SRB & ECB CMDI Seminar

16 October 2023

#SRBECBCMDI2023

Single Resolution Board

EUROPEAN CENTRAL BANK
BANKING SUPERVISION

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AGENDA

09:30 – 09:45	**Opening remarks**	• **Andrea ENRIA,** Chair of the Supervisory Board, European Central Bank
09:45 – 10:00	**Keynote speech**	• **John BERRIGAN**, Director-General for Financial Stability, Financial Services and Capital Markets Union, European Commission (DG FISMA)l
10:00 – 11:00	**Key CMDI changes and their impact**	• **Anneli TUOMINEN**, Member of the Supervisory Board, European Central Bank • **Sebastiano LAVIOLA**, Board Member, Single Resolution Board
11:00 – 11:15	**Break**	
11:15 – 12:00	**Panel discussion**	• **Sofia TOSCANO RICO**, Deputy Director-General of Horizontal Line Supervision, European Central Bank • **Martin MERLIN**, Director for Banking, Insurance and Financial Crime, European Commission (DG FISMA) • **Isabelle VAILLANT**, Director of Prudential Regulation and Supervisory Policy at the European Banking Authority • **Sebastiano LAVIOLA**, Board Member, Single Resolution Board
12:00 – 12:15	**Concluding remarks**	• **Dominique LABOUREIX,** Chair, Single Resolution Board

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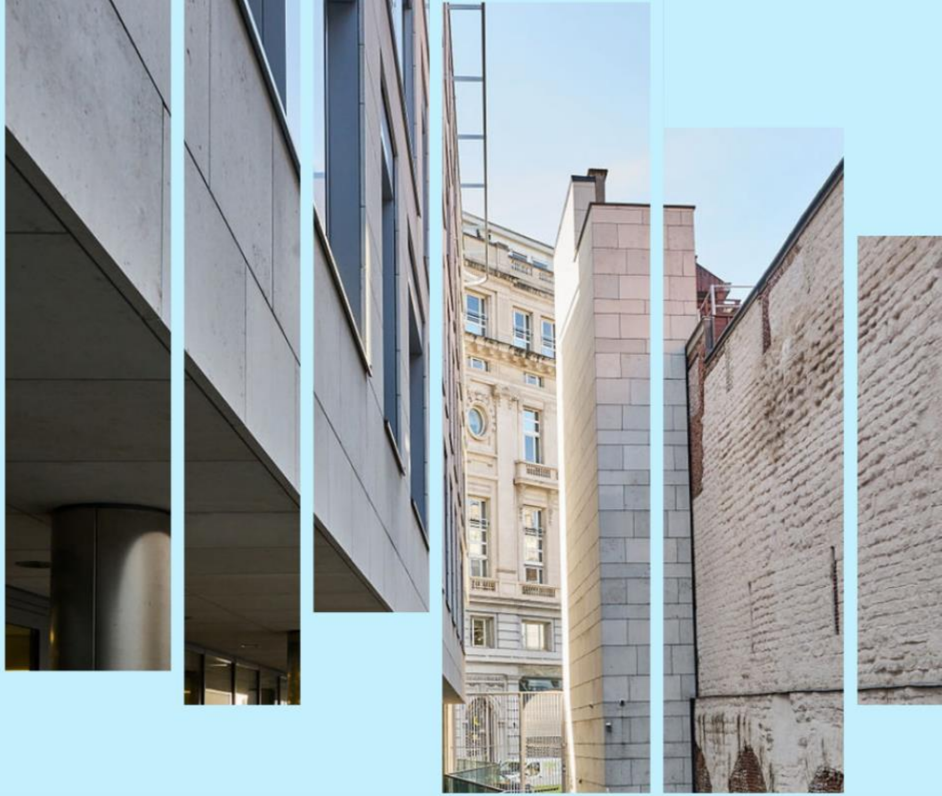

