Istituto Affari Internazionali

Varieties of Banking Union: Resolution Regimes and Backstops in Europe and the US

by Silvia Merler

ABSTRACT

In both the EU and the US, the global financial crisis and the euro crisis triggered important changes to bank resolution frameworks. Bank resolution in both jurisdictions shares the objectives of making financial institutions resolvable without threatening financial stability, while protecting taxpayer money. But the different environments and different crisis features and experiences have led to different structures on the two sides of the Atlantic. While the US evolved towards remedying a blind spot within an already existing integrated system, Europe changed its approach from coordination to centralization.

European Union | United States | Economic governance | Financial crisis | Financial institutions

keywords

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Varieties of Banking Union: Resolution Regimes and Backstops in Europe and the US

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Introduction

In both the EU and the US, the global financial crisis and the euro crisis triggered important changes to bank resolution frameworks. Bank resolution in both jurisdictions shares the objectives of making financial institutions resolvable without threatening financial stability, while protecting taxpayer money. But the different environments and different crisis features and experiences have led to different structures on the two sides of the Atlantic. In the US, the Dodd-Frank Act addressed the concern of vulnerability of the economy to the failure of large and complex financial institutions that were outside receivership of the Federal Deposit Insurance Corporation. In Europe, a decades-long quest for harmonization and coordination proved insufficient to shelter financial stability during the crisis. Reform was thus oriented towards centralization, within an environment of diverse national banking systems. Comparing the US and EU resolution regimes in their entirety and in detail would be too lengthy an undertaking for a single paper. The focus is thus on key aspects of the new EU resolution framework and the US Title II regime (although references to the ordinary resolution process for insured deposit institutions in the US will also be made), with special attention to scope, tools and funding of resolution.

1. Post-crisis resolution regimes: scope and triggers

1.1 The US: a blind spot

The US bankruptcy code is traditionally the framework for dealing with failing non-financial firms, but is less suited to the task of managing the failure of financial

* Silvia Merler is Affiliate Fellow at Bruegel and PhD candidate in European and Eurasian Studies at the Johns Hopkins University School of Advanced International Studies (SAIS).
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services firms – especially banks, insurers, and brokers.[1] Resolving a bank through general insolvency proceedings is complicated by the maturity transformation inherent in the banking business, where assets tend to be significantly less liquid than liabilities.[2] Federal law thus provides a specialized insolvency regime for insured depository institutions under the Federal Deposit Insurance Act (FDIA).[3] Before the crisis, more complex entities, such as bank holding companies, would be resolved under the same provisions of the US Bankruptcy Code as would apply to other corporate debtors.[4] The crisis of 2007–08 revealed this to be a blind spot in the US resolution framework. Large and complex financial institutions were ineligible for receivership of the Federal Deposit Insurance Corporation (FDIC) – which was set up in 1933 to manage failing insured deposit institutions and protect depositors[5] – with the implication that the only options for dealing with their failure were either bail-outs (as it happened for Bear Stearns and AIG), or disorderly bankruptcy (Lehman Brothers). Both solutions were tried, and both proved costly. The response was the Wall Street Reform and Consumer Protection Act of 2010, commonly known as "Dodd-Frank" after the name of the two senators who initially tabled the bill.[6] Dodd-Frank requires bank holding companies with total consolidated assets of 50 billion US dollars or more, as well as nonbank financial companies designated by the Financial Stability Oversight Council (FSOC) for supervision by the Federal Reserve (Fed), to periodically submit resolution plans to the Fed and the FDIC.[7] Although the Bankruptcy Code provides the default legal framework for the resolution of a failed bank holding company, Title II of Dodd-Frank creates an alternative resolution framework through the Orderly Liquidation Authority (OLA). OLA extends the scope of FDIC receivership to systemically important financial institutions (SIFIs),[8] with powers similar to those the FDIC

[1] Robin Greenwood et al., "The Financial Regulatory Reform Agenda in 2017", in *Harvard Business School Working Papers*, No. 9 (February 2017), p. 9, https://www.hbs.edu/faculty/Pages/item.aspx?num=52327.

[2] Phoebe White and Tanju Yorulmazer, "Bank Resolution Concepts, Trade-offs, and Changes in Practices", in *FRBNY Economic Policy Review*, Vol. 20, No. 2 (December 2014), p. 157, https://www.newyorkfed.org/research/epr/2014/1412whit.html.

[3] US Department of the Treasury, *Orderly Liquidation Authority and Bankruptcy Reform*, 21 February 2018, https://home.treasury.gov/sites/default/files/2018-02/OLA_REPORT.pdf.

[4] Stanley Fisher, *Comments on the Resolution Framework for Banks and Bank Holding Companies in the United States*, speech delivered at the Panel Discussion on Resolution Riksbank Macroprudential Conference, Stockholm, 22 June 2016, https://www.federalreserve.gov/newsevents/speech/fischer20160622a.htm.

[5] Phoebe White and Tanju Yorulmazer, "Bank Resolution Concepts, Trade-offs, and Changes in Practices", cit., p. 154.

[6] The rules on OLA have also been translated into Title 12 of the US Code – the Bankruptcy Code – in Sections 5301-5394. See US Code (USC), https://www.law.cornell.edu/uscode.

[7] Section 165(d) of the Dodd-Frank Act. See US Congress, *Dodd-Frank Wall Street Reform and Consumer Protection Act* (H.R. 4173), Public Law No. 111-203, 21 July 2010, https://www.congress.gov/bill/111th-congress/house-bill/4173/text. See also FDIC website: *FDIC and Financial Regulatory Reform - Title I and IDI Resolution Plans*, https://www.fdic.gov/regulations/reform/resplans.

