EU BANK CRISIS MANAGEMENT FRAMEWORK

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Crisis management: reform on the way

The current review of the crisis management and deposit insurance (CMDI) framework aims to improve the way we resolve crisis situations. Implementing the CMDI proposal is an important move to further enhance the European crisis management framework, making it possible to deal more effectively with the failure of smaller and mid-sized banks. This is a welcome step in the right direction. The urgency of having a proper crisis management framework in place cannot be overstated, as we saw last year.

I would like to emphasise a few aspects of the proposed reform.

When a bank does not meet or is unlikely to meet its supervisory requirements, we are empowered to take supervisory and early intervention measures aimed at keeping it viable and preserving financial stability. The proposed legislative changes include important improvements to the existing supervisory early intervention framework. This will support us to swiftly adopt the necessary and most appropriate measure for any given situation.

One key aspect that should be a cornerstone when assessing the proposed reform, is the principle of optionality. From a supervisory perspective, we consider it crucial that all relevant stakeholders can deal effectively with banks in distressed conditions. Recognising that no bank crises is identical, the relevant authorities should be able to choose the most appropriate tool for the situation at hand from a range of options and be able to make effective use of it. This optionality should exist at each phase. Policymakers should have a proper toolkit before a bank is declared failing, and they should also have access to robust tools once a bank has been declared failing.

An important element of the toolkit, is precautionary recapitalisation. We are pleased to see that the European Commission's proposal ensures that it remains available, subject to strict conditions. Though exceptional, precautionary recapitalisation is a useful part of the current crisis management framework, and its current conditionality appears appropriate. At the same time, the flexibility provided to relevant authorities to take the specific circumstances of each case into account should not be restricted.

Another notable development in the toolkit concerns the expanded role of deposit guarantee schemes (DGSs), traditionally seen as a safety net for depositors. The proposed changes call for DGS funds to be used for more than simply depositor payouts. For instance, instead of paying out covered depositors, DGS funds could contribute to facilitate transfers of assets and liabilities to an acquiring bank under what are known as "DGS alternative measures". The "DGS preventive measures" represent another form of DGS tool. These could be used in the pre-resolution phase by helping banks to ensure or restore compliance with the prudential requirements while they are still going concerns.

Ensuring adequate funding in resolution is an important precondition for the proposed expansion of resolution to medium-sized banks. The DGSs can also play an important role in helping to provide this funding.

Besides access to a robust set of tools, I would like to point out the need for close collaboration. The ECB and the SRB already cooperate very closely and exchange information based on a bilateral Memorandum of Understanding. We also work very closely with all other relevant stakeholders. The Commission's proposals to enhance cooperation and information-sharing are very much supported.

Finally, as the recent March turmoil in the US and Switzerland has shown, having proper arrangements in place for liquidity in resolution, is a crucial element to support a successful resolution. The Financial Stability Board considered in this respect that authorities need to have credible liquidity backstops and other frameworks in place that are overt and easily understood by market participants and depositors in order to restore market confidence when a bank is resolved.[1]

In conclusion, the CMDI proposal represents an important opportunity to further enhance the existing EU crisis management framework using the lessons learnt during the first years of its application. We hope the ongoing discussions will help to reach a consensus on these important changes to the European crisis management framework. At the same time, I would like to point out that, even if we reach a consensus and the crisis management reform takes place, that is not the end of the journey. The Commission's proposal does not address some fundamental elements of the broader crisis management architecture. The third pillar of the banking union, a European deposit insurance scheme, is still missing. Given its importance, we hope that this will be addressed in the next legislative term.

A robust set of tools is crucial to deal effectively with banks in distressed conditions.

1. *Financial Stability Board (2023), "2023 Bank Failures – Preliminary lessons learnt for resolution", October.*

DOMINIQUE LABOUREIX
Chair - Single Resolution Board (SRB)

A more complete toolbox for crisis management in the EU

In the past, some small and middle-sized banks fell between the cracks of the resolution framework. Resolution authorities were not able to resolve them, due to the current definition of the notion of public interest. Instead, with the announced objective to preserve financial stability, such banks were dealt with outside of resolution using public liquidation aid. As a result, while regional financial stability was indeed preserved, taxpayers had to foot the bill. The Crisis Management and Deposit Insurance proposal (CMDI) will help addressing this loophole in the framework.

CMDI, in fact, aims to expand the scope of resolution to a number of smaller banks – as most of the larger ones are already earmarked for resolution.

Resolution has, in fact, a number of advantages over liquidation. First, in resolution, the use of taxpayers' money is explicitly ruled out. Also, for instance, when a failing bank reopens after the resolution weekend, customers keep access to its full range of services. This is not necessarily the case in liquidation.