Opening remarks

Andrea ENRIA,
Chair of the Supervisory Board,
European Central Bank

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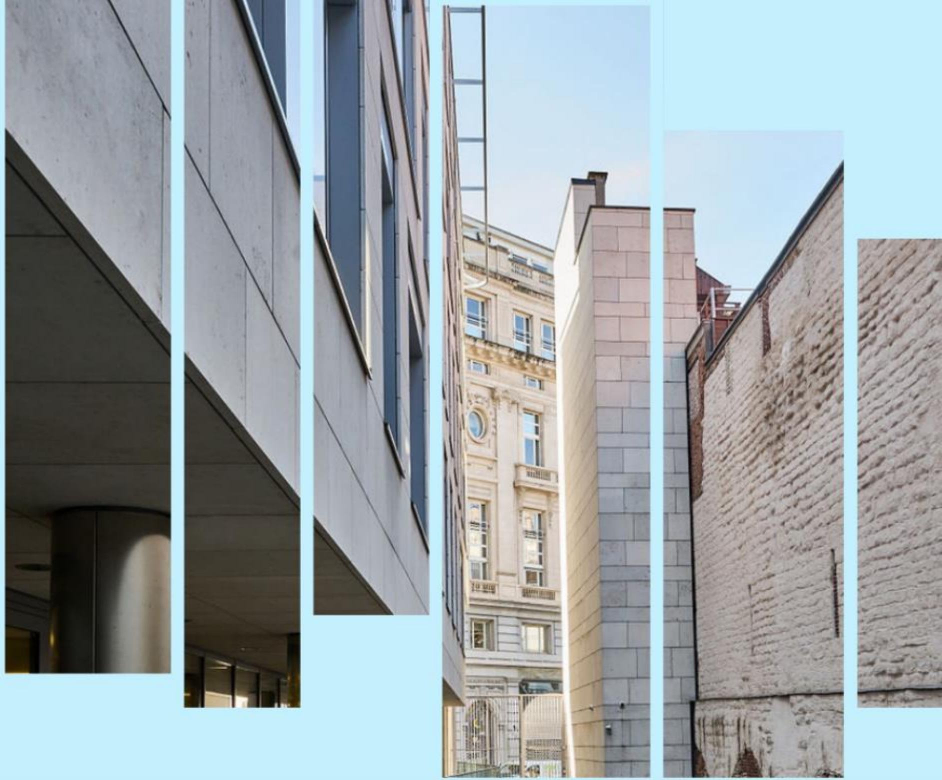
Keynote speech



John BERRIGAN,
Director-General for Financial Stability, Financial Services and Capital Markets Union, European Commission (DG FISMA)

SRB Single Resolution Board

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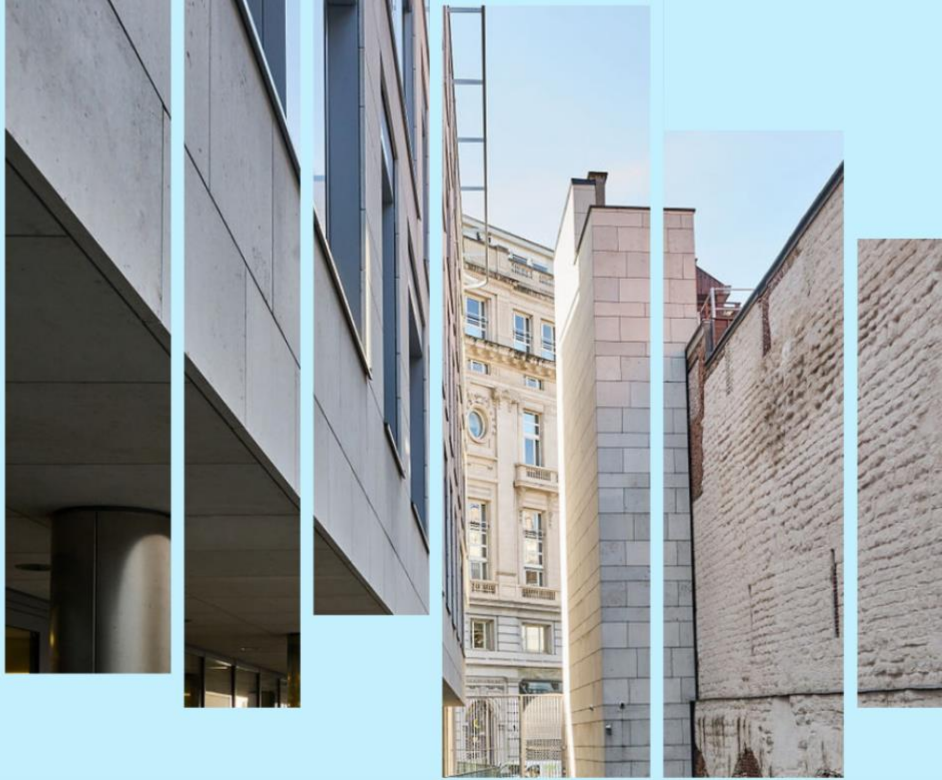
Key CMDI changes and their impact

