PUBLIC INTEREST ASSESSMENT: FROM RESOLUTION PLANNING TO RESOLUTION ACTION

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Congreso Internacional “La Propuesta de Reforma del Régimen Europeo de Gestión de Crisis Bancarias y Garantía de Depósitos”

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Single Resolution Board

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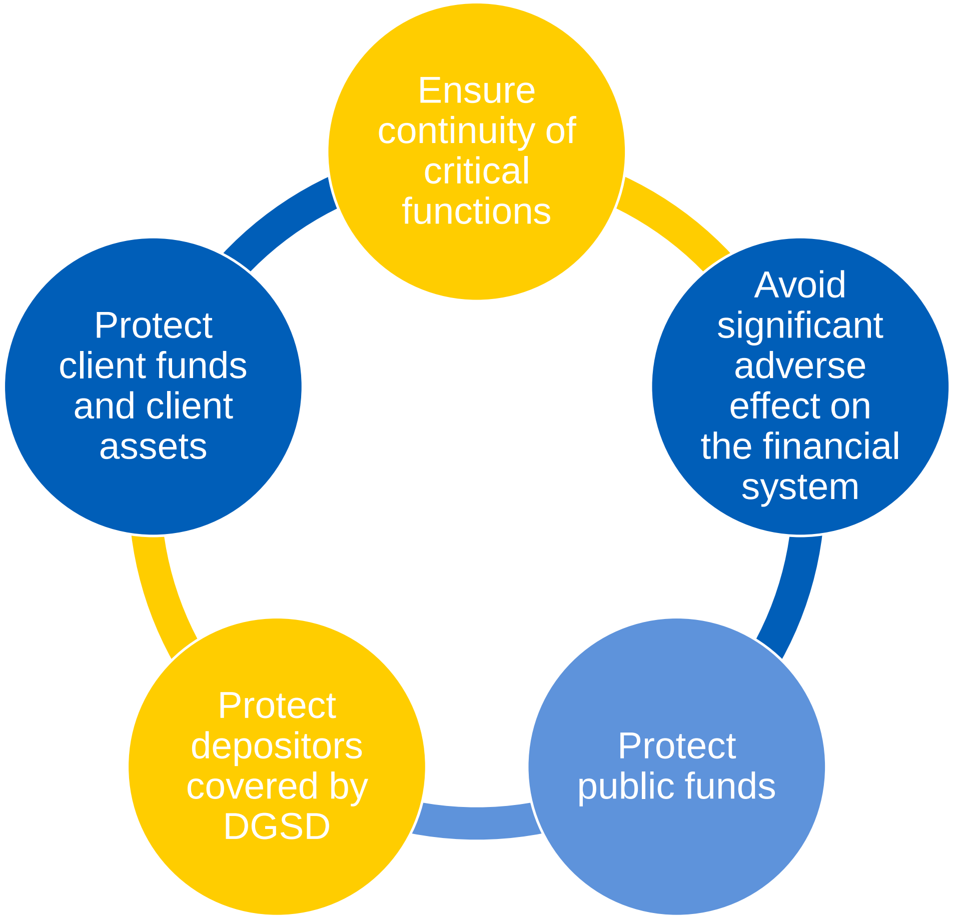
What is the public interest assessment (PIA)?

