POSITION PAPER

ESBG response to the EC call for feedback on its legislative package on CMDI.

ESBG (European Savings and Retail Banking Group)

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ESBG

Single Resolution Mechanism Regulation - SRMR

As a general comment on the CMDI framework, ESBG members generally oppose the review overall for various reasons.

An operational and effective liquidity-in-resolution tool: ESBG takes note of the recent initiative of the Single Resolution Board (SRB) to assess banks' capacity to measure and report liquidity in resolution including the availability of collaterals eligible for monetary policy and the Emergency Liquidity Assistance (ELA). This allows, among other aspects, to consider the potential mobilization of available contingent liquidity during resolution. Yet, we believe that the available resources in resolution in the framework should usefully be complemented with a liquidity-in-resolution tool. Such a tool, would contribute to ensure an effective and credible overall EU crisis management framework, avoiding unwarranted or increasing ex-ante contributions to existing resources. The liquidity-in-resolution tool would provide short-term "gone concern" liquidity support to the resolution process (period during while a failing bank is being resolved following the steps and approaches provided in the CMDI framework).
A coherent, consistent, and effective resolution framework generally requires the coordinated action of different authorities. In the same vein, the underlying legislation should also provide and facilitate such coordination, even if this requires developments in different pieces of EU legislation.
The liquidity-in-resolution tool is usually implemented by central banks, which have vast experience in providing collateralized funding under diverse circumstances.[1] Procedural rules should be well defined and known ex-ante by banks. The existing ELA is too discretionary and not sufficiently operational in practice to provide liquidity assistance during resolution. The US experience, for example, has clearly shown the need for a liquidity-in-resolution tool with sufficient firepower to make the framework truly effective in practice.

Single Resolution Fund (SRF) - target level & contributions: ESBG continues to be critical regarding the SRB's and EU Commission's view that the SRF target level is to be understood as dynamic and should therefore always comprise at least 1% of the covered deposits. Unfortunately, the CMDI review does not contain any adjustments in this regard nor in the key for contributions.

[1] In relation to this, Mr. Laboureix's has recently flagged the need for policymakers' to come back to the drawing board on the issue of funding in resolution (link) stressing that "clear inter-institutional support" from EU member states, the ECB and the resolution authorities is key.

We welcome the possibility of **deferring the collection of ex-ante contributions** for one year or more when the amount to be collected is not proportionate to the costs of the collection process. This is primarily a procedural relief for the SRB and the resolution authorities. It is to be expected that the institutions will still have to report data for a potential bank levy on an annual basis. We believe the change will not have a material impact on the institutions, as the levying of the contribution is merely postponed. We also believe that the legislative text should foresee that this decision will be communicated in the right time to credit institutions in order to facilitate their planning tasks accordingly.

ESBG is critical of the adjustments to the upper limit of **ex-post contributions**. Basically, the new regulation appears to be only a formal change in relation to the current status quo. However, it is not possible to estimate the future target level. In this respect, linking ex-post contributions to the target level represents a significant deterioration.

Bank Recovery and Resolution Directive – BRRD

As a general comment on the CMDI framework, ESBG members generally oppose the review overall for various reasons.

Resolution scope: the EU Commission is undertaking far reaching adjustments in the BRRD, specifically regarding the extension of the application of the resolution mechanism, including small and medium-sized institutions. Thus, the EU Commission aims for a fundamental shift, as resolution was once conceived as a response to "too big to fail", not a concept for small and medium-sized savings and retail banks. ESBG underlines that the turmoil in the US was not related to small banks. The troubled banks, when assuming that they were European, would already have been under SRB-remit, considering the current legal framework.

