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Help for Europe's Zombie Banks? – Open Questions Regarding the Designated Use of the European Bank Resolution Regime

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by

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A. Introduction

It has become a common belief that banks and financial institutions are to be exempt from common insolvency law as they are "too big to fail". Even in cases like the Cyprus banking crisis where financial institutions were not too big to fail, they often seemed too interconnected to fail. Due to their size and/or interconnections with other banks, many financial institutions seem irreplaceable for governments and authorities.

In this paper, I will not address the common sense response to the problem of a banking crisis that would be to prevent them from failing. The current EU financial stability framework is addressing this task by ensuring that banks are adequately capitalised and supervised. Instead, I will examine the proposed European bank resolution regime, which does not aim at preventing failure but at reducing the impact of failure. Though it may not be its main purpose, an efficient bank resolution regime contributes to the prevention of bank failure by reducing a moral hazard as this may prevent a bank's management and executives from engaging in excessive risk in cases where they can no longer trust in the government to use public funds to offset bad speculation. Under an efficient bank resolution regime, a failing bank would be subject to a resolution process, and its management and owners would have to face consequences and suffer losses for taking disproportionate risks. This paper will indicate that the upcoming European bank resolution regime does focus less on handling the scenario of an abrupt failing financial institution (a "Lehman scenario") and more on addressing the current problem of the slow recapitalization of European banks (a "zombie bank scenario").

B. The proposed European Bank Resolution Mechanism

On June 6, 2012, the EU Commission published its "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" (Bank Recovery and Resolution Directive).[1] The framework is intended to equip the relevant authorities in all Member States with common and effective tools and powers to address banking crises pre-emptively, safeguarding financial stability and minimising taxpayers' exposure to losses.

On July 10, 2013 the EU Commission specified this framework for Euro Zone Member States by publishing its proposal for a "Single Resolution Mechanism" ("SRM").[2] The proposed SRM is supposed to form the "second pillar" of the Banking Union (next to the Single Supervisory Mechanism and the Single Resolution Fund). It would apply the substantive rules of bank recovery and resolution directive (RRD) in a newly designed, centralised decision-making process.

[1] COM(2012) 280 final.

[2] COM(2013) 520 final.

The original Commission's SRM proposal was modified before it received the approval of the Council and the European Parliament on March 20, 2014. While no official text for the modified SRM Regulation has yet been released, the statement from President *Barroso* and Commissioner *Barnier*[3] indicates that, as a major modification, the establishment of a Single Resolution Fund is not to be governed by the SRM Regulation but will instead depend on future "inter-governmental agreements". The European Parliament backed the modified SRM Regulation in its session on April 15, 2014.

C. The questionable efficiency of the European Bank Resolution Regime in a "Lehman Scenario"

The proposed SRM Regulation and the Bank Recovery and Resolution Directive both target the very same scenario in which a supervised financial institution unexpectedly experiences a severe liquidity or solvency problem. The new European framework shall provide for tools that "allow for the in-depth restructuring of banks by authorities whilst avoiding the very significant risks to economic stability and costs derived from their disorderly liquidation under national insolvency laws, and putting an end to the need to finance the process with public resources."[4] Such a situation could be referred to as a "Lehman Scenario" as *Lehman Brothers Inc.* was the most notorious while not, of course, the only financial institution to have experienced such problems in the past ten years.

The decision to address such a scenario with a special legal regime instead of applying regular insolvency proceedings is legitimate because – ultimately – "banks are special".[5] It seems doubtful, however, whether the proposed SRM Resolution is well designed to serve the special needs of a SIFI failure. Three aspects, in particular, could cause some doubts:

I. Pre-packaged content of a resolution plan

As time is of the essence in a bank failure, and a bank's assets and financial structure are quite complex, there is not much time for preparing a plan at the onset of a crisis. Instead, a pre-packaged plan seems ideal as it both provides a ready-to-use solution if it is up to date and prepares a response (where possible) to scenarios of possible failure. The EU framework therefore requires all (recovery and resolution) plans to be prepared in good times and updated annually. They must also cover a range of scenarios and response options. While there is good reason for such requirements in theory, it is hard to believe that contingency plans will precisely predict the scenario that sees a bank fail. It's hard to make predictions, especially about the future.[6] Nevertheless,

[3] European Commission – Statement/14/77 (March 20, 2014).