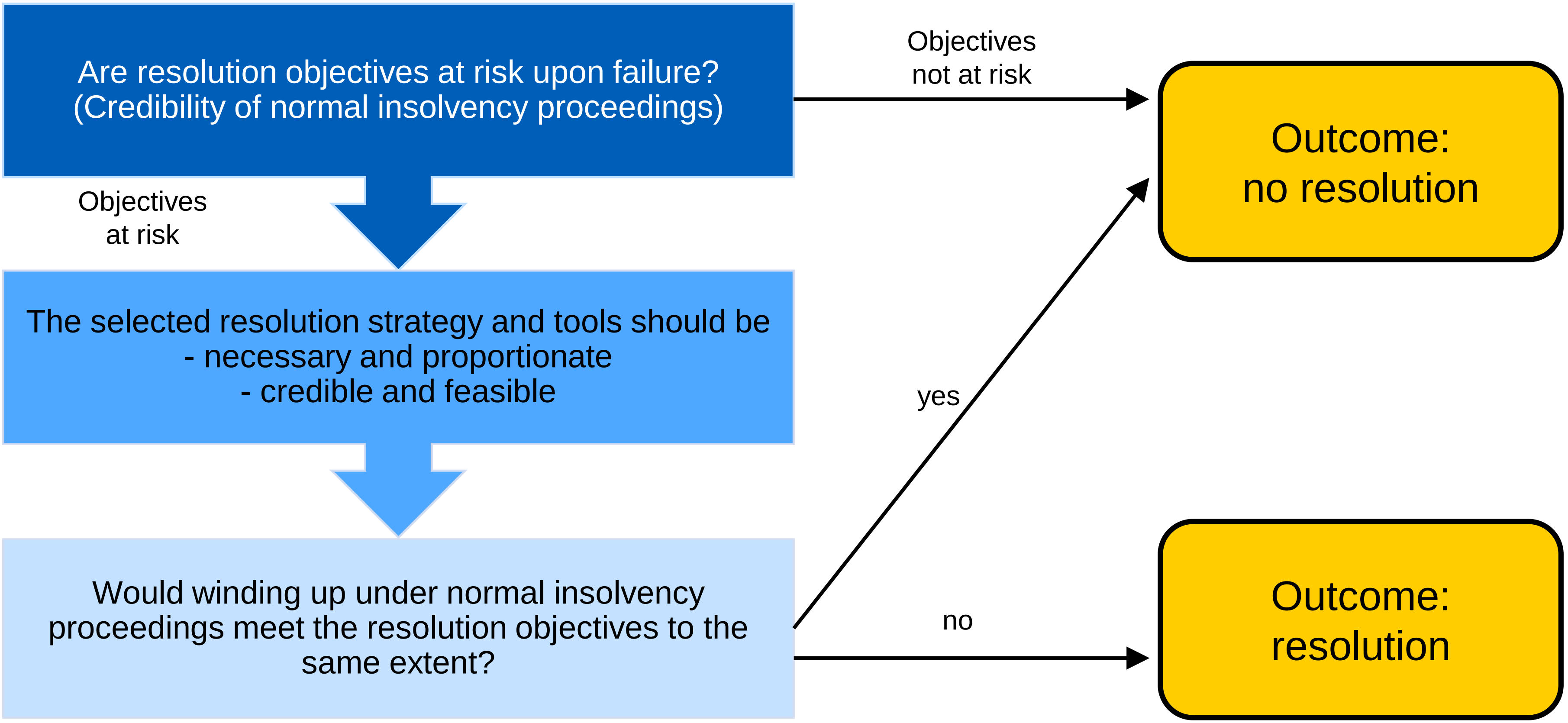
- PIA is one of the three **conditions for resolution**, after the assessment that (i) the institution is failing or likely to fail and (ii) that there are no alternative measures able to prevent the failure in a timely way

- Resolution action is in the public interest where:
  - It is **necessary** for the achievement of, and is **proportionate** to, one or more of the resolution objectives
  - **Winding up** under normal insolvency proceedings would not meet the resolution objectives **to the same extent**



Resolution objectives

What is the PIA? PIA at work



PIA at the planning stage

- When preparing the resolution plans for each institution or group, the SRB assesses the resolution objectives that could potentially be at risk by considering the following:

  - Does the bank perform any **critical function** that needs to be preserved?

  - Would the failure of the bank be expected to have **significant adverse effects** on the financial system of one or several Member States?

- The SRB published initially its approach in 2019

  https://www.srb.europa.eu/system/files/media/document/2019-06-28_draft_pia_paper_v12.pdf

PIA at the planning stage: critical functions

- A function is critical if:

  - ➢ It is provided to **third parties** not affiliated to the institution or group;
  - ➢ The sudden disruption of that function would likely have a **material negative impact** on the third parties, give rise to **contagion** or undermine the **general confidence** of market participants (taking into account size, market share, external and internal interconnectedness, complexity, and cross-border activities of the institution or group);
  - ➢ It is not considered **substitutable** since it cannot be replaced in an acceptable manner within a reasonable time frame without creating systemic problems for the real economy and the financial markets.

