EU BANK CRISIS MANAGEMENT FRAMEWORK

ELKE KÖNIG
Chair, Single Resolution Board (SRB)

A European solution to deal with failures of medium-sized banks in the Banking Union

In Europe, we have built our resolution framework from scratch in just a few short years. This required prioritising tasks in the initial phases. Up to now, we have mainly focused on the operationalisation of the bail-in tool, as it is the preferred resolution strategy for most of the banks under our direct remit. We have done so because the largest institutions are those that imply a larger risk for financial stability.

One of our current priorities at the SRB is to work on the transfer tools at our disposal. The latter serves the purpose of improving the resolvability readiness of Significant Institutions falling under our direct remit with transfer tools as preferred resolution strategy. Indeed, experience has taught us that the failure of medium-sized institutions can also hamper financial stability, so all banks must be resolvable.

In such cases, the MREL targets are modulated through bank-by-bank adjustments to the recapitalisation amount. However, such transfer tools are not a free lunch, and they come at a cost. Indeed, where a key driver of value for the main assets transferred are the client relations, any transfer strategy must reflect the need to maintain these client relations. Bailing in non-covered deposits might in such cases damage client relationships and thereby possibly deplete the franchise value. Therefore, banks must build up the necessary MREL calibrated to ensure a successful exit from the market in case of failure.

BRRD3 must grant the SRB with stronger powers to deal with bank failures in the Banking Union, together with the management of EDIS.

The European Deposit Insurance Scheme (EDIS) is the main missing element of our Banking Union, intended not least to break the bank-sovereign-doom-loop. It is closely related to bank resolution. Indeed, we support further exploring the use of EDIS in resolution, in combination with the SRF. However, the existing restrictive rules for the use of DGS funds to support a sale of business put into question its operationalisation. Thus, we call for the removal of DGS super priority in the creditor hierarchy, and a review of the "Least Cost Test" to provide stringent and harmonised criteria across the Banking Union.

Such amendments could provide solid funding options for the transfer tools, and subsequent exit of market of ailing medium-sized banks. Of course, the review of the crisis management and deposit insurance framework is inextricably intertwined with the discussions on EDIS that are taking place in parallel. Only EDIS would ensure a harmonised and European approach, guaranteeing the same level of protection for all depositors.

If this were not the case, it would lead us to an undesired outcome: the renationalisation of bank failures. Relying on national DGS funds and national decisions could put pressure to circumvent resolution and go for national solutions, especially in case access to DGS has lower burden-sharing requirements than the SRF. We cannot afford to go back to past mistakes based on inconsistent national solutions that inevitably reinvigorate the sovereign-bank doom-loop. Banking failures in the single market require a European approach.

All of the above is also closely linked to the need for a targeted harmonisation of the key features of bank liquidation regimes, to set the basis for a harmonised EU liquidation regime. This is important for us in order to carry out our Public Interest Assessment and respect the "non-creditor-worse-off" principle. The SRB would have administrative liquidation powers for banks under our direct remit, and National Resolution Authorities would have more consistent and efficient powers to transfer assets and liabilities in liquidation, to be funded through EDIS with a robust governance system within the Single Resolution Mechanism.

"Aller guten Dinge sind drei." BRRD3 must ensure that we have a well-functioning European solution for all banks. This requires ultimately granting the SRB with stronger powers to deal with bank failures in the Banking Union, together with the management of EDIS.

I believe in completing our framework to reduce value destruction, increase and harmonise deposit protection, ensure transparency and reliability, safeguard public funds, and improve financial stability.

MARIA VELENTZA

Director Financial Services,
DG Competition,
European Commission

Developments in the state aid and banking crisis management framework

Since the beginning of the financial crisis in 2008, the European Commission has exercised its duties as competition enforcer by assessing the compatibility of support from the public budget to the financial sector with the State aid provisions enshrined in the EU Treaty. Specific guidelines (a series of "communications") were adopted establishing minimum criteria for this compatibility assessment. Through state aid control the Commission has contributed to safeguarding financial stability by facilitating the orderly market exit of unviable banks and preventing the disorderly failure of otherwise viable entities. This has contributed to a more robust EU banking sector by fostering deep restructuring.