[8] Formally "covered financial companies". "Financial companies [for the] scope of application of Title II are (i) bank holding companies; (ii) nonbank financial companies that are supervised by the FRB pursuant to section 113 of the DFA; and (iii) financial companies that are predominantly engaged in activities that are financial in nature or incidental thereto as set forth in FRB regulations". See

has as a receiver for insured deposit institutions (IDIs).[9] Together with the FDIC's single point of entry (SPOE) resolution strategy, and the Federal Reserve's total loss absorbing capacity (TLAC) requirements, OLA constitutes a specialized resolution regime for large, complex financial firms.[10] The goal is to ensure that these institutions can be resolved in an orderly manner without threatening financial stability and minimizing taxpayers' contributions.

1.2 EU: from coordination to centralization

The change in the EU banking resolution landscape is better understood as part of the European Banking Union project, and with the historical evolution of European financial integration in mind. The euro crisis of 2010–12 showed that the original design of the Eurozone lacked common institutions to safeguard financial stability.[11] There was no lack of European-level efforts at regulatory harmonization, in the early days of financial integration,[12] but supervision and resolution were left to the national level,[13] although within improved coordination between national authorities.[14] In 2009, the de Larosière group recommended strengthening the supervisory framework by creating three European Supervisory Authorities (ESAs), together with a European Systemic Risk Board (ESRB). The ESAs process was yet another exercise at coordination: although an effort was made to foster convergence, supervision and resolution remained ultimately a national prerogative. Despite the harmonized regulatory framework and the incentives for cooperation created by the ESA system, the euro crisis showed that the fragmentation of banking supervision and resolution along national lines could lead to suboptimal decisions by national authorities, who would have little interest in internalizing cross-country spill-overs from their actions and would

International Monetary Fund (IMF), "United States: Financial Sector Assessment Program-Review of the Key Attributes of Effective Resolution Regimes for the Banking and Insurance Sectors", in *IMF Country Reports*, No. 15/171 (July 2015), p. 21, https://www.imf.org/external/pubs/cat/longres_gsause.aspx?sk=43056.

[9] Ibid. See also FDIC website: *2018-2022 Strategic Plan*, https://www.fdic.gov/about/strategic/strategic/receivership.html.

[10] Robin Greenwood et al., "The Financial Regulatory Reform Agenda in 2017", cit., p. 9.

[11] Silvia Merler, "Squaring the Cycle: Financial Cycles, Capital Flows and Macro-Prudential Policy in the Euro Area", in *Bruegel Working Papers*, No. 14 (November 2015), http://bruegel.org/?p=11000; Erik Jones, "The Forgotten Financial Union: How You Can Have a Euro Crisis Without a Euro", in Matthias Matthijs and Mark Blyth (eds), *The Future of the Euro*, Oxford, Oxford University Press, 2015, p. 44-69; Grégory Claeys, "The Missing Pieces of the Euro Architecture", in *Bruegel Policy Contributions*, No. 28 (October 2017), http://bruegel.org/?p=22566.

[12] E.g., the Banking Directives 77/780/EEC of 12 December 1977 and 89/646/EEC of 15 December 1989, the Investment Services Directive 93/22/EEC of 10 May 1993, the Financial Services Action Plan (European Commission, *Implementing the Framework for Financial Markets: Action Plan* (COM/1999/232), 11 May 1999, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:51999DC0232).

[13] See Zsolt Darvas, Dirk Schoenmaker and Nicolas Véron, "Reform of the European Union Financial Supervisory and Regulatory Architecture and Its Implications for Asia", in *Bruegel Working Papers*, No. 9 (2016), p. 18, http://bruegel.org/?p=17682.

[14] Such as in the context of the "Lamfalussy process".