Types of economic functions:

- Deposits
- Lending
- Payment, cash, settlement, clearing, custody
- Wholesale funding
- Capital markets

PIA at the planning stage: financial stability

- Objective: avoiding a **significant adverse effect** on the financial system, in particular by preventing **contagion**, including to **market infrastructures**, and by maintaining **market discipline**

- SRB uses a four-step approach to assess the impact of a bank's failure:

Systemic relevance	Direct contagion	Indirect contagion	Impact on the real economy
• Size, interconnectedness, cross-border activities, complexity, importance for the MS and substitutability, G-SII and O-SII designation	• The direct losses to counterparties would lead to their default or likely default and affect their ability to perform their macro-economic functions efficiently	• Failure of the bank causes a negative reaction by market participants or other stakeholders, leading to a severe disruption of the financial system with potential to harm the real economy	• Risk of a potential spillover from the failing bank to the non-financial sector

PIA at the planning stage: system-wide events

- With the 2021 addendum to the SRB's policy, the PIA in resolution planning considers that the failure of the institution or the group would occur under two sets of circumstances:
  - **Normal market conditions**: idiosyncratic failure;
  - **System-wide events**: the rest of the banking system is assumed to be affected by an adverse scenario. After assuming a CET1 depletion to the rest of the banking system (in line with the outcome of the EBA stress tests), the PIA takes into account the direct and indirect contagion effects caused by the failing bank.
- These circumstances are considered when assessing the impact of the failure on the resolution objectives, testing the preferred and variant resolution strategies and determining the credibility of normal insolvency proceedings.
- The PIA assessment continues to consist of a single assessment and a **single conclusion**.

https://www.srb.europa.eu/system/files/media/document/2021-05-29_srb_addendum_to_public_interest_assessment.pdf

PIA at the planning stage: DGS use

- The protection of covered deposits is ensured by the national deposit guarantee schemes (DGSs).
- However, the available financial means of a DGS may not be sufficient to pay out all covered deposits: the need for the DGS to raise *ex post* contributions might have a significant adverse impact on **financial stability** and on the **protection of covered deposits**.
- Since the 2022 addendum to the PIA policy, the PIA assessment comprises the following steps:

1. Have the **DGSD requirements** been met by national authorities?
2. Can the **payout** be met through a combination of available financial means, capped *ex post* contributions and alternative funding arrangements?
3. Is the **impact** of the capped/uncapped *ex post* contributions on the solvency or the liquidity of the remaining participant institutions significant so that financial stability might be at risk?

https://www.srb.europa.eu/system/files/media/document/2022-05-19_SRB-Addendum-to-the-Public-Interest-Assessment%e2%80%93Deposit-Guarantee-Schemes-Considerations.pdf

PIA at the failure stage

- In an event of actual failure of an institution, the SRB may only adopt a resolution scheme where the institution has a positive PIA. The resolution plan provides a **presumptive path**.

- When assessing whether PIA is met in a concrete failure, the outcome of the PIA is taken as a **starting point** and **updated** with the specific circumstances of the case, using up-to-date and detailed information on the failing bank and on the condition of financial markets, financial stability and interconnectedness of the bank.

- As an outcome of this reassessment:
  - A bank that had been earmarked for normal insolvency proceedings may end up having a positive PIA and thus needing to be resolved;
  - Normal insolvency proceedings may turn out to be deemed credible for a bank for which the resolution plan had assumed a positive PIA.