- **Anneli TUOMINEN**

Member of the Supervisory Board
European Central Bank

- **Sebastiano LAVIOLA**

Board Member
Single Resolution Board



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Reform of the European Crisis Management and Deposit Insurance (CMDI) framework

Views from supervisory perspective

16 October 2023

Anneli Tuominen

ECB Representative to the Supervisory Board

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Introduction

Introduction

- General importance of the current review of the European crisis management and deposit insurance (CMDI) framework
- Successful progress in crisis management at European level
- Practical experience gained in the banking union has supported this review
- Today's focus topics:

The role of supervisors in crisis management	Ensuring optionality in crisis situations

2

Role of supervisors in crisis management

Role of supervisors in crisis management

Development of stress level

Preparation/ planning

- Assessment of banks' recovery plans and recoverability

- Consultative role in resolution planning & assessment of banks' resolvability

Early intervention

e.g. possible application of supervisory or early intervention measures

Assessment of Failing Or Likely To Fail

e.g. supervisor in consultation with resolution authority

Determination of conditions for resolution

- Resolution authorities are responsible for deciding on the appropriate resolution action

- Close cooperation with the respective resolution authorities

Business as usual | Distressed situation | Failure or likely failure

CMDI proposals: early intervention and cooperation

ECB welcomes the proposals on Early Intervention Measures (EIM), in particular:

- **Direct legal basis** for the ECB
- **Removal of overlap** between EIM and supervisory measures
- **Alignment of the conditions** to use supervisory measures and EIM.

ECB supports very much the **proposal to further enhance cooperation and information exchange with resolution authorities in legislation.**

As proposed by the Commission, it will be important that **this new early warning process does not affect the well-established resolution procedure**.

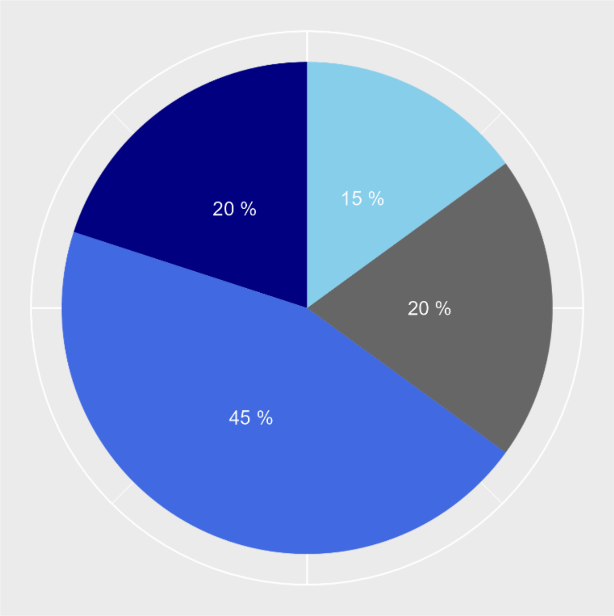
3

Ensuring optionality in crisis situations

Ensuring optionality in crisis situations

Supervisory measures and EIM	DGS preventive measures	Precautionary recapitalisation	**Before FOLTF**
DGS alternative measures	Liquidation	Resolution	**After FOLTF**

Role of DGSs



Pay-box (20%) Pay-box plus (45%) Loss Minimiser (20%) Risk Minimiser (15%)

Source: 2021 IADI Annual Survey

Advantages of transfer strategies

Compared to a liquidation, transfer strategies can:

- **Improve value recovery** by preserving franchise value and through faster process
- **Reduce strains on DGSs' liquidity** arising from payouts
- **Improve depositor protection**: Uninterrupted access and broader scope of protection
- Strengthen **financial stability** and **minimise** the need for **government support**

How can value recovery be improved by a transfer?