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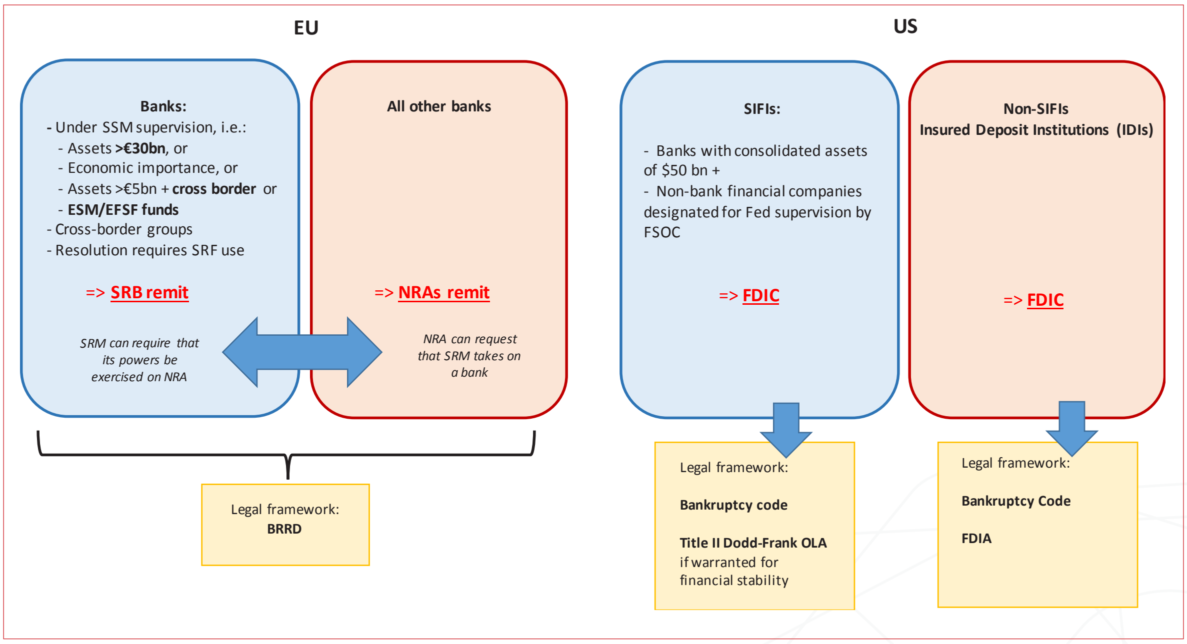
be potentially prone to domestic regulatory capture.[15] In such context, financial stability could easily be undermined. EU policymakers thus committed to the creation of a Banking Union to address these issues by means of centralization rather than coordination. The Banking Union comprises a single rulebook for supervisory and resolution practices – embodied in the Capital Requirement Directives (CRDs) and Regulation (CRR) and in the Bank Recovery and Resolution Directive (BRRD). These are implemented by a Single Supervisory Mechanism (SSM) and by a Single Resolution Mechanism (SRM). The EU bank resolution framework is underpinned by the regulatory provisions in the BRRD, and revolves around the SRM, which includes a Single Resolution Board (SRB), the National Resolution Authorities (NRAs), and a Single Resolution Fund (SRF).[16] Differently from Dodd-Frank Title II, the BRRD is a legal framework that applies to all banks in the EU.[17]

Figure 1 | EU and US bank resolution scope



Source: Author's compilation.

Figure 1 presents an overview of the differences in the scope of the two regimes. The EU's quest for centralization of resolution within a multi-country environment led to a system where all banks are resolved under the same legal framework regardless of size, but resolution is operated at different levels by differently centralized authorities. The SRM manages resolution of the banks it supervises, of cross-border groups, and of *any bank* whose resolution requires the use of the SRF.

[15] Silvia Merler, "Squaring the Cycle", cit.

[16] See SWB website: *About SRB*, https://srb.europa.eu/en/mission.

[17] See European Parliament and Council of the European Union, *Directive 2014/59/EU of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms*..., https://eur-lex.europa.eu/eli/dir/2014/59/oj.

IAI PAPERS 18 | 21 - DECEMBER 2018 ISSN 2610-9603 | ISBN 978-88-9368-088-2

All other banks are left to the NRAs. The SRM however can require that its powers be exercised on any bank in the NRA remit, and the NRAs can request that specific banks be taken on by the SRM.

Table 1 | Resolution triggers

Triggers	EU (BRRD)	US (Title II D-F)
Likely to fail	The institution is failing or likely to fail (Art. 32(4) BRRD): • No longer fulfils requirements for authorization • Assets > liabilities • It is unable to pay its debts as they fall due • It requires extraordinary financial public support	The company is in default or danger of default (Sec. 203(c) Dodd-Frank): • A case under the Bankruptcy Code has commenced/is likely to commence • Has incurred /is likely to incur losses that will deplete all or substantially all of its capital • Assets are (or are likely to be) greater than liabilities • It is (or is likely to be) unable to pay its obligations in the normal course of business
No private alternative	No supervisory or private sector measures can restore the bank to viability within a reasonable timeframe	No viable private sector alternative is available to prevent the default (Sec. 2013(b) Dodd-Frank)
Public interest	Resolution is necessary in the public interest; resolution objectives would not be met to the same extent if the bank were wound up under normal insolvency proceedings	• Failure and resolution under otherwise applicable federal or state law would have serious adverse effects on financial stability • Effects on claims or interests of creditors, counterparties, and shareholders and other market participants are appropriate, given the impact that any action would have on financial stability • Action would avoid or mitigate such adverse effects [...] (Sec. 2013(b) Dodd-Frank)
Debt conversion	--	A federal regulatory agency has ordered the financial company to convert all of its convertible debt instruments that are subject to the regulatory order

Source: Author's compilation based on EU and US legal documents.

The triggers for resolution are similar in the US and the EU (Table 1). In both jurisdictions, resolution is triggered by a determination that the bank is failing or likely to fail. The operationalization of this criterion is similar – e.g., violation of capital requirements or inability to pay debts as they come due. The EU framework

IAI PAPERS 18 | 21 - DECEMBER 2018
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IAI PAPERS 18 | 21 - DECEMBER 2018 ISSN 2610-9603 | ISBN 978-88-9368-088-2

also prescribes that a bank in need of extraordinary public financial support is deemed failing or likely to fail, unless the support is required to remedy a serious disturbance in the economy of a member state and preserve financial stability, and it takes the form of: (i) a state guarantee to back liquidity facilities provided by central banks; (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 (Art. 32(4)(d) BRRD). In both systems a second requirement is the absence of alternative private solutions. The US framework also includes one condition – which has no equivalent in BRRD – whereby resolution under Title II would be triggered when a regulatory agency has ordered the institution to convert all of its convertible debt instruments.