CMDI review: changes to PIA

- The **CMDI package** adopted by the Commission introduces targeted amendments to the rules on PIA:

Definition of critical functions	Adjustments to the resolution objectives	Procedural changes
• Relevance of the impact on the real economy and financial stability at *regional level* of the discontinuance of a critical function	• Protection of public funds: support from the industry-funded safety nets is preferable to taxpayers' money • Protection of depositors while minimising losses for DGSs	• Resolution to be chosen where normal insolvency proceedings would not meet the resolution objectives *more effectively* (currently: to the same extent) • Resolution authorities to consider any extraordinary public financial support that would be granted in insolvency

- The purpose of the amendments is to **better frame** the discretion of the PIA and ensure improved harmonisation at EU level, so that the resolution framework can be applied properly to **any bank**, regardless of size or business model, when that best achieves the resolution objectives.

CMDI review: changes to PIA

- PIA remains a **discretionary assessment**, to be carried out by resolution authorities on a case-by-case basis
  - ➢ While the proposal aims at expanding the resolution scope to more smaller and medium-sized banks, **it does not have the intention of presuming that all banks should be earmarked for resolution**, especially in the absence of EDIS (see the impact assessment accompanying the CMDI package).
- Importantly, the **DGS bridge** (i.e., the contribution of the national DGS counting towards compliance with the 8% TLOF threshold for accessing the SRF) is only available to institutions that have **not** been earmarked for winding up under normal insolvency proceedings in the resolution plan.
  - ➢ This aims to ensure that MREL remains the first line of defence, as it requires institutions to have built up a '**full MREL**' (loss absorption and recapitalisation components).
  - ➢ The proposal would not prevent institutions with a negative PIA in planning, but a positive PIA in failure, to otherwise access SRF or the national DGS, where the respective conditions would be met.
  - ➢ Changes to the preferred resolution strategy (e.g., going from open-bank bail-in to a transfer strategy) would not prevent access to the DGS bridge.

CMDI review: resolution funding

- To accommodate the expanded PIA and ensure that resolution can be applied to any bank, regardless of its size, the CMDI proposals makes some **balanced adjustments** to the rules on the **funding in resolution**.

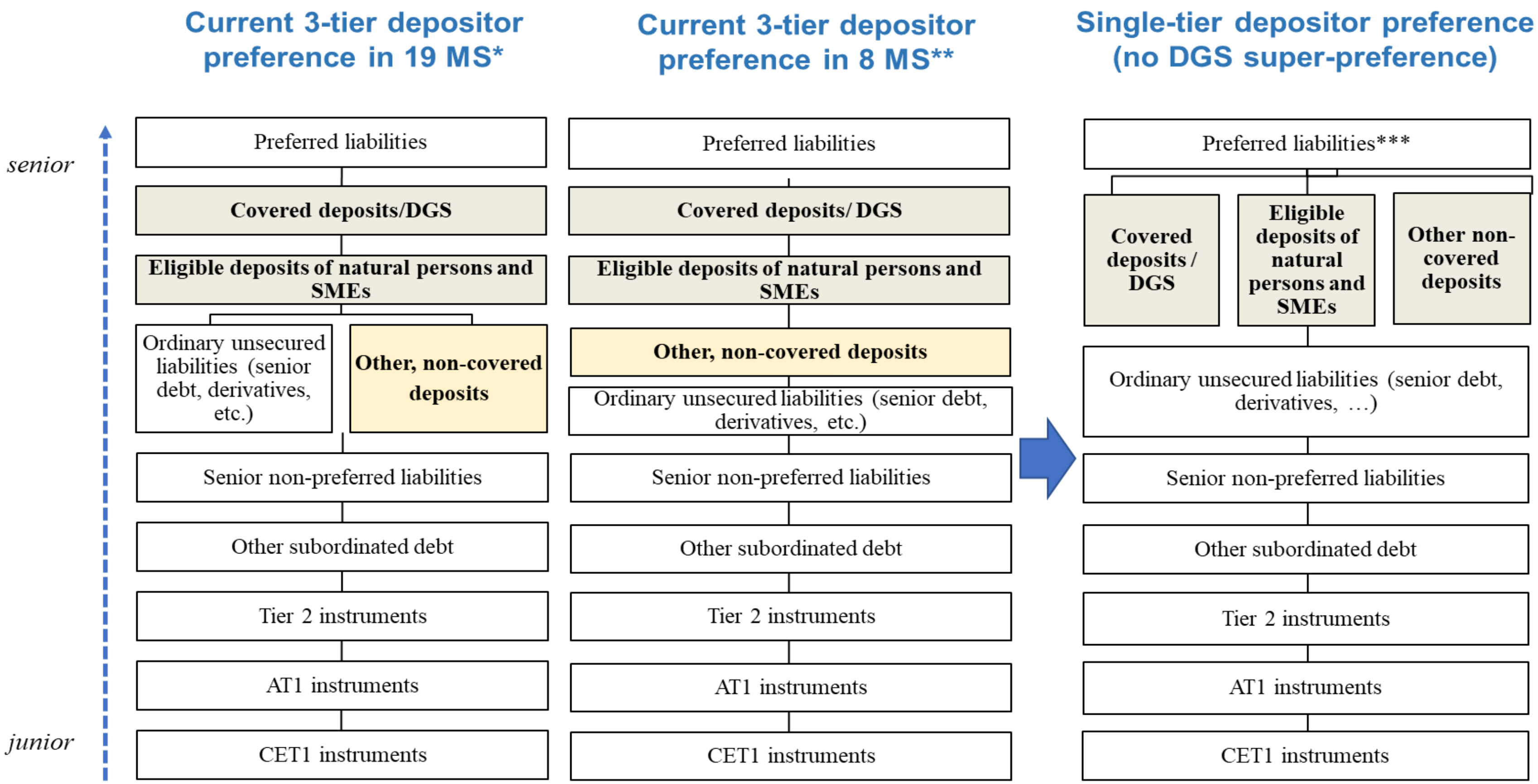
The most important rules on resolution financing are preserved...