[4] COM(2013) 520 final, 3.

[5] For a detailed discussion of this aspect, see *Madaus*, in: Wessels/Haentjens (Eds.), Bank Recovery and Resolution, 47-52.

[6] A quote commonly attributed to *Niels Bohr*.

reasonable efforts to plan for a SIFI's resolution seem appropriate because the very process of planning may expose risks and initiate a timely restructure. "Plans are of little importance, but planning is essential." (*Winston Churchill*). It is the right balance between the costs and benefits of resolution planning that should not be lost in the process.

II. Strong and central decision-making

The European legislature understands that time is a critical factor when a financial institution is failing.[7] In order to preserve financial stability, markets need to know quickly how an ailing bank is dealt with as the impact of such treatment on other market participants must be calculated immediately. Therefore, an efficient bank resolution regime must be able to generate a decision about how to treat a failing bank in a resolution before markets reopen (a timespan of a night or the course of a weekend). SRM decision-making is set to minimize sources of uncertainty in the markets by centralising the decision regarding whether and how to resolve a bank at the European level. Unfortunately, this aim did not lead the EU legislator to establish a single decision-maker. Instead, the decision-making process remains one reliant on of cooperation.

While no official text for the modified SRM Regulation has as yet been released, the statement from President *Barroso* and Commissioner *Barnier*[8] indicates that the Resolution Board would be competent to decide about the resolution of all failing banks, including those that operate nationally and are not subject to full ECB direct supervision if resolution involved the use of the Fund. While this statement may sound like a central and strong decision-making scheme, European politics have ensured that all effected parties are involved in the decision-making process at the European level.

First, the Resolution Board would at least consist (in executive sessions) of the Chair, the Executive Director, and three other permanent members, while the Commission and the ECB would be permanent observers. In addition, further (national) members would be part of that session according to the institution being resolved to ensure that the interests of all Member States on which the resolution had an impact were considered. To illustrate this fact, in the case of a failing banking group structured such as *Banco Santander S.A.*, with subsidiaries in 8 Euro zone Member States, the Board would be composed of 12 members, none of the participants in the deliberation could veto a decision supported by a simple majority (see Art. 51 SRM Regulation), and resolution decisions involving the use of the Single Resolution Fund above 5 billion would require a Board plenary session, which means that representatives of the Commission, the Council, and the ECB would join the group of participants.

Second, even if the Resolution Board actually arrived at a decision on a Resolution Scheme for a failing bank in time, the SRM Regulation would still offer the Commission as well as the Council the right to object. While the Council could only

[7] See COM(2013) 520 final, 5.

[8] European Commission – Statement/14/77 (March 20, 2014).

object to a Board's decision when the amount of resources drawn from the Single Fund is modified or if there is no public interest in resolving the bank, the Commission would be entitled to assess all discretionary aspects of the Board's decision. In cases where the Council or the Commission object to the resolution scheme, the Board would have to amend the Resolution Scheme accordingly.

Considered in the narrow timeframe for decision-making on a bank resolution, decision-making under such a regime would require immediate and direct negotiations with all authorities in order to adopt a Resolution Scheme that is not only supported by the relevant majorities in the Board but also the Commission and the Council. Under a resolution regime that is biased towards recapitalising a failing bank, such voting rules create quite a complex bargaining situation in times of an urgent crisis.

III. The bail-in tool as a key instrument

The bail-in tool is only one out of four tools to resolve a bank failure under the new framework.[9] It is intended to give resolution authorities the power to recapitalise a failing financial institution "to restore its ability to comply with the conditions for authorisation and to carry on the activities for which it is authorised" (see Art. 37 (2) (a) RRD). The bail-in tool introduces a reorganisation option to the bank resolution regime as the failing entity would survive its "resolution".

The SRM Regulation, as the RRD before, was drafted with a clear bias towards the bail-in tool as the default resolution tool. It was referred to as the "key instrument".[10] In a "Lehman Scenario", however, a bail-in is a very questionable tool both for its policy implication and efficiency.