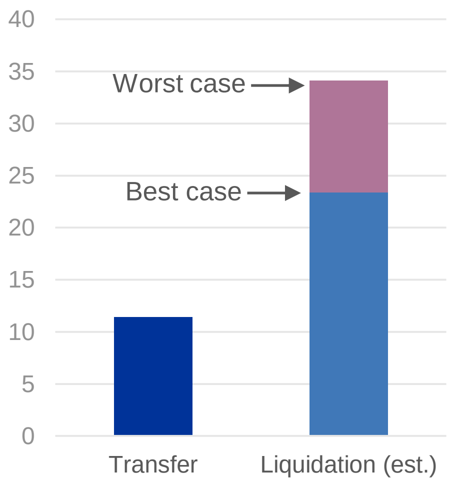
Transferring the **whole bank – or key parts –** often generates more value than liquidating **individual assets**

- Customer relationships
- Experienced staff
- Deposit base
- Transfer of whole bank minimises administrative costs

Example: **Banco Popular:**

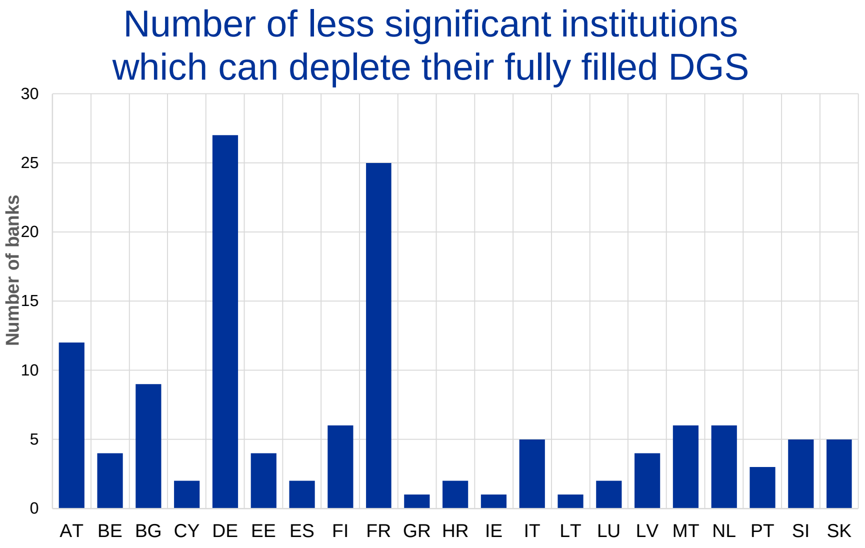
- Liquidation would have inflicted 2-3 times the amount of losses on shareholders and creditors than the transfer.
- Looking at creditors alone, costs would have been 7-12 times higher.

Shareholder and creditor losses Banco Popular in €bln



Source: Published version of BPE valuation 3: https://www.srb.europa.eu/system/files/media/document/2018-08-06%20Annex%20I%20-%20Valuation%203%20Report%20EN.pdf