- Banks' **capital** and **MREL** buffers remain the first to bear losses and contribute to recapitalisation;
- The 8**% TLOF threshold** to access the SRF is maintained;
- The DGS contribution cannot exceed the **least cost test**.

... but the DGS is given an enhanced role in the funding of bank failures.

- DGS can be used as a **bridge** to meet the 8% TLOF threshold without bailing-in deposits;
- Implementation of a **general depositor preference** with a **single-tier ranking**;
- **Harmonisation** of the least cost test across all uses of DGS outside payout.

CMDI review: single-tier depositor preference



** AT, BE, CZ, DE, DK, EE, ES, FI, FR, IE, LV, LT, LU, MT, NL, PL, RO, SE and SK.*
*** Other 8 MS have preferred non-covered deposits relative to ordinary unsecured claims (BG, CY, EL, HR, HU, IT, PT and SI).*
**** The Single Resolution Fund/ National resolution funds are among preferred liabilities.*
Note: this illustration is stylised and simplified. In reality, the hierarchies of claims across Member States are only partially harmonised (in particular the subordinated layers), while the senior layers are largely unharmonised and may include additional sub-classes.

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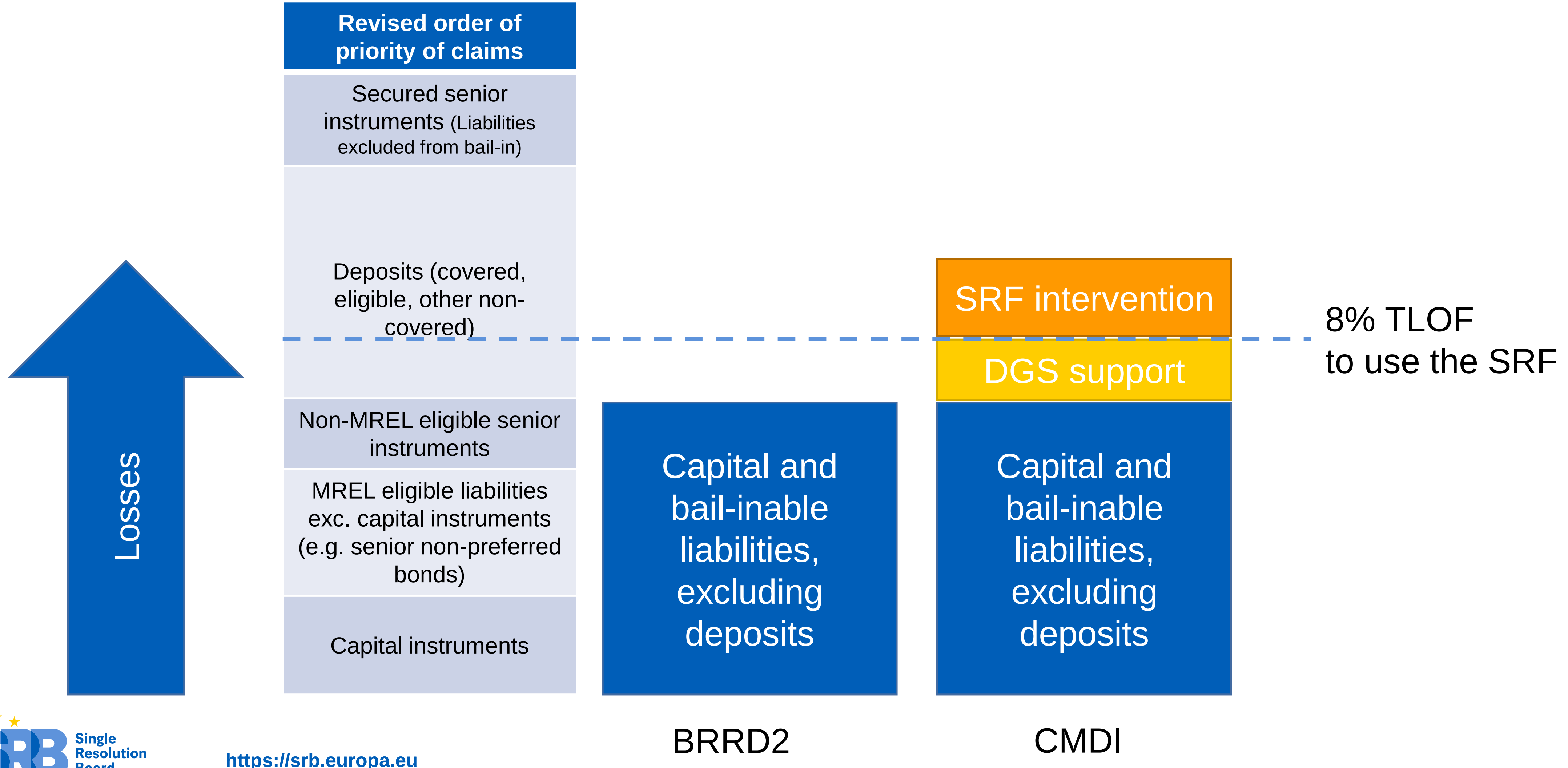
Source: Technical presentation by DG FISMA on the review of the CMDI framework

CMDI review: stylised example of DGS bridge



CMDI review: DGS use in resolution

Under the CMDI proposals, the use of the DGS in resolution is subject to important safeguards:

- Where the DGS is used as a **bridge** to meet the 8% TLOF threshold:
  - The DGS can only step in to safeguard **deposits** from bearing losses; the protection of non-covered deposits is a **discretionary decision** of the resolution authority, taken on a case-by-case basis where **justified** under certain grounds;
  - The bridge function is only available for **resolution transfer strategies leading to market exit** and for banks that had **not** been earmarked for **liquidation**;
  - The contribution of the DGS **cannot exceed** by the amount needed to meet the 8% TLOF requirement;
- The DGS contribution is limited by the **least cost test** (i.e., the hypothetical net losses in case of a payout of covered deposits in insolvency);
- The **NCWO safeguard** applies to the DGS use.

Experience from a recent case: Sberbank

- **Sberbank Austria AG was the direct EU subsidiary** (total consolidated assets EUR 12.9bn) **of Sberbank Russia and the parent company of entities in EU** (in the BU – SI, HR, 1 branch in DE – and outside BU – HU and CZ) **and other entities outside EU.**

- Sberbank provided domestic retail/corporate banking services in several Central and Eastern European markets.