1. Policy implications

A reorganisation option that is almost guaranteed by authorities as the preferred option in a future bank failure because it is a key element of a bank's resolution plan weakens the incentive to avoid a moral hazard. If the only consequences that a financial institute has to fear in case of a failure are the mandatory replacement of senior management [Art. 29 (1) (c) RRD] and the dilution of shares [Art. 42 (1) (b) RRD], any decision to enter into risky business would not mean risking the very existence of a company. Such a bank resolution regime would seriously not serve its chief political purpose.

Preferring the bail-in tools also means that a failing bank would principally not be resolved in terms of liquidation. Such a bank resolution regime would not only re-

9 Both the Directive and the Regulation provide for four tools: sale of business, bridge institution, asset separation, and bail-in. For a more details, see the explanatory memorandum in COM(2012) 280 final, 12-14; see also *M. Schilling*, Bank Resolution Regimes in Europe II –Resolution Tools and Powers, 16-42, available at: SSRN: http://ssrn.com/abstract=2136084 (visited on June 2, 2014).

10 COM(2013) 520 final, 3.

place insolvency proceedings but also exclude any liquidation-type of solution to a failing financial institution with systemic relevance. Such a "resolution regime" could not prevent governments from transforming bank debts into public debts because it would still allow for the use of taxpayers' money as a last resort to enable a recapitalisation according to a bail-in scheme in order to avoid any liquidation of a failing bank.

And even if a bail-in of a failing bank is to be financed by funds acquired from competing financial institutions (see the Single Resolution Fund), such funding would be secured by amounts raised by ex-ante contributions from all financial institutions. In contrast to regular insolvency proceedings in which the stakeholders of an insolvent company or private investors need to fund a reorganisation process, such mandatory financial support of a competitors' rescue is hardly consistent with the principles of a European market economy.

2. *Efficiency*

In a "Lehman Scenario", in order to maintain financial stability despite a (major) bank's failure, quick, convincing and predictable solutions are required to calm the financial system. A bail-in cannot provide for such an effect.[11] First, a bail-in requires an ex-ante valuation of the failing bank's assets and liabilities (see Art. 17 SRM Regulation), which is impossible to be done convincingly over the course of a night or a weekend. Second, even a quick recapitalisation of a failing bank with a bail-in of sufficient amounts of debt would only address a financial distress and could not ensure that a bank's business model is sound. A discharged bank without a viable business model would experience another failure within a short period of time. Regarding the significant rate of unsuccessful reorganisations despite successfully confirmed reorganisation plans, financial stability does not appear to be guaranteed by a default reorganisation option of financial institutes – especially if a considerable number of liabilities remain intact. Any bail-in would therefore have to be connected with a reorganisation plan developed after the bail-in (see Art. 47 RRD). Thus, the bail-in itself could not spur any immediate market confidence in the success of the resolution.[12]

It is a next-to-impossible task to seriously plan for a reorganisation of a financial institute by setting up a pre-packaged plan based solely on crisis scenarios.[13] Even in a moment of crisis, it is complex and difficult to design and negotiate a rescue plan. As all the precautions in Section 5 of the RRD demonstrate, the preparation of a contingent resolution plan with a bail-in tool would absorb a substantial portion of a resolution authorities' capacity and would still not guarantee a quick and successful reorgan-

[11] *Ibid*, supra note 9, 33 and 38.

[12] *Ibid*, supra note 9, 40. In contrast to a bail-in, contingent capital or distress-contingent convertible debt like coco bonds could provide for a quick debt to equity swap because they convert debt automatically at a contractual rate when triggered; see *ibid*, supra note 9, 30-31. Coco bonds could not, however, spur confidence that the discharge is sufficient nor that the discharged bank's management will adjust the business model to prevent another failure.

[13] *Packin*, 9 Berkeley Bus. L.J. 2012, 29 (76): "But, since financial calamities are typically unexpected, planning in advance reorganization and liquidation plans, in order to be ready to face the unknown, is virtually impossible." For a similar sceptic German view: *Chattopadhyay*, WM 2013, 405 (414).

isation, especially in case of an unforeseen development such as where banks run out of a scheme of "flexible" accounting as seen in the case of Lehman Brothers, for instance. Plans will not work where they are based on false data. After all, the cost-benefit-ratio calls for a very restricted use of the bail-in tool in resolution regimes at the very least.