The Commission's proposal increases the administrative burden for those institutions, which were classified as "liquidation entities" up until now. Consequently, there could be a further wave of mergers. The EU Commission thus reinforces the unsolved "too big to fail" problem itself and acts in contradiction to all previous efforts to achieve proportionality. In addition, the associated increase in capital requirements (MREL – Minimum requirement for own funds and eligible liabilities) could also have a negative impact on lending opportunities on a local scale, bearing in mind that risk based MREL of small and medium-sized institutions could be highly sensitive to increases in capital requirements. Moreover, the extension of the resolution framework to small and medium entities opens the discussion on how to grant their access to funding in resolution,

considering that some of these entities face difficulties in accessing the capital markets to build up their MREL.

If institutions were reclassified as resolution entities (no longer liquidation entities), this would mean that these institutions, even with a balance sheet total of up to EUR 5 billion, would no longer be able to claim the status of "small, non-complex" according to Art. 4(1) No. 145 CRR and thus would not benefit from regulatory relief according to CRR.

In this respect, ESBG rejects the reference to "regional level" within the definition of critical functions (Art. 2 (35) BRRD), as well as the reversal of the principle after that prospectively, liquidation will only be allowed if winding up under insolvency proceedings meets the resolution objectives more effectively. The Public Interest Assessment (PIA) should also be more transparent and fully compliant with harmonized EU policies.

Failing or likely to fail (FOLTF): regarding the FOLTF assessment of institutions with a central body, we reject the new wording proposed in the Art. 32a. Indeed, FOLTF should be assessed as it is, e.g. at resolution group level and not at the level of each affiliated entity.

Waiver from internal MREL requirements:

- the extension of the resolution scope will probably result in IPS members[2] being subject to MREL requirements. To avoid a double safety net, since the IPS funds ensure an additional loss absorption capacity, the conditions for IPS institutions to apply for an internal MREL waiver need to be simplified or IPS institutions should be in general excluded from MREL requirement.
- It makes also sense to reduce internal MREL requirements for an entity benefiting from a solvency waiver and to grant MREL exemptions to vehicles whose business is issuing covered bonds.

Use of DGS funds in resolution: ESBG disagrees with the EC proposal to use national DGS funds to bridge the gap to the 8% of Total Liabilities and Own Funds (TLOF) required to access the SRF (rule initially implemented to reduce moral hazard). It will put further pressure on the DGS by increasing the assumptions regarding the use of their resources, given that one of the main objectives of the CMDI review is that resolution becomes the first strategy. Additionally, the removal of the 50% threshold of the target level of DGS funds for using the available financial means in resolution cases will lead to a discretionary access to DGS funds by resolution authorities and consequently, to their quick depletion, requiring each time ex-post contributions (Art. 109 BRRD). In our understanding the main purpose of a DGS should remain the protection of covered

[2] IPS: Institutional Protection Scheme

deposits and not the funding of resolution cases which should rely on the existing SRF as long as the 8% TLOF bail-in condition is met. ESBG members fear that (a) the potentially wider used industry-funded safety nets (deposit guarantee schemes and resolution funds) and (b) the extended depositor protection to public entities and client money deposited in certain types of client funds would cause disproportionate additional contributions. Therefore, an impact study should be carried out by the European Commission or the EBA to determine the conditions and likelihood of using the SRF and the consequences of this use on DGS.

General depositor preference: with a preference for all deposits, senior preferred liabilities are not protected to the same extent as before by the so-called "no creditor worse off" principle, which requires creditors to be compensated to the extent that they incur greater losses in a resolution procedure than their losses would be in liquidation. This means that unsecured creditors in resolution/liquidation may bear losses before corporate deposits, compared to today when both bear losses at the same time. This may affect rating agencies' assessment of senior-preferred risk and result in lower credit ratings, or lead to the need for banks to issue larger volumes of senior preferred and senior non-preferred debt to counteract such rating decisions. This, in turn, can lead to increased funding costs for banks, especially if they need to issue additional senior preferred to meet the overall MREL requirements. Hence, in addition to the increased volatility in fees (due to the replenishment of resolution reserves and DGSs) the banks will likely face higher funding costs. These effects may disadvantage European banks compared to global peers (due to lower profit margins) and the cost of lending to the real economy.