This does not mean that all banks running into trouble should be resolved. Even after CMDI, liquidation will stay relevant for most banks. The Banking Union is home to around 2 000 small banks – the so called less significant institutions (LSIs) – and, even after CMDI, for the most part, liquidation will remain the preferred approach in case of crisis. So, resolution will not be the general case.

Also, CMDI will never be a free lunch. We will hold those smaller banks, entering in the scope of resolution, to the same standards as their larger peers, in a proportionate way. In this vein, the Minimum Requirement for Own Funds and Eligible Liabilities (MREL) will still be the first line of defence to absorb losses. A proof of the intense resolution planning work carried out on smaller banks can be found in our recent LSI report[1]. These "resolution LSIs" are advancing toward resolvability (including MREL compliance), in line with their larger peers. The same rules will apply for banks entering in the scope of resolution thanks to CMDI.

Nevertheless, resolution authorities will need a more flexible toolset to deal with the resolution of these smaller banks. This is why CMDI introduces an alternative way of funding a market exit for the bank in crisis, if it is in the public interest. CMDI, in fact, allows for the use of Deposit Guarantee Schemes funds (DGS), and possibly of the Single Resolution Fund (SRF), to facilitate "market exits", funding the sale of the ailing bank to a solid acquirer. By doing so, CMDI also curtails the risk that some uncovered depositors would suffer losses and cause a bank run.

CMDI makes the resolution toolkit more flexible, increasing trust in the crisis management framework.

Some stakeholders are concerned that this proposal would be expensive for the industry – through an increased need to fund national DGS and the SRF. However, these concerns are overblown. Our estimations are reassuring[2]. Even if CMDI makes the possibility of using the DGS (and the SRF) more plausible, such use in resolution would have limited impact on their finances – and, in turn, on the banks. This is because, as mentioned above, MREL remains the first line of defence, and due to the relatively small size of the banks concerned. Besides being low cost, the DGS funding of a sale is a practical solution that has recently been contemplated also abroad.

The expansion of the scope of resolution and the use of DGS funding – the core of this proposal and the most debated issues – should be considered interconnected and mutually necessary. Expanding the scope of resolution without the source of funding would not work. If we are to take a decision to put a bank into resolution, we have to be certain we have the right tools. Otherwise, liquidation may become the only option.

Whatever compromise legislators may find on the sensitive issues around the creditor hierarchy, they should make sure it delivers the same results in terms of funding available for a resolution decision. To make it more concrete, if the legislators converge around multiple tiers for the depositor preference, then the least cost test, and its governance, have to be modified so that sufficient funding for resolution and alternative measures can still be unlocked in case of a need.

To conclude, the current framework works well and many of its aspects should not be modified. However, CMDI offers a great opportunity to legislators to make the crisis management toolkit more flexible, increasing trust and confidence in the crisis management framework. This opportunity should not be squandered or we risk going backwards to a more fragmented system, which would be particularly detrimental to the Banking Union.

1. *Single Resolution Board, "Resolution planning and crisis management for less significant institutions", October 2023*
2. *Single Resolution Board, "The Commission proposal to reform the EU Bank Crisis Management Framework: A selected Analysis", December 2023*

HELMUT ETTL
Executive Director - Austrian Financial Market Authority

Enabling an orderly market exit irrespective of banks' size

There is no "one size fits all" solution in banking resolution since small and medium-sized banks would often not pass public interest assessments. However, it is a misconception to say that only the very large, systemically important banks significantly impact our financial system and stability and therefore, a smooth exit of failing small and medium-sized banks must also be guaranteed.

Tackling the problem of small and medium sized-banks is necessary in order to complete the framework for failing banks. But how should we best go about it? The current resolution framework and requirements for resolvability are intrusive and costly – maybe excessively so for smaller banks. Substantially enlarging the public interest assessment (PIA) might not be the optimal solution. In Austria, for example, the existing insolvency regime has proven its effectiveness and suitability for smaller banks combined with the national Deposit Guarantee Scheme (DGS) on three occasions in recent years.

Nevertheless, past experiences have shown some room for improvement. One main issue is sufficient liquidity coverage, in the case that the problem boiled down to a shortage of short-term liquidity rather than the asset quality per se. In such cases, interim financing would have been needed to avoid an insolvency. One possibility would be to consider a complementary liquidity regime for such banks in order to permit an institution's orderly and value-preserving wind-down. By embedding such a regime in a national administrative wind-down-procedure, a "least cost test" could fully avoid or at least limit the impact on the Deposit Guarantee Schemes and their member institutions.

There is a merit in an additional wind-down instrument for small and medium-sized banks. This instrument would require external liquidity support (e.g. from Deposit Guarantee Schemes, central banks, or the industry) and could be used in cases where a better economic outcome would be possible compared to ordinary insolvency, for example in crises that are liquidity-based rather than more asset-driven.