The 2013 Banking Communication, which is the latest revision of the financial-sector State aid guidelines, has been a stable guide as to the Commission's exercise of State aid control in that sector. Until the introduction of the EU bank resolution framework in 2015, financial-sector State aid control de facto served as the Union's bank resolution regime, ensuring a level playing field at a time when many Member States mobilised their public budgets to support their banks. It is worth noting that these guidelines introduced loss-sharing by the shareholders and subordinated creditors of aided banks. And, finally, they supported fair competition by requiring aid beneficiaries to make efforts to mitigate competition distortions.

Since 2015, State aid control in the financial sector has fulfilled these roles in complementarity with the new EU bank resolution and deposit insurance rules. For instance, the Bank Recovery and Resolution Directive explicitly recognises the applicability of the State aid framework in the context of precautionary recapitalisation or resolution; in its State aid decisions, the Commission has consistently taken into account the new regulatory setting.

The EU bank crisis management framework has also entailed the creation of new actors, attributing the role of bank supervisor to the European Central Bank within the Single Supervisory Mechanism, and the Single Resolution Board as central resolution authority within the Single Resolution Mechanism. However, the Commission's role as competition authority – contained to assessing the compatibility of State aid measures – has remained unaltered.

In the future, a holistic assessment of the crisis management framework will ensure consistency between State aid and Banking Union rules.

Six years after the entry into force of this new regulatory setting, the EU banking sector is in general more resilient, but some pockets of vulnerability remain – and the effects of the COVID crisis are still unknown. The implementation of the bank resolution framework is still ongoing, in particular with respect to banks' compliance with the minimum requirements for own funds and eligible liabilities, which serve as a bail-inable buffer to protect taxpayers and depositors in case of a bank failure. Further revisions of the crisis management framework are ongoing or being discussed, including as part of a public consultation; the economic effects of the COVID-19 pandemic - which represent a serious disturbance in the Member State economies - further underline the need to proceed thoughtfully.

The Commission is now set to review the State aid rules for banks in the context of a broader review of the EU bank crisis management framework which is to be completed by 2023. While financial sector State aid guidelines and the EU bank resolution and deposit insurance regime each follow their own logic, these frameworks are highly interdependent, and so are the decisions of the various public actors involved.

Given these interdependencies, a holistic approach towards the review of State aid rules for banks and the EU bank crisis management framework is the best way to ensure a coherent set of rules in both frameworks in the future.

A holistic analysis and revision of all the pieces of the crisis framework "puzzle" will support consistent and predictable outcomes which safeguard fair competition, promote financial stability, protect taxpayers and set appropriate incentives for banks and their shareholders and creditors.

HELMUT ETTL

Executive Director,
Austrian Financial Market Authority

Winding down smaller and mid-sized banks – A possible way forward

Since the establishment of the new crisis management and resolution framework in 2015, the number banks declared failing or likely to fail has been limited. The number of resolved banks according to the new framework is even lower. One possible reason is that for a certain type of banks the resolution framework is not (fully) suitable. But exiting the market through ordinary insolvency proceeding seems to be not suitable either due to the potential negative impact on financial market stability – leaving the supervisory authority in kind of a limbo situation to forbear the ultimate supervisory measure, declaring a bank failing or likely to fail.

Moreover, the resolution regime as such was developed to counteract the "too big to fail" hypothesis. Thus, it was created for the big, systemic banks. Therefore, it might be not proportional and too intrusive for smaller banks.

DGS could play a role in supporting the wind down of non-systemic banks, given prior fixation of strict least-cost-tests and adequate loss sharing.