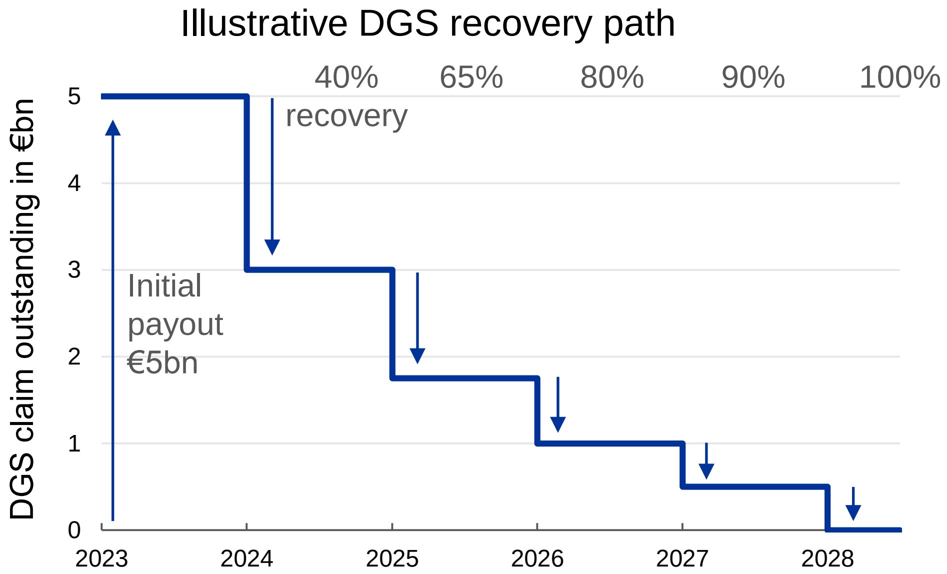
Pay-outs can strain the DGS (1/2)



Source: Eule, Kastelein, Sala (2022) Protecting Deposits and Saving Money, Q4 2020
Notes: The chart counts the number of LSIs, LSI groups and LSIs' hosted subsidiaries per Member State whose covered deposits match or exceed the target level of the relevant DGS.

Looking at gross payout amounts, **in each Member State** in the banking union**, at least one less significant institution** can **deplete** its **fully filled DGS with** a **single** depositor **payout.**

Pay-outs can strain the DGS (2/2)



Annual cost in €m	200	120	70	40	20

Even with eventual full recovery of its initial outlay (best-case scenario), a payout of €5bn can currently cost **more than €400m** in lost interest income/financing costs.

Assuming 4% annual costs of the outstanding claim.
Repayment path is only illustrative, but inspired by real cases.

DGS bridge function to the SRF

Shareholders and creditors bear losses first

↓

DGS contribution counts towards 8% threshold

↓

Recourse to the single resolution fund

Builds on single-tier depositor preference/least cost test and is subject to several further safeguards, e.g.:

- Only banks earmarked for resolution
- Transfer strategies which lead to a market exit
- Compensating only for deposits and up to the amount necessary to meet the 8% TLOF requirement to access the SRF; for uncovered deposits only in exceptional circumstances to be confirmed by the resolution authority
- Contribution capped by the amount of covered deposits at the respective credit institution

IMPACT OF CMDI PROPOSAL ON FUNDING

SRB ECB CMDI Seminar 16 October 2023

Sebastiano Laviola
SRB Board Member

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Introduction

- The presentation has the following goals:
  - To assess the impact of the use of the DGS in resolution (‘DGS bridge’) and of the general depositor preference on the DGS and the Single Resolution Fund (SRF) - as compared to the current creditor hierarchy - both for banks already earmarked for resolution and for banks that could change strategy from liquidation to resolution;
  - To assess the effects of the general depositor preference on the DGS costs for the banks earmarked for liquidation.

Methodological elements: Assumptions and Data

- Assumptions for all simulations:
  - Reduction of capital to a level corresponding to minimum capital requirements (capital buffers depleted);
  - 85% net recovery rate for assets (same as in the EBA study and Commission Impact Assessment);
  - General depositor preference, i.e. all deposits rank pari passu in insolvency;
  - All deposits are excluded from loss absorption;
  - Reference Date: End-2022.

Methodological elements: Scope

- 204 Banking Union banks: i.e. 92 SRB banks (SIs and cross-border LSIs, excluding host banks) and 112 LSIs (under NRAs remit), as per 2022 Resolution Planning Cycle.
- The sample includes both BU banks earmarked for resolution (142) and for liquidation (62), with the exception of banks subject to Simplified Obligation (SO).
- All resolution banks are considered in the analysis, irrespective of the chosen resolution tool (not only banks having a transfer tool as preferred strategy).