Finally, a reorganisation option might be useful, but it is neither necessary nor effective to achieve the aims of a bank resolution regime: maintaining financial stability despite the failure of a SIFI. There are less extensive and less costly tools available that ensure financial stability in every bank failure than any attempt at a quick reorganisation. If there is no market interest in a take-over of a failing bank, the solution is to transfer valuable parts to a bridge institution to be continued without any disruption. Here, it could be restructured or sold in a near future with a better market environment. A restructuring of a bridge institution could actually be done by a debt-to-equity swap but under company law and without time constraints. In such a restricted approach, a bail-in tool would not interfere with the good policy choice of a principal dissolution of the entity of a failing financial institution.

D. Outlining a "default resolution option" for a "Lehman Scenario"

The shortcomings of a bail-in in a "Lehman Scenario" leads to the conclusion that the resolution of a failing financial institution should principally consist of a quick and pre-packaged transfer of such an institution's valuable assets in addition to systemically relevant services and financial contracts (to a buyer[14] or a "good bank"), thus liquidating the failing entity.[15] Such a quick transfer achieves all the key targets of a bank resolution: maintaining the bank's vital functions for the real economy: allocating losses with shareholders and creditors, and providing markets with immediate certainty in a crisis. This has proven to be very efficient in the United States, where it has been the key tool to resolve failing commercial banks before and after the Dodd-Frank Act.[16]

In cases where a banking group is concerned, the concept of a pre-packaged transfer also falls into place with the "SPE (single point of entry) approach", which is held to be the preferred approach in the Federal Deposit Insurance Corporation and the Bank of England Memorandum on Resolving Globally Active, Systemically Important Financial Institutions from December 2012.[17]

[14] The case of *Bradford & Bingley*, a UK bank that failed in September 2008 and went thru a pre-pack sale, may serve as a good example.

[15] *Van der Zwet*, DNB Occasional Studies Vol.9/No. 2 (2011), 27.

[16] *Ibid*, 10-11.

[17] *Resolving Globally Active, Systemically Important, Financial Institutions. A joint paper by the Federal Deposit Insurance Corporation and the Bank of England*, 10 December 2012, 2, available at: http://www.bankofengland.co.uk/publications/Documents/news/2012/nr156.pdf (visited on June 2, 2014). The key feature of this approach is to resolve the parent company ("topco") while leaving all other group companies with their regular business. It is particularly useful where topco is not an operating company but only a holding company that holds shares and loans to the operating subsidiaries. With such a group structure, a topco-only resolution could guarantee the continuation of services for the financial market and thus limit risks for financial stability while quickly

Such a regime would reduce the costs of any resolution planning while increasing the certainty of available options in the critical moment of the resolution decision as it does not require a vague ex-ante valuation of the failing financial institution. It would consist of three stages:

I. Resolution planning and resolvability

In order to enable a quick transfer of not only small or medium size banks, but also of SIFI's in the case of a failure, a marketability assessment of a financial institution's core assets and services must be undertaken and updated. This should focus on potential investors for a bridge entity that would be established in a resolution and that would require fresh money. A resolution plan would also need to identify and document the relevant assets, service units, and types of contracts to be transferred in an inventory.[18] Impediments to service transfers were to be addressed by resolution authorities, e.g. by requiring the institutions' restructuring ex-ante.

II. The Resolution of a failing financial institution

As soon as a financial institution fails, the respective resolution authority should arrange for a sale to a willing buyer or for the transfer of all vital assets, services and financial contracts, specified in the resolution plan, as well as all unsecured creditors' claims and sufficient valuable assets to a bridge institution (a 'good bank'). By doing so, the failure would be resolved quickly and risks to financial stability would be contained promptly. All deposits would be part of the transfer and served by the buyer or the good bank, so no impairment on their part would be incurred initially.

In the case of a transfer to a bridge institution, the resolution process would have to continue. Resolution authorities would assign the management of the good bank to business professionals and distribute shares according to the priority set in Art. 15 SRM Regulation by converting transferred unsecured claims to equity. In case there is a shortage in liquidity at this stage, the Single Resolution Fund could be used for interim funding. Disputes between parties about the value of transferred assets or about a violation of the no-creditor-worse-off-principle should not be capable of slowing down this process but result in separate damages litigation only.