Business transfer strategy: regarding the preferred resolution tool so far, the sale of business, (preceded by a write-down and conversion of capital instrument), there are some elements which could be improved. For example, in the current framework, the acquirer of a FOLTF bank or of all or any assets, rights or liabilities of a FOLTF bank faces the uncertainties derived from facts or events that were underestimated or unrecorded prior to the resolution because it holds the subsidiary liability. In this sense, we propose to enhance the provided protection of the acquirer's responsibility with regard to contingent and hidden liabilities. Making the acquirer directly or indirectly responsible for the conduct of management in resolution is unjustified and cannot be easily prevented through due diligence, particularly bearing in mind the speed required in this type of process. The less uncertainties the potential acquirer has to face, the more attractive the purchase will be for potential investors. In order to clarify that there is no intention to transfer risks to parties that are not accountable for the purchase of a FOLTF bank or its assets and liabilities (such as the EU Member States, the national DGSs, the SRF, or the rest of the banking sector) we believe that the person or persons

that have consciously hidden or underestimated the aforementioned liabilities should be the one/s to be held liable for them.

Contractual recognition of bail-in: the scope of Art. 55 (bail-in recognition) should be circumscribed to financial liabilities only, unless the resolution authority identifies a particular need due to pressure on the MREL ratio.

Early intervention measures (EIMs): the Commission proposes to clarify measures within the framework of EIMs, i.e., proposals to reduce the overlap between regulations ("early intervention" and "supervisory measures"), which we consider to be positive. A clear set of rules is desirable to avoid ambiguity. However, ESBG advocates for the deletion of Art. 30a BRRD, which provides for an earlier start of resolution measures. This would negatively affect the functioning of the IPSs, as it would force IPSs to initiate financial support measures for the affected institution even before it is "likely to fail".

Extraordinary public financial support: all measures under the DGSD should not be explicitly subject to state aid law. This also applies in particular to preventive measures; Art. 32c(1b) BRRD should be clarified to not be considered as “Extraordinary Public Financial Support“. A clarification on the multi-layered regulations in terms of early measures (early, preventive, precautionary, etc…) and their interactions with the state-aid rules is necessary.

Deposit Guarantee Schemes Directive - DGSD

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Preventive measures: adjustments in the DGSD within the framework of the CMDI review primarily focus on preventive measures. The Commission’s proposal increases the administrative burden of the DGSs as well as the supervisory and resolutions authorities and, consequently, the need for resources. The newly formulated requirements for preventive measures are very time-consuming: coordination processes with supervisory and resolution authorities, implementation of a least cost test (LCT), definition of a strict timetable in advance for the repayment of liquidity protection measures, limitation of the amount of funds that can be used and absence of failing or likely to fail. As a consequence, preventive measures financed through the DGS financial means are neither credibly, functional nor feasible in the future. ESBG cannot understand why proven preventive measures should be restricted in the current and future context. It is remarkable that this goal is to be achieved through a multitude of small-scale bureaucratic

regulations. In the event of a crisis, this will lead to a diffusion of responsibility. Thus, these proposals are neither in the interest of depositors and customers nor in the interest of financial market stability. Ultimately, the EU Commission's proposals weaken small and medium-sized regionally oriented savings and retail banks and infringes the basic principle of proportionality.

Specific case of the IPS: the implementation of a mandatory LCT may impair the proper functioning of the IPSs:

a) External benefits of the institutional protection such as the guarantee of continuation of existing credit lines and payment transactions for regional small or medium-sized enterprises and private retail customers in the region - as well as aspects of protecting the common brand are not taken into account.
b) The calculation of the LCT based on an EBA RTS will foreseeably be very time-consuming, resulting in preventive measures being used with a very long delay.
c) The requirements do not consider the structure of financial networks in which the securities and capital market business is bundled in central institutions. The volume of deposits there is correspondingly low. Nevertheless, the central institutions and specialised institutions are necessary for the work of the deposit-based primary institutions.

