ESBG

ESBG short paper on the bank crisis management and deposit insurance framework (CMDI)

The aim of this paper is to present ESBG's positions for the review of the CMDI framework before the publication of the European Commission's proposal. The paper is structured as follows: 1) Provisions to manage the failure of banks (FOLTF, PIA, harmonization of NIPs); 2) DGS Preventive and alternative measures; 3) Funding in resolution; 4) Resolvability aspects.

1. Provisions to manage the failure of banks (FOLTF, PIA, harmonization of NIPs)

General remarks: the current CMDI framework is sufficiently developed given that it already provides for a variety of resolution strategies, without the need to extend the current resolution tools. On the one hand, the dual approach to resolution should be maintained: (a) resolution under SRMR/BRRD for those banks that meet requirements of the public interest assessment (PIA) and the other conditions for entering resolution; (b) liquidation under national bankruptcy rules where PIA requirements or other conditions are not met. The present legal framework already provides the opportunity for an appropriate and unambiguous treatment of banks with a traditional business model and a positive PIA assessment.

Failing or Likely To Fail (FOLTF): the level of determination should be clarified, i.e., it should apply only at the consolidated level of the resolution group level or also at the level of the consolidated banking group (prudential scope of consolidation). Premature FOLTF decision should be avoided, since early signaling of institution difficulties could accelerate and make a process of resolution/liquidation irreversible. It would be preferred to apply other tools (such as Early Intervention Measures) to address banking difficulties in a timely manner rather than resolution that can affect financial stability. Finally, potential conflicts of interest within the supervisory authorities that must make the FOLTF decision should be addressed by ensuring that the objectives of supervisors are correctly balanced and aligned.

The Public interest assessment (PIA): it is necessary to ensure an efficient solution for FOLTF banks. The essential criterion for PIA is not only whether or not the resolution of the failing institution is in public interest, but also if the resolution proceedings can fulfil the objectives of the public interest to a greater extent than liquidation under the applicable national insolvency proceedings. Furthermore, the PIA needs to respect the principle of proportionality. Additionally, the PIA should be more transparent and predictable. Less discretion is needed in the level 1 text because too broad of a scope of discretion for the resolution authority, as is the case with the current one, leads to untraceable decisions and uncertain outcomes. Limiting national crisis management cases that involve public intervention to circumvent the bail-in as the founding principle of the resolution, should remain one of the key priorities. Furthermore, the communication among resolution authorities should be improved and legal framework enhanced to include institutions in the PIA (in both stages).

National insolvency procedures (NIP): in order to ensure a level-playing field and to avoid cross-border "no creditor worse off" (NCWO) issues, it would be desirable to have the NIP triggers for banks aligned with FOLTF triggers, avoiding "limbo situations" where banks are determined FOLTF but do not meet the national insolvency criteria. Besides, the coexistence of the EU resolution framework with a plurality of national regimes generates unintended dysfunctionalities and gives rise to inefficient, costly,

and heterogeneous outcomes. This could be addressed by a targeted harmonization focused on bank insolvency law under the direct remit of the Single Resolution Board (SRB). It is important to underline that harmonization should not imply that well-functioning frameworks would be changed. The important principle guiding harmonization should be to obtain an efficient framework where losses in case of a negative PIA are minimized in the liquidation procedure and recourse to public funding is avoided.

2. DGS preventive and alternative measures

Preventive and alternative measures of DGSs: they are essential to the CMDI framework and should be maintained because they have proven to be successful, cost efficient and target oriented. In the case of IPS, preventive measures as stated in Art 11(3) of DGSD are necessary to fully reflect the functioning of these schemes.

State aid rules: the relationship between State Aid and the use of DGS funds needs to be clarified. It is important that DGSs act in a consistent and consequent way across the different countries. That is why the level playing field should not be degraded between Member States. In some Member States, DGSs' actions are imputable to State Aid, while in other Member States, this is not the case, which creates a level playing field issue. Furthermore, it should also be made clear that when DGS funds are used for support measures, state aid rules should not be applicable and no special approvals from authorities should be required.