A measure of public interest also needs to be established in both cases. In the case of the US Title II regime, this is mostly related to the potential negative effects that handling institutions under otherwise applicable state or federal law could have on financial stability. In the EU, the establishment of public interest is a prerogative of the SRB, which balances considerations of financial stability as well as the need to protect public funds as well as depositors' and creditors' assets and funds (Art. 31(1) BRRD). While being a key element in both regimes, the determination of public interest raises peculiar issues in the EU, due to the absence of a common framework for insolvency and liquidation. The implication of this two-tier framework is that failing banks risk facing different insolvency proceedings in different countries, and significant uncertainty – including, but not limited to, the extent to which public funds could be used.[18]

2. Resolution strategies and tools

The guidelines on recovery and resolution planning issued by the Financial Stability Board (FSB) in July 2013 outline two resolution approaches for resolving global financial institutions: multiple point of entry (MPE) and single point of entry (SPE). In an SPE strategy, resolution powers are applied at the level of the parent company by the home resolution authority. The MPE strategy involves potentially multiple resolution authorities acting on different parts of the group. In a SPE resolution strategy, losses incurred within the group are absorbed by the ultimate parent company. In an MPE strategy, resolution and resolution tools operate independently at the level of individual subsidiaries.[19]

[18] For a longer discussion, see Silvia Merler, *Critical Functions and Public Interest in Banking Services: Need for Clarification?*, European Parliament, November 2017, http://www.europarl.europa.eu/thinktank/en/document.html?reference=IPOL_IDA(2017)614479.

[19] See Bennet Berger, Pia Hüttl and Silvia Merler, *"Total Assets" versus "Risk Weighted Assets": Does It Matter for MREL Requirements?*, European Parliament, July 2016, p. 9, http://www.europarl.europa.eu/thinktank/en/document.html?reference=IPOL_IDA(2016)574414.

Resolution of SIFIs under Title II is expected to be carried out under an SPE strategy,[20] whereby the FDIC would resolve the financial group by initiating an OLA receivership at the level of the holding company. Solvent subsidiaries would continue operating as usual, avoiding the need for separate resolution proceedings which could otherwise add complexity.[21] The FDIC takes over all powers previously granted to the management, and shall ensure the maximization of the value of assets within the context of liquidation. There are five resolution tools envisaged in Title II of the Dodd-Frank Act: (i) sales of assets to a third party; (ii) transfer of the assets to a bridge financial company; (iii) merger of the financial institution with another company; (iv) transfer of separated assets and/or liabilities to a third party without the need for any approval, assignment or consent of the related parties; and (v) bail-in of the unsecured creditors and shareholders (Sec. 210(a)(1)(D)–(M) Dodd-Frank; Sec. 5390(a)(1)(D)-(M) Title 12 USC).

Discretion is left to the FDIC as to the resolution measures to be taken[22] and the calculation of the amount of debt and/or equity reduction to be performed.[23] In the SPE strategy put forward by the FDIC most assets would be transferred to a bridge company. The bridge company would continue to provide the holding company functions of the failed parent, so that the subsidiaries could keep operating.[24] Losses would be apportioned according to the order of priority among creditors, whose equity, subordinated debt and senior unsecured debt would remain in the receivership.[25]

The inverse order of claim is reported in Table 2, for comparison with the EU case. In general, secured claims remain unaffected; administrative expenses of the FDIC, amounts due to the US within resolution, and wages, salaries, commissions and benefit contributions of employees rank before all other unsecured debt; senior unsecured debt and any other general liability of the financial institution rank before subordinated debt; and shareholders are the first to absorb losses.

There can be exceptions. First, if funds are provided by the FDIC within the framework of the Orderly Liquidation Fund (see next Section), these will rank before all remaining unsecured debt. Second, the FDIC can decide on further exceptions,

[20] US Department of the Treasury, *Orderly Liquidation Authority*..., cit.; Federal Deposit Insurance Corporation (FDIC), "Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy", in *Federal Register*, Vol. 78, No. 243 (18 December 2013), p. 76614-76624, https://www.gpo.gov/fdsys/pkg/FR-2013-12-18/pdf/2013-30057.pdf.

[21] IMF, "United States: Financial Sector Assessment Program", cit.; US Department of the Treasury, *Orderly Liquidation Authority*..., cit.

[22] Sec. 210(a)(1)(D) Dodd-Frank states that "the Corporation shall [...] liquidate and wind-up the affairs of a covered financial company, in such manner as the Corporation deems appropriate [...]".

[23] For a discussion, see Thomas Philippon and Aude Salord, "Bail-ins and Bank Resolution in Europe. A Progress Report", in *Geneva Reports on the World Economy*, Special Report No. 4 (March 2017), https://cepr.org/sites/default/files/news/GenevaSpecialReport4.pdf.

[24] FDIC, "Resolution of Systemically Important Financial Institutions", cit.

[25] Ibid. See also US Department of the Treasury, *Orderly Liquidation Authority*..., cit.