All these considerations must not weaken the existing Institutional Protection Schemes (IPS), as these IPS systems form an essential part of the crisis management framework. Ex-ante funds are available in the event of a sectoral imbalance for approximately two-thirds of the Austrian banking sector. Such IPS systems have proven themselves to be effective in the past. They should be considered rather than overlooked, when creating a comprehensive framework for exiting the market or for restructuring failing banks.

A complementary liquidity regime permits an institution's orderly and value-preserving wind-down.

In addition, the current regime contains a regulatory gap, which requires addressing. When a bank is declared as "failing of likely to fail" (FOLTF), a danger exists that a "zombie" bank might remain that neither meets the criteria for a positive public interest assessment, nor fulfils the insolvency criteria, thereby ruling out the bankruptcy regime. This occurs in the event that it is not possible for a bank's licence to be withdrawn immediately. The process to revoke the licence following the declaration of FOLTF should be harmonized within the European Union, while simultaneously ensuring that this does not create unregulated territory or a legal vacuum regarding the failing bank.

Moreover, harmonisation of insolvency law would be a further milestone to strengthen the European crisis management and the Banking Union. This would especially be the case for cross-border banking groups, where the heterogeneity of national insolvency regimes poses a challenge to successful cross border resolutions. For this reason, I do see considerable merit in making a further concerted attempt towards harmonising insolvency laws. Nevertheless, I would like to point out in this context, that the Austrian insolvency regime has proven to work very well and efficiently, especially in terms of the resulting recovery rates and the duration of insolvency proceedings. It has already proven itself to be a suitable and effective option for winding up smaller banks. Therefore, any harmonisation must not worsen the status quo of the Austrian insolvency regime.

Despite numerous achievements in recent years, there is still additional room for improvement to ensure a smooth market exit especially for small and medium-sized banks. However, we should not overlook one of the most significant outcomes post-2008, namely that the public, especially taxpayers, are no longer called upon to bail out failing banks. This must remain the overarching goal when completing the resolution framework.

JACEK JASTRZĘBSKI
Chair of the Board - Polish Financial Supervision Authority

The use of DGSs' funds in resolution: bank's total cost as a litmus test

On 18 April 2023, the European Commission published its proposal for updating the CMDI framework for banks, with a focus on small and medium-sized banks. The Commission has seen many failing medium-sized and smaller banks being managed using tools outside the resolution framework. That is something to avoid, especially as in some cases that involved using taxpayers' money instead of private, industry-funded resources. Hence, the general philosophy behind the CMDI is to address the problem while protecting both taxpayers and depositors. To that end, the CMDI package comes up with several new solutions. One of them is a facilitated use of the DGSs' funds in crisis situations.

In certain circumstances, the DGSs' funds could be earmarked for resolution. That would only be possible after banks have exhausted their internal loss-absorbing capacity, and only for banks that have already been earmarked for resolution in the first place.

Resolution shows undisputable advantages over traditional liquidation, usually involving an insolvency procedure and deposit insurance pay-outs. Liquidation of a bank under the standard insolvency procedure, which triggers deposit insurance, is likely to involve public funds. This may be the case when the amount of covered deposits held by a bank significantly exceeds the amount of resources of a DGS. In certain cases, extraordinary contributions must be collected from the banking sector, which is an additional financial burden for banks and may lead to second-round-effects and higher systemic cost.

Despite the advantages of the resolution procedure versus regular insolvency procedure, sceptics highlight their concerns about the use of the DGSs' funds in resolution. They claim this creates a financial burden on the DGSs, many of which anyway have insufficient financial resources to finance their primary goals. Sceptics highlight that the DGSs were established for a purpose other than financing resolution, i.e. for the benefit of covered depositors. I do not believe that scepticism is well founded. I see a clear value of a pragmatic approach, allowing for the use of the DGSs' financial resources for resolution purposes. Ultimately, the resolution process is also to protect depositors.

Therefore, instead of being dogmatic, I advocate for a pragmatic approach. It calls for a case-by-case assessment whether the involvement of the DGSs' funds would minimise the total cost of managing the distress of a financial institution. The least-cost-test should serve as the ultimate indicator. The testing should holistic, to include potential second-round-effects, the systemic cost related to all other banks forced to bear the burden of additional contributions, as well as opportunity costs of lost interest or other returns on the DGSs' funds.

In certain circumstances, the DGSs' funds could be earmarked for resolution.

The holistic approach to the least-cost-test and its relevance also bring me to the conclusion that a proper and comprehensive assessment of the total cost requires smooth cooperation, including information exchange and joint modelling efforts, between the national DGS manager and the resolution authority, be it the SRB or the national resolution authority. Future regulations should provide a robust legal basis for such cooperation. This also demonstrates an advantage of the institutional set-up where the DGS is managed by the same institution which is competent for resolution. This is the case in Poland, where the Bank Guarantee Fund (Bankowy Fundusz Gwarancyjny – BFG) acts both as the DGS and national resolution authority.