Hereafter, the future of the good bank lies in the hands of its new management and owners, and the resolution authorities' focus may shift to the management of those non-vital assets and (derivative) contracts that remained with the failed entity. Of course, national law may also assign this task to other authorities or insolvency courts. Any proceeds from these proceedings would be distributed to the good bank.

restructuring the debts of the group at the top level. The transfer of assets would also provide for the replacement of management, while the difficult task of restructuring the groups' business operations and long term funding is assigned to the new management of the bridge entity.

[18] See *M. Schilling*, Bank Resolution Regimes in Europe II –Resolution Tools and Powers, supra note 9, 20, available at: SSRN: http://ssrn.com/abstract=2136084 (visited on June 2, 2014).

Finally, it should be noted, that – in contrast to a bail-in-based model – the good bank model is regarded to be "best practice" in resolving a banking crisis because it has demonstrated its efficiency in Sweden in 1992, and (as far as it was used) in Iceland in 2008.[19]

E. The European Bank Resolution Mechanism – a response to a lingering "Zombie Bank Scenario"?

While the bail-in tool of the European Bank Resolution Regime does not appear to be well-fitted to handle a "Lehman Scenario", the verve from within EU Commission and Legislation towards it may stem from another scenario: the "Japanese experience" or "zombie bank scenario".

I. Zombie banks and zombie companies

In the early 1990's, a bursting housing and stock market bubble hit the balance sheets of Japanese firms and produced substantial numbers of non-performing loans for Japanese banks. To avoid the recognition of these losses, which had been followed by a large number of prominent bank and business insolvencies, the Japanese government bailed out its troubled banks, and the Bank of Japan kept providing them with liquidity. While technically (balance sheet) insolvent, banks and major companies lived on like "Zombies". Zombie banks were neither healthy enough to lend to healthy businesses and consumers (and to help the economy) nor weak or unsupported enough to collapse. Zombie companies lacked to ability to invest as they saved the money to restore their balance sheet over the years while having at least the liquidity to pay interest.[20]

The similarities to Europe's economy in its present state are rather obvious.[21] A bursting bubble led to a banking crisis which has caused a sovereign debt crisis because all efforts have been used to prevent a recognition of the losses that the initial bubble burst produced. Extensive monetary-policy measures by the ECB have so far calmed the bond markets but the soft "stress tests" of 2010 and 2011 have been unable to restore market confidence in the balance sheets of most European banks. The Economist reported in July 2013 that "the average price-to-book ratio for European banks remains below one, suggesting that investors think lenders are worth more dead than alive. In America, where banks were recapitalised quickly, the ratio exceeds one.

[19] *Danielsson*, How Not to Resolve a Banking Crisis: Learning from Iceland's Mistakes, VoxEU.org, October 26 2011, available at: http://www.voxeu.org/index.php?q=node/7157 (visited on June 2, 2014). See also *Howden*, Economic Affairs Vol. 33.3 (2013), 348 (349).

[20] For a more detailed analysis of the Japan's lost decade, see e.g. *Koo*, The Holy Grail of Macroeconomics-Lessons from Japan's Great Recession; *Schnabl*, Working Papers on Global Financial Markets No. 36, (with further references).

[21] See *Schnabl*, ibid at 3; see also *Binder*, JBB 2013, 297 (310).

Italy's two big lenders, *UniCredit* and *Intesa Sanpaolo*, have ratios of 0.34 and 0.42, respectively."[22]

II. The opportunities provided by and limitations of a bail-in tool

The special case of zombie banks has one crucial difference to any "Lehman scenario" – a relaxed timeframe. Once a zombie scenario has been established, there is no need to resolve any bank within a weekend. Instead, legislators and supervisors can decide on how they want to address the situation.

All over Europe, the right to file for insolvency proceedings against a bank has been concentrated in the hands of government authorities. Even if there is good reason to believe that a financial institution is (balance sheet) insolvent, no creditor or even the management of the institution may simply file a petition. Under Art. 16 of the SRM Regulation, only the Resolution Board would be allowed to assess a bank failure. Such mechanisms allow authorities to control the timing of a resolution process in a "zombie bank scenario".