IAI PAPERS 18 | 21 - DECEMBER 2018 ISSN 2610-9603 | ISBN 978-88-9368-088-2

in light of economic considerations (Sec. 210(b)(4)(A) Dodd-Frank; Sec. 5390(b)(4)(A) USC), i.e., if it deems them necessary to (i) maximize the value of the assets; (ii) initiate and continue operations essential for implementing the receivership or a bridge financial company; (iii) maximize the present value return from the sale or other disposition of the assets of the financial institution; (iv) minimize losses realized upon the sale or other disposition of assets. While the "no creditor worse-off" (NCWO) principle applies also to these exceptions, the conditions of determination of the hypothetical value of the claims under the NCWO are not described further.[26]

Table 2 | Liability cascade

EU (BRRD)	US (Title II D-F)
• CET1 capital (Shareholders) • Additional Tier 1 (AT1) • Tier 2 (T2) • Subordinated debt not in AT1 or T2, in accordance with the hierarchy of claims in insolvency proceedings • Other eligible liabilities, in accordance with the hierarchy of claims in insolvency • Uncovered deposits from natural persons and micro, small and medium-sized enterprises • Covered deposits and deposit guarantee schemes subrogated to their rights	• Obligation to shareholders, members, partners or other equity holders • Wages, salaries or commissions owed to senior executives and directors • Any obligation subordinated to general creditors (not in the previous two categories) • Any other general or senior liability (not in the previous three categories) • Contributions owed to employee benefit plans* • Wages, salaries or commissions of employees** • Any amount due to the US*** • Administrative expenses of receiver

Note: details for (*),[27] (**)[28] and (***)[29].
Source: Author's compilation based on EU (Art. 48 of BRRD) and US legal documents (Sec. 210(b)(1)(A-H) Dodd-Frank; Sec. 5390(b)(1)(A-H) Title 12 USC).

In the EU framework, the resolution strategy is determined by the SRB on the basis of the bank's structure, its loss-absorbing capacity and separability. The choice could be SPE, MPE or a combination. This can be rationalized in view of the broader scope of BRRD – which applies to all banks in the EU – and in light of the diversity of banking structures in the EU.[30] Article 37 BRRD envisages four

[26] Thomas Philippon and Aude Salord, "Bail-ins and Bank Resolution in Europe", cit., p. 13.

[27] "Contributions owed to employee benefit plans arising from services rendered not later than 180 days before the date of appointment of the Corporation as receiver, to the extent of the number of employees covered by each such plan, multiplied by $11,725 [...], less the aggregate amount paid to such employees under subparagraph (C), plus the aggregate amount paid by the receivership on behalf of such employees to any other employee benefit plan".

[28] "Wages, salaries, or commissions, including vacation, severance, and sick leave pay earned by an individual [...] but only to the extent of $11,725 for each individual (as indexed for inflation, by regulation of the Corporation) earned not later than 180 days before the date of appointment of the Corporation as receiver".

[29] "Any amounts owed to the United States, unless the United States agrees or consents otherwise".

[30] Willem Pieter de Groen, *The Different Legal and Operational Structures of Banking Groups in the*

IAI PAPERS 18 | 21 - DECEMBER 2018 ISSN 2610-9603 | ISBN 978-88-9368-088-2

resolution tools: (i) sale of business; (ii) bridge bank; (iii) asset separation; and (iv) bail-in (see Articles 38–43 for details).

While in the OLA bail-in is utilized as part of a liquidation procedure for the holding company ("closed bank" process), Article 43(2)(a, b) BRRD provides for both an "open bank" bail-in process (i.e., to recapitalize an institution that may be restored to viability) and a "closed bank" one[31] (i.e., in combination with the bridge bank, sale of business tool or asset separation tool). The pecking order is reported in Table 2 above, which however takes the adoption of Directive (EU) 2017/2399 of 12 December 2017 into account. This amends BRRD as regards the ranking of debt instruments in insolvency – particularly by stipulating that senior non-preferred instruments will rank senior to regulatory capital but junior to other senior liabilities – and will need to be transposed by member states by the end of 2018.[32] Claims within the same rank in cascade must be reduced *pari passu*[33] among themselves, and the NCWO principle applies (Articles 34(1)(g) and 73 BRRD). Moreover, in the EU framework some liabilities are *always* excluded from the application of bail-in (Art. 44(2) BRRD).[34]

3. Funding, backstops and the use of public funds

3.1 The US ordinary liquidation fund

The SPE resolution strategy under OLA is expected to provide the bridge company with a strong balance sheet, but short-term liquidity from the private sector may not be immediately available.[35] Dodd-Frank thus envisions the establishment of an Orderly Liquidation Fund (OLF) in the Treasury (Sec. 210(n) Dodd-Frank; Sec.

Euro Area, and Their Impact on Banks' Resolvability, European Parliament, November 2016, http://www.europarl.europa.eu/thinktank/en/document.html?reference=IPOL_IDA(2016)587378.

[31] See also Emilios Avgouleas and Charles Goodhart, "Critical Reflections on Bank Bail-ins", in *Journal of Financial Regulation*, Vol. 1, No. 1 (March 2015), p. 3-29, https://doi.org/10.1093/jfr/fju009; Thomas Philippon and Aude Salord, "Bail-ins and Bank Resolution in Europe", cit.

[32] For a detailed discussion, see Amélie Champsaur, Michael Kern and Bernardo Massella Ducci Teri, "The Reform of Bank Creditor Hierarchy in the EU", in *Revue de droit bancaire et financier*, Vol. 19, No. 1 (January/February 2018), https://www.clearygottlieb.com/-/media/files/the-reform-of-bank-creditor-hierarchy-in-the-eu_rdbb-3-14-18-pdf.pdf.

[33] Articles 34(1)(f) and 48(2) BRRD; Article 17 of Regulation (EU) No 806/2014 of 15 July 2014 (SRM Regulation, or SMR). See also Amélie Champsaur, Michael Kern and Bernardo Massella Ducci Teri, "The Reform of Bank Creditor Hierarchy in the EU", cit.