204 BU

92 SRB banks

83 resolution

9 liquidation

Not considered in the analysis

(5 liquidation banks under SO, specific business model banks, e.g. mostly promotional banks)

112 LSIs

59 resolution

53 liquidation

Not considered in the analysis

(1892 liquidation banks under SO, of which 78% are members of IPSs, around 90% have Total Assets below EUR 5 bn)

Funding gap for resolution banks

- For banks currently earmarked for resolution:

  - 47 resolution banks (out of 142 in the 2022 cycle), i.e. 17 SIs and 30 LSIs, would not reach 8% of Total Liabilities and Own Funds (TLOF) without bailing-in deposits;

  - These 47 banks are in 13 MS of the Banking Union;

  - The median gap to reach 8% TLOF is 2.4%. For the 17 SIs and 30 LSIs the median gap is respectively 1.7% and 3.1 % TLOF.

CMDI proposal and Public Interest Assessment (PIA)

- CMDI is expected to expand the scope of resolution, i.e. leading to higher number of banks with positive PIA (e.g. strategy equal to resolution).
- However, PIA remains subject to discretion of Resolution Authorities.
- The following assumptions have been made regarding the proposed changes of the PIA:
  - Banks where depositors would suffer losses in liquidation, and at the same time the cost for DGS would be lower in resolution than in liquidation, would have the resolution objective of depositor protection at risk, and thereby a positive PIA;
  - Banks with high share of deposits / loans in a given region (and not at national level) would have critical functions at regional level at risk, and thereby a positive PIA;
  - Banks currently subject to SO would continue to have negative PIA, and therefore remain outside of the scope.

CMDI proposal and PIA

- Based on the above assumptions, 26 additional banks (out of the 62 earmarked for liquidation in the 2022 cycle) could have their PIA changed from negative to positive;
- Out of these 26 banks, 19 would not reach the 8% TLOF without bailing-in deposits;
  - These banks are in 12 MS of the Banking Union;
  - The median gap to reach 8% TLOF for these banks is 2.2%.

Estimates of DGS use

- 36 banks (out of 47 banks with funding gap) would have a positive least cost test (LCT) with a general depositor preference, which would enable the use of DGS funds in resolution, after use of MREL, to reach the threshold allowing to access the Single Resolution Fund (8% TLOF);
  - The median DGS contribution would be 15% of DGS Available Financial Means (AFM);
  - Average figures are influenced by two-three outliers.
- 19 banks (out of 26 changing PIA) would need funding and have a positive LCT with a general depositor preference;
  - The median DGS contribution would be 3.7% of DGS AFM.

DGS bridge (36 and 19 banks)

	All	current resol.banks	addit. resol.banks
quartile 1	3%	9%	2%
median	9%	15%	4%
average	25%	40%	7%
quartile 3	24%	31%	7%

Note: DGS contribution expressed as % of AFM.

Estimates of SRF use

- The SRF can only be accessed after 8% TLOF, for the banks earmarked for resolution;
- For the 36 banks currently having a resolution strategy and positive LCT:
  - the maximum contribution required from the SRF* for the median bank would be 1.6% of the current SRF capacity;
- For the 19 banks assumed to have a positive PIA test and a positive LCT:
  - the maximum contribution required from the SRF* for the median bank would be 0.1%.

SRF use (36 and 19 banks)

	All	current resol.banks	addit. resol.banks
quartile 1	0,1%	0,5%	0,1%
median	0,8%	1,6%	0,1%
average	1,5%	2,0%	0,5%
quartile 3	2,3%	3,2%	0,5%

Note: SRF contribution expressed as % of SRF capacity

**assuming maximum contribution of 5% TLOF (coming after the 8% TLOF)*

Estimates of impact on DGS costs in liquidation

- Following the removal of the DGS' super priority and the introduction of a general depositor preference, the average costs to be borne by the DGS of the banks in the sample which will remain in liquidation (36, i.e. 8 SIs and 28 LSIs) would not be substantial.
- In comparison to the current situation, the additional costs for the DGSs for the banks that would remain in liquidation would be on average 5% of AFM.
- For the banks under SO (excluded from the scope), the costs for the DGS should be similar or lower, given also the presence of IPSs in most cases.