A more relaxed timeframe such as this allows for two unique remedies to the "undercover insolvency" of a zombie bank.

First, supervisors may give the troubled financial institutions a timespan to clear their balance sheets by selling off non-performing loans and by acquiring new capital using capital markets or cheap central bank money. While such a "macroeconomic strategy" may allow some stronger banks to restructure themselves out of a crisis, it may "discourage more active bank restructuring that would allow banks to recover more quickly and renew lending, with the risk of prolonging the crisis and depressing growth for a prolonged period of time."[23] Zombie banks will not be able to restructure this way within a reasonable timespan. Banks in peripheral Member States, in particular, have a hard time selling non-performing loans and mortgages in an economy with record high unemployment and house prices in steady decline. At the same time, they are under pressure from local governments to continue acquiring their government's bonds. In the end, there is neither any lending capacity left for loans to real businesses, which hurts the economy, nor is there much room for restructuring. So the problem of zombie banks will not resolve itself in the foreseeable future.

Second, the financial restructuring of a zombie bank that lacks the capacity or market environment to restructure on its own can be conducted by a bail-in under the European Resolution Regime. The "undercover insolvency" of a zombie bank provides authorities with time to prepare a debt to equity swap under a resolution scheme. A profound ex-ante valuation would be possible and could generate credible results. The resolution regime would also prevent creditors and shareholders from vetoing a bail-in scheme and enable a smooth financial debt restructuring. Eventually, the bail-in tool could, and likely would, actually become a key instrument.

[22] The Economist, *Blight of the living dead. Europe's financial system is in a terrible state, and nothing much is being done about it*, July 13, 2013.

[23] *Laeven/Valencia*, IMF Economic Review Vol. 61 (2013), 225 (246).

Unfortunately, the European resolution regime contains some significant limitations – particularly in comparison to a notorious financial restructuring with a scheme of arrangement under English law. The exclusion in Art. 24 (3) for liabilities arising from covered deposits, secured debt, client assets, fiduciary duties, short term debt, clearing, relationships to employees, trade creditors or tax/social security authorities with preferential status under national law leaves only a small amount of remaining bank debt for an effective reduction of the debt burden. The write-down would mostly wipe out shareholders and creditors of subordinated debt while non-excluded unsecured creditors would receive equity in exchange for their debt.

In many instances, such a limited form of debt restructuring might not be sufficient to restore a positive net asset value. As capital markets may not be willing to invest into a partly restructured bank without costly public guarantees,[24] and a public recapitalization of the banking sector is to be averted,[25] Art. 24 (7) allows for a contribution of the Single Resolution Fund to cover the gap by providing capital or purchasing shares or other instruments of ownership up to 5% of total liabilities. As the Fund would contain money raised from contributions by all European banks, the recapitalization of a failing bank would eventually be financed by its competitors. Further gaps could eventually be filled with national government money, which would make the bail-in tool a measure to reduce the amount of public cash or guarantees needed to bail-out a zombie bank.

III. Where to go from here?

Comparing the feasibility and efficiency of the bail-in tool in a "Lehman scenario" and a "zombie bank scenario" makes a good case for the argument that those European leaders and legislators responsible for designing the European bank resolution regime primarily did so to resolve the current banking crisis, which is characterized by the "undercover insolvencies" of zombie banks. After its enactment, a credible European stress test could disclose risks in the quality of the assets of many European banks and raise the pressure to recapitalize banks quickly. The European Banking Authority expects to publish the final results of the 2014 EU-wide stress test in October 2014.[26]

Following negative stress test results, a number of banks could potentially face a resolution under the SRM that would enter into force on January 1, 2015. But as bail-in and resolution functions would only apply from January 1, 2016[27] and the establishment of the Single Resolution Fund and the mutualisation of its national compartments by inter-governmental agreements would take at least one year, the restructuring of banks under the new regime will probably not start before 2016.

[24] See *ibid*, supra note 22, 240.

[25] While a public recapitalisation could theoretically increase welfare and growth (see *ibid*, supra note 22, 239), the common experience in Member States like Ireland make a compelling case against it.