[34] Covered deposits; secured liabilities; client assets and client money provided that such a client is protected under the applicable insolvency law; liabilities arising from fiduciary relationships; short-term liabilities with a maturity of less than seven days; salaries, pension benefits or other fixed remuneration of the employees; liabilities to tax and social authorities; deposit guarantee schemes; and liabilities to trade and commercial creditors providing goods or services that are critical to the daily functioning of its operations. Further exclusions can be granted by the resolution authority under exceptional circumstances.

[35] See US Department of the Treasury, *Orderly Liquidation Authority*..., cit.; and FDIC, "Resolution of Systemically Important Financial Institutions", cit., p. 76616.

IAI PAPERS 18 | 21 - DECEMBER 2018
ISSN 2610-9603 | ISBN 978-88-9368-088-2

5390(n) Title 12 USC). As for all actions under the OLA, the use of the OLF is limited to when the FDIC determines that such action is necessary for financial stability. The FDIC is allowed to issue obligations to the US Treasury to initially fund the OLF. This issuance is considered a public debt transaction of the US (Sec. 210(n)(5)(E) Dodd-Frank; Sec. 5390(n)(5)(E) Title 12 USC), and cannot exceed (i) 10 per cent of the total consolidated assets of the covered financial company, during the 30-day period immediately following the appointment of the FDIC as receiver; and (ii) after such 30-day period, 90 per cent of the fair value of the total consolidated assets of each covered financial company that are available for repayment. According to the US Treasury Department, this effectively represents a 10 per cent discount of the fair value of the assets as a precaution against the risk that the fair value was overstated or that the value of the assets could decline.[36]

The FDIC could also facilitate private-sector funding to the bridge financial company and its subsidiaries by providing guarantees, backed by its authority to obtain funding through the OLF.[37] The latter can only be used to provide liquidity – Section 206(6) Dodd-Frank prohibits the FDIC from taking an equity interest or becoming a shareholder[38] – and OLF funding is given reimbursement priority over all other unsecured claims. If needed to repay its OLF borrowing, after exhausting proceeds from sale of the failed company's operations, the FDIC shall charge one or more risk-assessments on the other financial companies with consolidated assets of 50 billion US dollars or more, within a five-year period.[39] This provision goes in the direction of protecting taxpayers' money, and ensuring that OLF is a temporary public disbursement, consistently with the prohibition of taxpayer funding laid out in Section 214 of the Dodd-Frank Act. Outside of Dodd-Frank remit, the US legal framework provides for a Deposit Insurance Fund (DIF), which is funded *ex-ante* by assessments on insured deposit institutions (IDIs) and may be used by the FDIC in connection with resolution of IDIs,[40] on a least cost basis. The current target for DIF's designed reserve ratio is set at 2 per cent. In addition, the FDIC has the authority to borrow 100 billion US dollars from the US Treasury if necessary for deposit insurance purposes, to be repaid through *ex-post* assessments.[41]

3.2 The EU's Single Resolution Fund

The EU regime includes a Single Resolution Fund, owned and administered by the SRB. Consistently with the EU's gradual move towards centralization, the SRF is

[36] US Department of the Treasury, *Orderly Liquidation Authority...*, cit.

[37] IMF, "United States: Financial Sector Assessment Program", cit.

[38] The FDIC shall "not take an equity interest in or become a shareholder of any covered financial company or any covered subsidiary".

[39] The period can be extended (Sec. 210(o)(D) Dodd-Frank).

[40] IMF, "United States: Financial Sector Assessment Program", cit. See also FDIC website: *The Deposit Insurance Fund*, https://www.fdic.gov/deposit/insurance.

[41] See FDIC website: *FDIC Law, Regulations, Related Acts*, https://www.fdic.gov/regulations/laws/rules/1000-1600.html; and IMF, "United States: Financial Sector Assessment Program", cit.

IAI PAPERS 18 | 21 - DECEMBER 2018 ISSN 2610-9603 | ISBN 978-88-9368-088-2

composed of national compartments for a transitional period of eight years, and fully mutualized thereafter. In the transition period, mutualized funds may be used after exhausting certain parts of the non-mutualized funds. The target level for the SRF is at least 1 per cent of the amount of covered deposits of all credit institutions within the Banking Union (55 billion) by 31 December 2023. In February 2017, the member states agreed to transitional credit lines of up to the estimated target level, which would only be available to back the SRF's national compartments in case of a funding shortfall and after having exhausted all other financing sources.[42] The SRF is funded by *ex-ante* contributions from banks in the participating member states, and where the available financial means are not sufficient to cover losses, costs or expenses incurred by the use of the Fund in resolution actions, extraordinary *ex-post* contributions can also be raised (Articles 70–71 BRRD).