For this and various other reasons, it is a consensus that there is the need for a further improvement of the crisis management and resolution framework for these so-called small and mid-sized banks – banks that are too small for resolution, but potentially too big for ordinary insolvency. For sure EDIS combined with an "EDIC" would be the solution for such problem. Unfortunately, this seems to be a rather long-term solution. Steps in between are necessary.

There are various possible ways forward, all of them with positive aspects and drawbacks. All of them are circling mostly around one crucial element – funding of winding the failing bank down. Let me try to outline one of these options: One could argue that only the systemic banks should be eligible for resolution. For smaller banks, it should be either ordinary insolvency including triggering the DGS or an alternative administrative wind down procedure, which could be developed alongside the following principles:

1. Losses have to borne by shareholders and holders of regulatory capital (AT1 and T2) first. The failing bank must exit the market. Only relevant parts of the bank should be safeguarded (e.g. covered deposits) by transferring them to other market participants.
2. There might be the need for external financing (capital and liquidity) to support the transfer-mechanism. As covered deposits are concerned, DGS could step in and support. A strict least-cost-principle-test should be a pre-condition.
3. Internal preparation of banks for the implementation of such a transfer-tool will be necessary. Such preparation could include a certain financial cushion for supporting the transfer (reserved assets) or bearing losses (additional gone-concern instruments beyond regulatory capital requirement).

As mentioned above – this is only one possible way forward. There are several others. But we should always bear in mind: losses will not vanish – they have to be borne by someone and they have to be allocated in the process of winding down a failing bank. We should strive for the most efficient way and aim for using as less public and mutualized financial means as possible.

MARTIN MERLIN

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European Commission

Evolution rather than revolution in crisis management and deposit insurance

Completing the Banking Union remains a priority for the Commission, currently working on the review of the crisis management and deposit insurance framework, with a public consultation launched in February, a high-level conference mid-March and legislative proposals scheduled at the end of the year.

EDIS is a natural complement of such a review. Seeking to facilitate interventions by deposit guarantee schemes (DGS) to finance the sale and market exit of smaller, deposit-based, banks, the liquidity support from EDIS would mitigate the lack of available funding and the risks of shortfalls in the DGS financial means, requiring the recourse to public financing.

The pooling of resources in EDIS would avoid "re-nationalising" the Banking Union and could lower bank contributions while maintaining an appropriate firepower and ensuring a more sustainable replenishment. Synergies with the Single Resolution Fund could also strengthen the resilience of the EU crisis management toolkit and deliver efficiency gains.

The Banking Union would not be complete without its third pillar, EDIS.

The ongoing health crisis reaffirms the urgency for robust financial safety nets financed by the industry in a crisis management framework for every bank whatever its location, size or business model. Such a robust framework with effective and proportionate instruments available for all banks would strengthen depositor confidence and pave the way for further market integration.

The priority should be to preserve financial stability and level playing field in full respect of the diversity in the EU banking landscape while limiting the use of taxpayer money.

Overall, the Banking Union should ensure a solid and stable banking sector in Europe, taking full advantage of the single market. Indeed, market integration generally increases access to funding for the real economy, lowers the cost of capital, contributes to risk diversification and stronger resilience to shocks. Banks in Europe need such a regulatory environment to continue contributing to the economic recovery and play their role in other important challenges ahead.

The work on the so-called hybrid EDIS, based on the coexistence of national DGSs and a European central fund, continues in the Council and in the intergovernmental context. The hybrid model would provide liquidity support as a first step and, is evolutive in nature, allowing for a gradual and conditioned transition towards loss mutualisation in the steady state.

The process for Banking Union completion also involves other components, including on mitigating the sovereign-bank nexus, reflecting upon banks' exposures to sovereigns, their financial stability implications and the need for safe assets at the EU level. Progress on EDIS should unlock some of home-host issues and ring-fencing practices.

At this juncture, one observes only one resolution case managed by the SRB and a frequent recourse to public money under national procedures. The current efforts to complete the Banking Union provide a momentum, not for a revolution of the framework, but for targeted changes to improve existing tools, ensure a broader application of the EU framework and mark the start of the gradual establishment of the third pillar.