Banks under Simplified Obligation (*Art.4(1) BRRD*)

- Eligibility for SO is based on the consideration of no significant negative effect of the failure of the institution & its liquidation under national normal insolvency proceedings (NIPs) on financial markets, other institutions, wider economy;
  - E.g. due to the nature of its business, its risk profile, interconnectedness, scope and complexity of activities, its membership in an IPS.
- Resolution Authorities can determine reduced contents of resolution plan, lower frequency for its updating (e.g. every 2 years); reduced reporting requirements, reduced resolvability assessment;
- Two-stage SOs eligibility assessment (as per Delegated Regulation 2019/348): Quantitative assessment (Stage 1, following OSII methodology) + Qualitative assessment (Stage 2).

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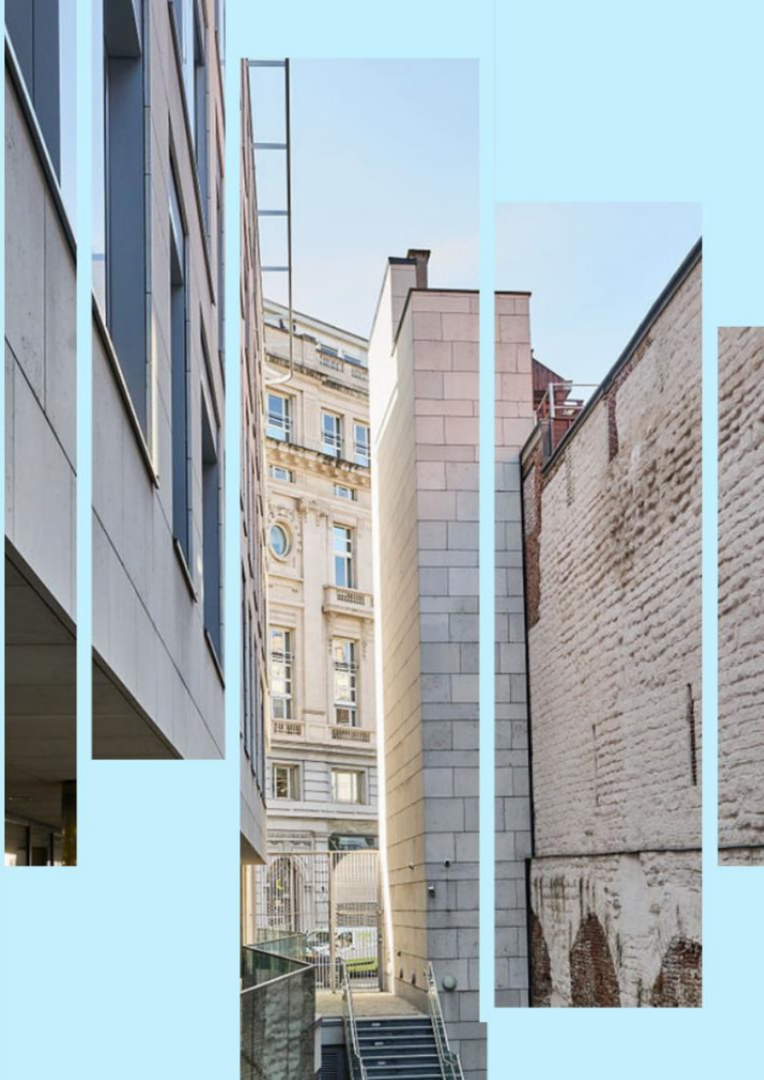
Break



