recovery and resolution legal resolution objectives, in particular, the continuity of bank's critical functions. Increasing partnerships between banks and FinTech will require greater cooperation and attention from both supervisory and resolution authorities. It is expected the relevance of legal provisions linked to outsourcing will increase, and this will require greater attention from regulators at the global, EU and national levels. The first steps, updating outsourcing legal framework, have already been done at the EU level. However, it is already evident that moving forward it will need to be amended taking into account not only the EU prudential supervision legal framework but also greater attention to the EU bank recovery and resolution legal framework and its objectives. Only an integrated approach could also ensure the achievement of one of the key EU bank recovery and resolution legal framework objectives – the continuity of the bank's critical functions which are essential to the real economy and financial stability.

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NOTES

Vilnius University Press
9 Saulėtekio Ave., Building III, LT-10222 Vilnius
Email: info@leidykla.vu.lt, www.leidykla.vu.lt
Print run copies 20