If institutional protection measures can no longer be implemented due to the extensive requirements, there is a risk that compliance with Art. 113(7) CRR which requires IPS to safeguard the liquidity and solvency of the affiliated institutions, will be withdrawn. That would mean that the specific regulatory treatment of intra-network transactions would cease to apply.

Deposit protection scope: the extension of deposit coverage to client funds held by non-bank financial institutions in banks will likely entail an increase in credit institutions' contributions to national DGS since these deposits are not currently covered. We also see substantial challenges in implementing this measure, since non-bank financial institutions usually deny the banks' requests for necessary information to identify those clients. They often claim that they are not obliged to provide such information due to data protection provisions. We propose either to consider those non-bank financial institutions as obliged to adhere to their respective national DGSs, or to state clear and strong client identification requirements that should be fulfilled ex-ante by non-bank financial institutions, being those non-bank financial institutions held accountable to their clients while they do not provide the required information. In this sense, the client information requirements should be included in level I EU legislation (such as the DGSD and/or the GDPR 2016/679) before being developed by the EBA. Furthermore, we observe that the Commission proposal implies that deposits from public authorities will be covered by the DGS. We question the need for this amendment as such deposits tend to be

large. Hence the impact of such coverage on deposit stability may be rather limited. It is however essential that the coverage level is not increased for public authorities, as this may have a substantial impact on the level of guaranteed deposits and consequently on the contributions to the DGS.

DGS contribution calculation: a negative consequence of the Commission's proposals is that DGS funds may be used for broader purposes than what is currently possible and that a group of banks can benefit from the funds through various mechanisms. Even though these new prerogatives would create additional needs not covered by the current available financial means, ESBG emphasizes the importance that the DGS target level should remain stable whatever the circumstances in order to ensure sufficient certainty for the banking sector. Furthermore, the calculation of DGS contributions could be more transparent and further risk differentiated.

Information Sheet for Depositors: Art. 16 (2) of the proposal can be construed to mean that banks are obliged to provide depositors with the information sheet annually and have them acknowledge its receipt annually. It should be sufficient that banks provide the depositor with the information sheet once, before they enter into a contract on deposit-taking, and the depositor should never have to acknowledge the receipt. The information sheet does not provide a real benefit to the depositor, its distribution is very expensive, harmful to the environment, and it leads to cumbersome user journeys online.

Daisy Chain proposal

The current determination of MREL for liquidation entities puts a significant burden on resolution authorities to issue MREL decisions on a regular basis due to the link with resolution planning, and on banks to ensure monitoring and compliance with other related requirements, such as the prior permission regime for the call, redemption, repayment or repurchase of eligible liabilities provided in Art. 77(2) and 78a of the CRR.

However, in practice this decision changes very little in terms of the structure of liabilities used to comply with MREL because the liquidation entity already needs to comply with its own funds requirements by using own funds instruments (as long as the entity is subject to prudential requirements on an individual basis). The lack of added value of these MREL decisions, when mirroring existing own funds requirements, calls for a legislative change that removes the obligation for resolution authorities to set MREL for liquidation entities, under specific circumstances.

Similar reasoning applies to the application of the prior permission regime to call, redeem, repay or repurchase eligible liabilities. According to the Commission's proposal, liquidation entities are removed from the scope of the prior permission regime (as the

liquidation entity would not have eligible liabilities on its balance sheet, even if certain liabilities would comply with the eligibility requirements).

ESBG appreciates the Commission´s proposal to remove the obligation for resolution authorities to set MREL for liquidation entities and to exclude liquidation entities from the scope of the prior permission regime.

About ESBG (European Savings and Retail Banking Group)

ESBG is an association that represents the locally focused European banking sector, helping savings and retail banks in 17 European countries strengthen their unique approach that focuses on providing service to local communities and boosting SMEs. An advocate for a proportionate approach to banking rules, ESBG unites at EU level some 871 banks, which together employ 610,000 people driven to innovate at 41,000 outlets. ESBG members have total assets of €6.38 trillion, provide €3.6 trillion loans to non-banks, and serve 163 million Europeans seeking retail banking services.

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