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Panel discussion

- **Sofia TOSCANO RICO**

Deputy Director-General of Horizontal Line Supervision, European Central Bank

- **Martin MERLIN**

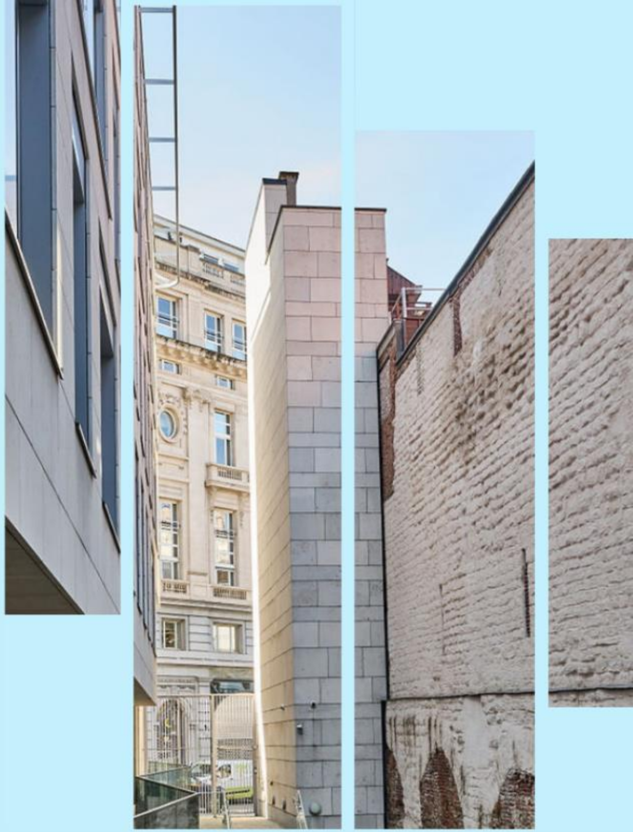
Director for Banking, Insurance and Financial Crime, European Commission (DG FISMA)

- **Isabelle VAILLANT**

Director of Prudential Regulation and Supervisory Policy at the European Banking Authority

- **Sebastiano LAVIOLA**

Board Member, Single Resolution Board



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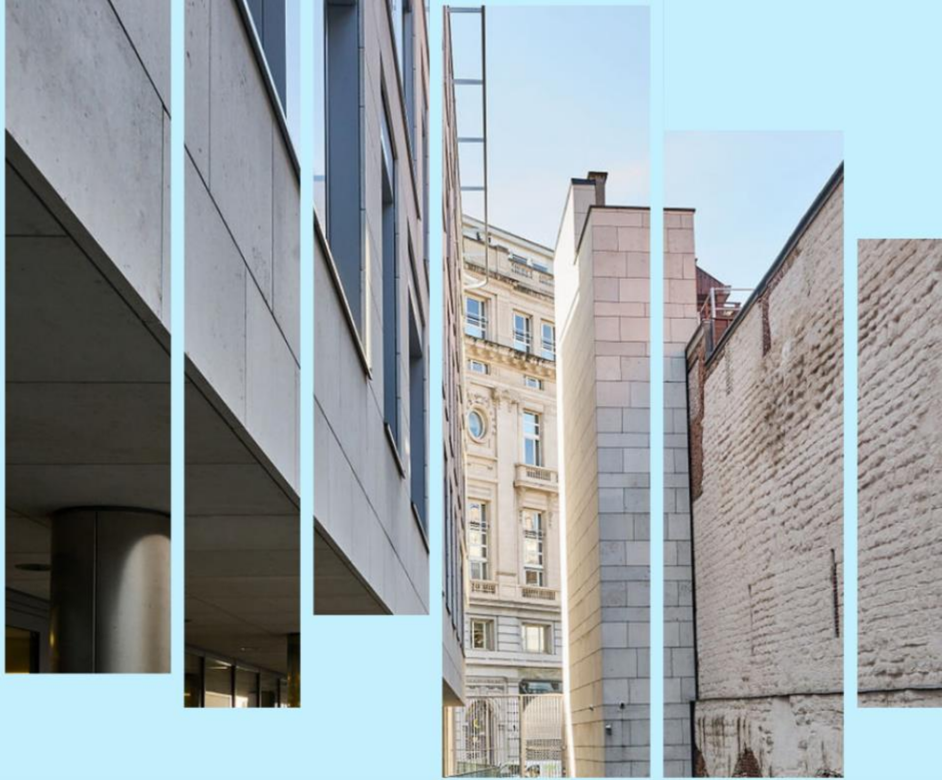

Concluding remarks

Dominique LABOUREIX
Chair
Single Resolution Board

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