Differently from OLF, the SRF can provide both capital and liquidity support, through loans, guarantees, asset purchases or capital for bridge banks.[43] The SRB owns and manages the SRF, but the decision to use the Fund is also subject to Commission and Council's approval and to certain constraints. First, the SRF can only be used in combination with other resolution tools and for specific purposes (Art. 101 BRRD). Second, the use of SRF funds is conditional on a bail-in of at least 8 per cent of total liabilities including own funds. Third, it is limited to the lower 5 per cent of the bank's total liabilities including own funds, or the available SRF funds plus any amount that could be raised through *ex-post* contributions in three years.[44] In extraordinary circumstances, BRRD allows the resolution authority to seek funding from alternative financing sources through the use of government stabilization tools. These are means of direct support from the national public sector, which can be granted only if certain prerequisites are met (Articles 37 and 56 BRRD). In particular, private creditors need to have contributed to loss absorption and recapitalization for an amount not lower than 8 per cent of total liabilities including own funds. The government stabilization tool must have been approved under the State Aid rules and must be used as a last resort, after having exploited other resolution tools to the maximum extent practicable whilst maintaining financial stability.[45] Unlike the FDIC in the US, the EU does not have a common Deposit Guarantee Scheme (DGS). Article 109 BRRD attributes a role to national DGSs – beyond payout – in financing resolution and insolvency, but a system based on national DGSs remains vulnerable to large shocks,[46] especially as

[42] SRB, *Banking Union – Single Resolution Board completes signature of Loan Facility Agreements with all 19 participating Member States*, 8 February 2017, https://srb.europa.eu/en/node/196.

[43] For a discussion, see e.g. Santiago Fernández de Lis et al., *Regulation Outlook: Compendium on Bank Resolution Regimes: From the FSB to the EU and US Frameworks*, Madrid, BBVA Research, June 2014, https://www.bbvaresearch.com/wp-content/uploads/2014/06/Global-resolution-regulatory-report1.pdf.

[44] These restrictions do not apply to liquidity support from the SRF.

[45] The tools available to governments are temporary public ownership and public equity support.

[46] IMF, "Euro Area Policies: Financial Sector Assessment Program-Technical Note-Bank Resolution and Crisis Management", in *IMF Country Reports*, No. 18/232 (July 2018), p. 16, https://www.imf.org/external/pubs/cat/longres.aspx?sk=46106.0.

IAI PAPERS 18 | 21 - DECEMBER 2018 ISSN 2610-9603 | ISBN 978-88-9368-088-2

some of the national DGSs are not adequately funded.[47] The European Commission proposed in 2015 a plan to create a European Deposit Insurance (EDIS), but this is controversial and no tangible step has been taken to date.[48]

Table 3 | Funding in resolution

	EU (BRRD): SRF	**US (Title II D–F): OLF**
Type of support	Liquidity and capital (Loans, guarantees, asset purchases or contribution to bridge banks)	Liquidity only (no recapitalization)
Funding	*Ex-ante* funding by banks (1 per cent of covered deposit target) + *Ex-post* contributions by banks if needed	*Ex-post* repayment through: Sales of assets + *Ex-post* assessment on banks if needed
Conditions for use	Bail-in of 8 per cent of total liabilities of the institutions including own funds	if private sector funding cannot be immediately obtained* + General Title II financial stability requirement
Cap	5 per cent of total liabilities	No viable private sector alternative is available to prevent the default (Sec. 2013(b) Dodd-Frank)
Backstop	None	Treasury
Public support	Government stabilization tools for extraordinary situation	Prohibition on taxpayer funding (Sec. 214 Dodd-Frank)

Note: (*) See FDIC, "Resolution of Systemically Important Financial Institutions", cit., p. 76616.

The EU framework also lacks a backstop for the SRF which, even at full capacity, will be limited to 55 billion euro. To enhance the financial resources available, heads of state and governments have recently agreed that the ESM will provide a backstop to the SRF through a revolving credit line.[49] The entry into force of such backstop is however conditioned on "sufficient progress" in terms of risk reduction – and thus

[47] A recent EBA analysis shows that while 32 out of 43 deposit insurance systems (DISs) in the EU have increased their funds in 2017, only 17 DISs have reached the target level of 0.8 per cent of covered deposits. See IMF, "Euro Area Policies", cit., p. 43; and European Banking Authority (EBA) website: *Deposit Guarantee Schemes Data*, https://eba.europa.eu/regulation-and-policy/recovery-and-resolution/deposit-guarantee-schemes-data.

[48] Even the Franco-German joint position as expressed in the recent Meseberg declaration is vague and non-committal. See *Meseberg Declaration*, 19 June 2018, https://archiv.bundesregierung.de/archiv-de/meta/startseite/meseberg-declaration-1140806.

[49] As outlined in the letter of the Eurogroup president: *Letter by Eurogroup President Mário Centeno to European Council President Donald Tusk ahead of the Euro Summit of 29 June 2018*, 25 June 2018, https://www.consilium.europa.eu/media/35798/2018-06-25-letter-president-centeno-to-president-tusk.pdf.

IAI PAPERS 18 | 21 - DECEMBER 2018
ISSN 2610-9603 | ISBN 978-88-9368-088-2

the timeline remains unclear. The backstop's target level would be aligned with that of the SRF, and its usage would be a last resort option. Moreover, the envisioned respect of "national constitutional requirements" in the context of the procedural decision to use the backstop may suggest that this will be subject to parliamentary vote in some countries.

Conclusions

This paper has briefly discussed points of similarity and contrast between the US and EU bank resolution regimes. The analysis is by no means exhaustive, but focused on the resolution regimes' scope, tools and funding sources. Resolution regimes in both jurisdictions were significantly reformed after the global financial crisis and the euro crisis, but these reforms responded to different needs and produced structures that differ in scope. The US had an established resolution authority for insured deposit institution (the FDIC) and an established resolution framework (through the Bankruptcy Code and the FDIA), but the experience of the global financial crisis highlighted the need for a way to resolve large and complex financial institutions – which were not eligible for FDIC receivership – without endangering financial stability. US SIFIs are generally organized under a holding company with a top-tier parent and operating subsidiaries that comprise many interconnected entities. This type of integrated structure makes it difficult to resolve one part of the company in an orderly manner without triggering collapse of the entire edifice, so under Title II of the Dodd-Frank Act the FDIC has said that it will implement an SPE strategy. The euro crisis on the other hand showed the limit of the coordination approach that had traditionally characterized the EU multi-country environment. The result has been a move towards centralization and a system with a single legal framework, applied by different resolution authorities depending on the banks being resolved. The significantly more diversified nature of the EU banking landscape is also reflected in BRRD's flexibility to allow for both an SPE and an MPE approach.