KARL-PETER SCHACKMANN-FALLIS

Executive Member of the Board, Deutscher Sparkassen- und Giroverband (DSGV)

Improving the crisis management and deposit insurance framework while preserving the diversity of the EU banking system

When the Banking Union – arguably the biggest EU reform project since the introduction of the common currency – was set up in response to the sovereign debt crisis, its core objectives were to ensure financial stability and to establish common principles for adequate banking supervision. Its three pillars have since been put firmly into place and their added value has been proven as recently as at the onset of the pandemic crisis, when regulators and supervisors across Europe acted swiftly and in unison.

The start of the review of the crisis management and deposit insurance (CMDI) framework offers the chance for measured reforms to address shortcomings identified since it entered into force. The wide scope of the European Commission's respective stakeholder consultation however suggests a much more fundamental overhaul of the entire framework.

Unfortunately, the underlying concept so far points to an insufficient consideration of institutional protection schemes (IPS), which are widely prevalent among small and mid-sized regional credit institutions in Europe, such as the German savings and cooperative banks.

Most notably, the Commission intertwines the CMDI review with its separate proposal for a European Deposit Insurance Scheme (EDIS). This is unnecessary and will not lead to any results since EDIS has been stuck in the legislative process since 2015 for failing to take account of the diversity of the EU's banking sector. Clinging on to EDIS is an impediment to finding the best European solution.

Not only appears there to be little intention of drafting a fresh proposal which would exclude IPSs from a centralised EDIS on subsidiarity grounds, there are now even additional considerations going in the same, flawed direction. In particular, this regards plans to further centralise competences at the SRB.

Contrary to this, the Commission should build on the subsidiarity inherent to the CMDI framework: A clear distinction between systemically important banks under direct responsibility of EU institutions and non-systemically important banks under national responsibility. Changing this foundation cannot be justified – neither economically nor politically. It would contradict the idea of a diverse Europe and undermine local responsibility.

The European Court of Justice's recent ruling in the so-called Banca Tercas case has highlighted the validity and the importance of preventative and alternative measures to support troubled members of a guarantee scheme from within their respective peer group. By definition, these measures are required to be economically more advantageous than mere reimbursement of depositors in the event of liquidation.

Following the reasoning confirmed by the highest court of the EU, the CMDI review should seek to strengthen the role of existing DGSs and IPSs within crisis management by committing to preventive and alternative measures. In addition, national authorities should be provided with additional tools to deal with banks going into national insolvency. This would improve the proper functioning of the Banking Union going forward and maintain the diversity of the EU banking system at the same time.

JACQUES BEYSSADE
Secretary General,
Groupe BPCE

We need to make the full use of the Banking Union as a single jurisdiction

The Banking Union (BU) is a great achievement but remains incomplete and below its potential to achieve a well-integrated Eurozone banking sector. Even within the BU, national interests still cement fragmentation along national lines and discourage cross-border banking groups. For example, not even liquidity is allowed to move freely within banking groups, not to mention capital. Considering that from a supervision perspective the BU is a single jurisdiction, such obstacles are not justifiable. This underlying flaw of the BU's first Pillar also undermines the functioning of the second Pillar, the ability to resolve significant banks and liquidate less significant banks in a way that preserves value, Shields taxpayers and protects depositors. But as long as achieving Banking Union as a single jurisdiction is not encouraged, most solutions (i.e. sale of business) have to be found at a national level. This holds back future sector integration but also risks amplifying issues in national banking sectors.

These dynamics in Pillar 1 and 2 also undermine the acceptability of any EDIS-like structure as a Pillar 3 where six years after the original proposal we are still in the dark on the direction of travel. Therefore, the first part of our response is clear: Improve the conditions for using the existing BRRD tools in the current legislation making the full use of the Banking Union as a single jurisdiction.

