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Position paper[1]: the introduction of a financial stability and resolvability assessment in the Qualifying Holdings Directive

1. Aim of the proposal

This position paper argues for the introduction of a financial stability and resolvability assessment in the Qualifying Holdings Directive (QHD).[2] The QHD harmonizes the procedural rules and criteria for the assessment of proposed acquisitions and further increases of qualifying holdings in the financial sector. At the moment the evaluation criteria in the QHD are all micro-prudential in nature.[3] These criteria as such do not take into account wider systemic implications or the resolvability of an institution resulting from a merger or acquisition. In other words, the QHD currently does not provide a legal ground to condition or refuse an acquisition on the basis of a risk to financial stability or resolvability. This seems to be an omission. Ensuring that competent and resolution authorities can assess the effects of an acquisition on financial stability and resolvability *before* the new entity is created, would help to prevent too-big-to-fail institutions and would prevent resolvability measures taken *ex post* by the resolution authorities reversing the acquisition immediately after it has taken place.

2. Reasons for the proposal

Since the revision of the QHD in 2007, in the wake of the financial crisis, the policy framework for the financial sector has changed fundamentally. The systemic importance (too-big-to-fail), solvability and liquidity of banks has attracted policymakers' attention and given rise to legislation designed to make banks safer. The crisis has shown that a disorderly failure of a systemic bank has such a disruptive impact on the financial system and the real economy that it is deemed unacceptable. This led, *inter alia*, to the introduction of a European resolution framework. In the United States, the Dodd-Frank Act introduces a financial stability criterion for the assessment of mergers and acquisitions to prevent uncontrolled increases in the concentration of the financial sector.

The introduction of the SSM and SRM brings us one step closer to a common market for banking services, making (cross-border) consolidation more appealing. While this can be beneficial for institutions and the financial system as a whole through diversification and economies of scale, consolidation could also create new too-big-to-fail problems. Mergers and acquisitions typically make banks substantially larger, less substitutable, more complex and more interconnected with other parts of the financial system.[4]

In addition, the BRRD stipulates that an institution's resolution plan must be reviewed *after* each material change to its legal, organisational or financial position of an institution that materially affects the plan's effectiveness or otherwise necessitates its review. After that assessment is performed, measures can be imposed to safeguard resolvability (*ex post*). These could undermine the efficiencies and business plan envisaged by the acquirer or result in previously unanticipated costs.

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[1] Common position of the Dutch Central Bank ("De Nederlandsche Bank") and the Dutch Ministry of Finance.

[2] Directive 2007/44/EC - Procedural rules and evaluation criteria for the prudential assessment of acquisitions and increase of holdings in the financial sector. The procedures and prudential assessment criteria for qualifying holdings in banks from the Qualifying Holdings Directive were transferred to the CRD IV in January 2014. The prudential assessment criteria are listed in Article 23 of the CRD IV, which has been transposed to national law.

[3] They regard reputation, integrity, financial soundness and compliance with prudential requirements, such as capital and liquidity requirements and governance arrangements.

[4] Basel Committee on Banking Supervision (2011). 'Global systemically important banks: Assessment methodology and the additional loss absorbency requirement'. Basel, Switzerland.

The introduction of a financial stability and resolvability assessment in the QHD is therefore a necessary step. The advantage of introducing such an assessment is that it works *ex ante*: before the newly (merged) institution is created. The financial stability and resolvability criteria would as such be an important complement to other regulatory initiatives designed to make banks safer (CRD IV), ensure the continuity of critical financial and economic functions and limit the costs of failure (BRRD, MREL, TLAC).

3. Design of the financial stability and resolvability assessment

The design of the financial stability and resolvability criteria within the QHD could build on the Basel and European standards for identifying systemically important banks and the criteria for resolvability as defined in the SRM Regulation/ BRRD. The competent and resolution authorities could as such consider size, complexity, interconnectedness, substitutability and other resolvability criteria of the financial institution resulting from the acquisition or increase of holdings. To give guidance to the authorities as to the application of these standards, certain trigger values could be introduced.

Under the SSM the ECB has the exclusive competence for both Significant Institutions (SIs) and Less Significant Institutions (LSIs) to assess notifications of proposed acquisitions.[5] It is important that the ECB, as the competent authority, has regard for both the European and local dimensions of an acquisition. The relevant market to assess financial stability concerns depends on the business model and market imprint of the banks involved in the merger. As such, a national bank merger might not raise a concern on a European scale but still lead to an unacceptable stability risk in a particular Member State.

The Single Resolution Board (SRB) is exclusively competent to judge whether an institution participating in the SSM is resolvable and to take measures to remove impediments to resolvability. In case of a proposed acquisition, the SRB should thus be enabled to (*ex ante*) determine whether the future entity will be resolvable, either independently or as part of the procedure by the ECB. In case of the latter, the procedure should be adjusted to accommodate a binding resolvability assessment by the SRB. For Member States outside the SSM a similar procedure could be introduced with their national resolution authorities.

[5] Article 4(1)(c) of the SSM Regulation. However, note that the ECB's exclusive competence is restricted 'in the context of bank resolution'.