The bank-level triggers of resolution are similar in the two jurisdictions, although BRRD also considers extraordinary public support as a trigger. The public interest requirement is focused on financial stability in the US, whereas in the EU financial stability is just one component of the public interest assessment, that also analyses the adequacy of the resolution framework to the achievement of resolution objectives. Resolution authorities share similar tools in both frameworks, and they enjoy flexibility as to the non-consideration of contractual clauses and civil law rules that may represent a hurdle to the application of resolution measures (e.g. in the context of sale of business or transfer of assets/liabilities to a bridge bank). A significant difference, however, is that BRRD allows for government stabilization tools such as temporary public ownership and equity support, which are off-limits in the Dodd-Frank framework.

IAI PAPERS 18 | 21 - DECEMBER 2018
ISSN 2610-9603 | ISBN 978-88-9368-088-2

Both regimes include clauses endowing the resolution authority with discretion in applying the bail-in tool, although this appears to be broader in the US, where it has been questioned in the context of the discussion on whether and how to reform the OLA regime.[50] As regards the priority of claims in the context of bail-in, both regimes establish depositor preference as a general principle, but the EU framework differentiates according to the seniority of certain deposits. The EU framework also codifies very specifically classes of liabilities that are excluded from bail-in a priori but leaves less opportunity for ad hoc disparate treatment of similarly situated creditors. What remains peculiar and problematic in the EU framework, however, is the fact that the state aid burden sharing requirements are weaker than the bail-in requirements under BRRD/SRMR and consequently some creditors could be better off in insolvency with liquidation aid than they would be in resolution, thus weakening the NCWO principle and the level playing field between regimes.[51]

Both the US and EU regimes are equipped with resolution funds and this is perhaps where the most significant differences between the two regimes are found. There are in fact jurisdictional differences as to the role of the funds, the condition under which they may be used, their backstopping, and the possibility to access extraordinary public support. The US' OLF can only provide liquidity support, up to 10 per cent of the total consolidated assets during first 30 days, and up to 90 per cent of the fair value of the total consolidated assets available for repayment, thereafter. The FDIC is backed by the US Treasury, so the OLF funds are effectively a public debt transaction, which is repaid *ex-post* by the industry. Differently from OLF, the SRF is more flexible in terms of what it can do, as it can provide both liquidity and capital support. But since no equivalent to a common treasury exists in the EU, the SRF is funded *ex-ante* (and potentially also *ex-post*) by banks' contributions. Its use is limited to a lower amount – only 5 per cent of the resolved bank's liabilities. Conditions for accessing the resolution fund are also much stricter in the EU – where a bail-in in the amount of 8 per cent of total liabilities is a prerequisite – than in the US, where the FDIC can decide to make recourse to OLF if private sector funding cannot be immediately obtained and there is a risk to financial stability.

Lastly, both regimes are in evolution. The American OLA has been criticized by some on the basis that it could potentially create moral hazard; that it is unpredictable because of the discretion that it leaves to the FDIC; and that a reform of bankruptcy would work better.[52] In a recent report to the President, the Treasury has shared many of the concerns raised by critics of OLA but has recommended retaining it as an emergency tool for use under only extraordinary circumstances. It has also proposed to narrow the path to OLA by building a more robust bankruptcy process

[50] See US Department of the Treasury, *Orderly Liquidation Authority...*, cit.

[51] See Silvia Merler, *Critical Functions and Public Interest in Banking Services: Need for Clarification?*, cit.; IMF, "United States: Financial Sector Assessment Program" cit.

[52] Aaron Klein, "A Primer on Dodd-Frank's Orderly Liquidation Authority", in *Up Front blog*, 5 June 2017, http://brook.gs/2rsTAOJ.

IAI PAPERS 18 | 21 - DECEMBER 2018 ISSN 2610-9603 | ISBN 978-88-9368-088-2

for financial companies through a new Chapter 14 of the Bankruptcy Code, the elimination of opportunities for ad hoc disparate treatment of similarly situated creditors, reinforcing existing taxpayer protections, and strengthening judicial review. In the EU, the Banking Union project remains unfinished, lacking the key element of common deposit insurance that would be needed to finally break the vicious circle between banks' and sovereigns' troubles. The political discussion on EDIS has been dominated by uncertainty as to how to deal with "legacy" problems in national banking systems, and it has not brought tangible progress, beyond a vague commitment in the June 2018 summit to "start on a roadmap for beginning political negotiations on the European Deposit Insurance Scheme".[53] Progress on this element ultimately depends on the feasibility of an agreement about the proper balance and sequence of risk sharing and risk reduction, which appears to be currently the most divisive issue between countries in the North and South of the Eurozone.

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IAI PAPERS 18 | 21 - DECEMBER 2018 ISSN 2610-9603 | ISBN 978-88-9368-088-2

[53] Statement of the Euro Summit, 29 June 2018, https://www.consilium.europa.eu/media/35999/29-euro-summit-statement-en.pdf.

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