3. Funding in resolution

The Single Resolution Fund (SRF): the solution to access funding would not be to increase in the size of funds (including DGS funds) but to allocate resources more efficiently. Due to the considerable increase of the covered deposits, which was not foreseen on this scale when the SRF was set up, the SRF will have funds of around EUR 80 billion at its disposal by the end of the initial period in 2023. This amount is around 45% higher than the original fully satisfactory and the estimated amount of the target level expected and agreed for the end of 2023. Thus, ex-ante contributions should stop raising once the fixed target is reached at the end of 2023. Furthermore, and with regard to the easing of access conditions to funding in resolution, providing different conditions to access those funds, which are built on the contribution from banks under the same rules, would seriously affect the level playing field among competitors on the same market. If it needs external funding, the resolution of a bank should mainly rely on the existing resolution fund as long as the 8% TLOF bail-in condition is met.

4. Resolvability aspects

Minimum requirement for own funds and eligible liabilities (MREL): banks where no impediments to resolvability have been identified by the resolution authorities shall have lower systemic and O-SII buffer requirements. Indeed, in cases where the resolution authorities do not identify material impediments, the resolution strategy can be successfully implemented. Level playing fields must be ensured among banks regardless of their differences in terms of business models, which play a significant role in their ability to fulfil the MREL target and to issue MREL instruments.

Internal MREL waiver: the underlying calculation methodology needs to be more stable and transparent. The level 1 text currently leaves too much discretion for the resolution authorities, which prevents banks from anticipating their future targets. As a result, many statutory exemptions are ineffective and not applied. Especially, the conditions

for granting an internal MREL waiver need to be further specified in the level 1 text. Therefore, the level 1 text (Art. 45f (3) BRRD and Art. 12h SRMR) should be amended to explicitly require the resolution entities to grant a waiver, provided that the conditions are met. Secondly, the interconnectedness between an iMREL waiver and capital waiver according to Art. 7 CRR as well as the influence of potential systemic/local significance on the decision on iMREL waiver should be disregarded as a precondition for an iMREL waiver by the resolution authorities. Lastly, the participation in a recognized IPS or in a financial solidarity mechanism established by law with functional horizontal support systems and loss-sharing mechanisms that simultaneously build a banking group, subject to prudential requirements on a consolidated basis, should also be considered as a strong factor for an iMREL waiver.

iMREL target: it must be considered as a tool to lower the systemic risks that the failure of the institution might pose for financial stability. Both, supervisory and resolution authorities need to better reflect the principles of the other Pillar of the Banking Union and include it in their consideration when determining additional capital measures. Banks with iMREL requirements where an upstreaming of losses is foreseen within the resolution groups shall have neither an O-SII nor a Systemic Risk buffer requirement, as the failure of the institution is protected by the iMREL.

iMREL scope: the quantitative threshold for internal MREL is not defined in the Level 1 text but is rather subject to discretion of the resolution authorities. Originally, the threshold has been set at 5% of TREA/LRE/operating income. Nevertheless, it has sunk to 2%, resulting in an increase of entities considered by the resolution authorities for iMREL. In order to maintain the nature of iMREL and to limit the scope of subsidiaries in line with the intention of the EU lawmaker, the threshold should be fixed at the original level of 5% in the level 1 text – the current lack of regulation does not prevent from resolution authorities' discretion.

Bail-in: if the resolution strategy does not actually include a bail-in, an adjustment of the MREL target can be discussed under certain circumstances. However, on the one hand, it must then be ensured that this assessment is so reliable that there is no bail-in in the actual resolution case. On the other hand, it would be inconceivable to exempt the creditors and shareholders for any given subset of the banking sector from bail in and loss sharing. This especially means that accessing the SRF still requires an 8% TLOF bail-in. Finally, the current framework for contractual recognition of bail-in/resolution stay powers has to be further improved. The framework for liabilities governed under third-country law should be reviewed in order to consider business/market practice. Furthermore, there should be a clear guidance for the resolution authorities when it comes to application and monitoring of these requirements. Currently, we observe that the SRB also requests resolution-proofing of contracts under the EU law. It does not enhance the quality of the contracts in resolution and contradicts the rudimental legal principles.