- Although the size of the bank was modest in comparison to other institutions under the SRB's remit, complexity arose from the **cross-border dimension of the group**.

- Sberbank Austria AG had no critical functions and a very low footprint in Austria, whereas **the main impact on financial stability or a critical function was identified in other EU countries, hence positive PIA in the resolution plan.**

- Decisions taken by SRB

  - **Negative PIA:** Non-resolution decision for Sberbank AG → Liquidation under AT NIP (DGS pay- out)

  - **Positive PIA:** Resolution decisions for both Sberbank d.d. (Croatia) and Sberbank banka d.d (Slovenia) → SoB ("share deal") following a marketing procedure

Experience from a recent case: Sberbank

Close monitoring
Monitoring by SRB and ECB

31 Jan 22 – 22 Feb 22

24 Feb 2022

Russian invasion of Ukraine

26 Feb 2022

Preparation
SRB starts preparing for resolution

European resolution college

27 Feb 2022

FOLTF and moratorium
Formal approval and notification of final 'failing or likely to fail' assessment by the ECB to the SRB

Adoption of moratorium decisions and notifications

28 Feb 2022

Communication
Press release on moratorium

Marketing process ongoing

1 Mar 2022

Final decisions
ERC process

SRB final adoption resolution schemes/decision not to take resolution action (and notifications)

EC endorsement of resolution schemes

End of moratorium

SRB press release

Experience from a recent case: Sberbank

A successful, yet unique case.

- **Failure**: Unexpected and highly dynamic, due to the reputational impact of looming sanctions
- **Resolution**: Deviation from the plan for valid reasons: resolution (sale of business tool) & liquidation to achieve optimal results
- **Cooperation**: Strong time constraints. Overall very good cooperation at BU, EU and resolution college (RC) level

Resolution Strategy	**Resolution action was successful** also thanks to the availability of bidders and the procedures followed by the national authorities in cooperation with the SRB
Moratorium tool	The first-time application of the **moratorium provisions proved it to be a very useful tool** to allow the time needed to conduct the PIA for the different entities, devise the best strategies for each of them and organise a fair and transparent process
Cooperation	**Close cooperation among authorities** proved to be a crucial for the success of the resolution process, notwithstanding the challenging development of the crisis
FOLTF timeliness	**Swift FOLTF process necessary** to allow for SRMR decision-making
Crisis Management team (CMT)	Taking into account the complexity and rapid unfolding of the case and the need to swiftly adapt the resolution strategy, the CMT was able to timely deliver the expected documents, while ensuring an adequate level of quality. The CMT also proved to have sufficient skills to produce **valuation reports** under considerable time pressure, data and policy availability constraints

ANNEX

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Experience from past cases: Veneto Banks, ABLV

Source of failure
- Liquidity (*ABLV*)
- Insolvency, long-standing high-level of NPLs (*Veneto Banca, Banco Popolare di Vicenza*)

SRB Decisions
- Negative PIA: **liquidation under national insolvency proceedings**

What happened?
- *Veneto banks*
  - ECB and SRB declared FOLTF due to persisting breaches of capital requirements and lack of credible options to restore the banks' capital position
  - Liquidation under NIPs with liquidation aid. Transfer of part of assets and liabilities to Intesa and NPLs to a State-owned asset management company
- *ABLV*
  - ECB and SRB declared that ABLV LV and ABLV LU were FOLTF due to insufficient available funds to match the stressed outflows
  - Bank and subsidiary to be wound up under law of LV and LU respectively

Lessons learnt
- *Veneto banks*
  - Negative PIA: critical functions and risks for financial stability can evolve in time due to banks` deleveraging, leading to possible movement from positive to negative PIA.
  - State aid rules to be updated to align to CMDI (see above)
- *ABLV*
  - Liquidity crises can escalate extremely quickly, importance of reputational risks
  - ECJ judgement (joined cases C551/19P, C552/19P) puts ultimate FOLTF responsibility on the SRB
  - Need for insolvency law harmonisation: need to address limbo cases, e.g. by enabling FOLTF as ground for withdrawal of licence (see CMDI review)