> "Same risks, same rules", regardless of the size of banks

The second part of our response is to step back and consider the problem at hand objectively: according to the Commission's consultation there are two dimensions to the problem. First, medium-sized banks that do not pass the PIA may be too difficult to handle for national insolvency proceedings. Second medium sized banks, especially when deposit financed, tend to struggle raising MREL. The first concern can be addressed by either harmonising key elements of national insolvency proceedings for the financial sector and, if this is too complex, the alternative is to better frame the Public Interest Assessment in a transparent manner which would allow for these banks to be resolved via SRB action.

The second concern cannot be taken at face value. We have not seen any evidence that raising MREL is a problem other than suggesting that an inability to issue may not be the bank's primary problem. Conversely, if some healthy mid-sized banks truly struggle in meeting their MREL requirement the solution would be to move forward with the Capital Markets Union.

On this basis, this is not the time to introduce another layer of special treatment into a complex framework just to solve issues that may or may not be incurred by a hazily defined group of banks. This means that the establishment of an ad hoc resolution mechanism for medium-sized banks with maintenance of their access to the Single Resolution Fund under very favourable conditions, i.e. without having to bail-in at least 8% of the Total Liabilities and Own Funds should be radically refused.

It is inconsistent with the principle "same activity, same risk, same rules" and would mean that taxpayers and DGSs indirectly subsidize these banks with insufficient MREL. The challenges we are faced with are real enough, we should not exert ourselves in adding new difficulties at national and European level.

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Improve the efficiency of the EU Crisis Management Framework: a key intermediate step in achieving Banking Union

The EU Crisis Management Framework has to a large extent contributed to the initial goals of strengthening the resilience of the banking system. Across the board systemic banks have become more resilient and built-up a sizeable cushion of bail-inable debt for absorption of losses and recapitalization if the situation requires so. Although differences remain, we view that amongst the most sizable EU banks there is an overall level-playing-field in terms of requirements and applications of rules throughout the Eurozone. Fortunately, in the decade after the financial crisis depositor protection has not been severely challenged which could be considered as a demonstration that banks have become increasingly resilient.

With respect to the smaller banks in the EU system the landscape and framework is more diversified. This makes the applicable resolution/liquidation rules challenging and diversified. To ensure predictability

we promote more clarity in the BRRD when defining a resolution action in the public interest or the winding up of a bank under normal insolvency law when the public interest test is not met.

Banks, irrespective of their size, that are in the scope of resolution should be subject to MREL requirements whereby the size, business model, local market and rating are duly taken into consideration thereby acknowledging that the MREL issuing capacity might be vary across countries. We welcome the proposals, currently under way by the SRB, to harmonize the public interest test and view that such a test should be applied by the SRB and no longer by national authorities.

A key challenge to address is the existing discrepancy between declaring an institution failing-or-likely-to-fail and the national triggers to initiate insolvency procedures; clarification should be made at EU level through the BRRD and the SRM regulation to establish administrative procedures that will be applicable for all banks and binding for the national insolvency regimes.

Furthermore, we envisage that more efforts could be undertaken to harmonise existing national insolvency procedures and financial means. One key element to consider is in our view to harmonise the use of DGS to finance alternative measures in liquidation, such as the transfer of assets and liabilities across the EU.

We note that only in a number of Member States DGS can be used a preventive measure; we believe the DGSD should be amended and DGS funds should only be used in liquidation. both for compensating depositors as well as alternative measures and always on a least cost basis. And in any event, to prevent an un-level-playing field, the use of preventive measures by both private and public DGSs against the background of state aid rules should be clarified.

Throughout the years the Crisis management Framework has also significantly contributed to a reduction of the sovereign feedback loop. However, there is an actual risk that dependencies are re-introduced or increased – we see this for instance when contributions into the national DGS funds are deposited in public treasury. The DGSD review should provide for clear rules to avoid this. Ultimately the European Deposit Guarantee Scheme is the best response to address this sovereign feedback loop.

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