[26] See, *2014 EU-wide stress test: Frequently Asked Questions*, available at: www.eba.europa.eu/documents/10180/669262/2014-04-29+FAQs+Stress+Test+-+April+2014.pdf (visited on June 2, 2014).

[27] European Commission – Statement/14/77 (March 20, 2014).

IV. Voluntary resolutions?

Eventually, after the Fund becomes sufficiently equipped with liquidity, its national compartments mutualized, and the bail-in tool available, a pre-pack resolution scheme might suddenly not look as threatening to a zombie bank. Bearing in mind the limited volume of the fund (the target level is ¬55 billion plus the necessary borrowing capacity to level up), national authorities could pressure their resolution candidates to apply for a resolution in order to take advantage of the Fund before the money is spent for failing competitors. Then, a pivotal decision would need to be taken by the Resolution Board, who would be required to assess the alleged failure of a voluntarily filing bank, and decide about the resolution scheme that such a bank is wishing for. After a voluntary resolution petition, the Board would not decide whether or not to intervene in a bank's business but instead determine whether or not to allow resolution funding. The decision could even become distributional by its nature as soon as several banks or banking groups apply for a pre-pack sponsored by the Fund. Given that the applicants may actually be failing or likely to do so and no private sector alternative may be at hand,[28] the answer to the petition would solely depend on the assessment of a public interest in the requested resolution action.[29] Provided that all of the applicants are considered as SIFI's, the Board and the Commission would be required to allow resolution proceedings in all cases but could still coordinate the respective resolution schemes to accommodate them with the liquidity available from the Fund. The explosive question concerning which financial institution would be supported by what amount of Fund money is therefore answered by the decision mechanism provided by the SRM Regulation (see above).

V. Coordinated decision-making!

To effectuate a coordinated resolution of Europe's zombie banks, the ECB could set a deadline for national authorities to present their candidates for a bail-in-type resolution with Fund support. The ECB could extend this list with its candidates based on information from supervision and stress tests. From there, the Board should assess the requirements of Art. 16 SRM Regulation for all candidates, and negotiations within the Board as well as between the Board, the Commission, and the Council on the existence of a failure and public interest in a resolution with Fund contributions could be conducted collectively for all candidates. Such coordinated decision-making would allow for a comprehensive solution to the European zombie bank problem. The decision-makers would need to consider the complex problem as a whole instead of deciding solely on a single entity and could clear mutual liabilities between the applicants in coordinated resolution schemes. Thus their decision – though perhaps harder to arrive at – should produce a superior result by better reflecting the complexity of the task. Ideally, decision-makers could determine the necessary banks to recapitalize (with or

[28] See Art. 16(2)(a) and (b) SRM Regulation.
[29] See Art. 16(2)(c) and (4), 12 SRM Regulation.

without Fund money) and banks to liquidate – in accordance with the public interest (which means relevance for financial stability).

It's the availability of majority decisions that might finally pave the way to actually liquidating some of the weaker, less connected financial institutions against local government support.[30] Finally, politicians may be willing to liquidate a bank or two as part of a compromise if they were to have the chance to publicly save others concurrently. This would, in fact, have to be considered a success as politicians would thereby change the status quo in the banking sector. Of course, the "too big to fail" problem would remain, and the breakup of financial conglomerates[31] would still be out of reach.

F. Conclusion

The upcoming European bank resolution regime appears to focus less on handling the scenario of an abrupt failing financial institution (a "Lehman scenario") and more on addressing the current problem of the slow recapitalization of European banks (a "zombie bank scenario"). The bail-in tool should only be considered a key instrument for the latter. Regarding the larger number of resolution candidates in Europe and the limited capacity of the Single Resolution Fund, the decision of the Resolution Board, the European Commission and the Council on the adoption of a resolution scheme should not be taken for each bank one at a time but instead collectively for all suitable candidates.

[30] This support is often spurred by the fact that the local governments depend heavily on the willingness of local banks to buy and hold government bonds – see *Paulus*, KTS 2013, 155 (162 f.). A Resolution Board decision could potentially overcome this dependency although it would still be a group of politicians instead of independent experts that vote.

[31] See *Fanto*, Brook. J. Int'l L. Vol. 35 (2010), 635 (657 ff.).

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