Regardless of whether to use the DGSs' funds for resolution or not, other alternatives are worth exploring. In Poland, eight largest commercial banks have established an institutional protection scheme (System Ochrony Banków Komercyjnych S.A. – SOBK S.A.). The mission of SOBK S.A. is to support financial safety of its members and their clients and the stability of the banking sector in connection with resolution procedures conducted by the BFG. That support is granted using various instruments (in particular loans or subsidies), financed from the fund to which members of SOBK S.A. contribute. Being funded by the member banks, these are considered private funds.

In conclusion, the new European solutions in the area of crisis management, including the use of the DGSs' funds for resolution purposes, should consider the overall cost of such mechanisms. The litmus test here should be a holistic least-cost-test. Involving institutional protection schemes in resolution funding seems like a notable option as well.

FERNANDO RESTOY

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MREL for mid-sized banks

The philosophy behind the introduction of minimum requirements for own funds and eligible liabilities (MREL) in the European Union is in line with the global reforms of bank failure management aimed at reducing the costs of such events for taxpayers.

However, the way MREL was introduced in European legislation followed a narrow focus. The design of those obligations directly aimed to support a specific resolution strategy, called open bank bail-in (OBBI). Under this approach, the conversion of liabilities into own resources after resolution should allow a bank to continue operating by itself after resolution.

However, experience – including the recent bank turmoil – shows that in order to resolve mid-sized banks, sale-of-business (SoB) resolution strategies seem to be, when feasible, much more effective. In particular, the transfer of all or part of failing banks' sensitive liabilities (like deposits) in exchange for banks' assets and some form of external support, normally from the deposit insurance fund (DIF), has been extensively used to deal with failures of traditional mid-sized banks.

Although unlike in the case of OBBI, SoB banks would exit the market, MREL still plays a relevant – albeit different – role. Together with the availability of external support, MREL can be instrumental for the success of SoB transactions as those liabilities would not be transferred to the acquirer but left behind in a residual entity that would be liquidated according to regular insolvency procedures. The asset counterparts of those liabilities would, however, be transmitted to the acquirer, thereby contributing to the compensation that the acquirers receive for assuming failing banks' deposits and other sensitive liabilities. Therefore, the larger the MREL, the more likely the success of the SoB transaction and the lower the need for external support.

External DIF support is limited in most jurisdictions by a least-cost constraint which caps the DIF contribution at the expected losses (net of recoveries) that the DIF would have to bear if it had to pay out covered deposits in liquidation. Available DIF support therefore crucially depends on the relative amount of covered deposits, the position of DIF claims in the creditor hierarchy and the efficiency of liquidation procedures.

Given the EU resolution framework's focus on OBBI strategies, the above SoB-specific considerations have been absent in European legislation and, therefore, in the MREL policies of the Single Resolution Board (SRB). Indeed, the initial MREL for most banks was conservatively calibrated as if they would have to be resolved with an OBBI strategy even if their preferred strategy in the resolution plans was SoB. In fact, given that DIF claims are super-protected in liquidation in the EU, the cap on DIF support is quite tight. That makes the feasibility of SoB transactions rather uncertain.

A great contribution to crisis management with still suboptimal provisions on MREL.

The revision of the Single Resolution Mechanism Regulation (SRMR) in 2019 required the SRB to establish MREL on the basis of the preferred resolution strategy. That led the SRB to adjust MREL targets for banks with a preferred SoB strategy.

At present, MREL adjustments for SoB banks are calibrated on the basis of criteria like balance sheet size, depositor base and asset valuation uncertainty. Those criteria try to approximate the attractiveness of the failing bank for potential acquirers. However, they fall short of recognising how MREL calibration itself affects that attractiveness by impacting the volume of assets that could be transferred. Moreover, as the conditions for DIF support have not been changed, the uncertainty regarding the feasibility of the preferred SoB strategies remains.

The European Commission's recent proposal on crisis management and deposit insurance (CMDI) is an important improvement. By alleviating the least-cost constraint for DIF support by eliminating the super-protection of DIF claims, the CMDI proposal significantly increases the feasibility of well designed SoB strategies.

Yet the CMDI proposal still fails to recognise the need to adjust MREL to what is actually required, given the expected available external support, to maximise the chances of successfully applying the foreseen SoB transaction. Importantly, the explicit prohibition for the SRB to incorporate the (now more ample) available support from the DIF when calibrating MREL is, arguably, an important flaw. That prohibition prevents the SRB from properly considering factors like the proportion of non-covered deposits over total deposits, which affects the least-cost constraint for the DIF and has proven highly relevant in recent resolution cases. From a technical point of view, it is not easy to understand why the proposal for MREL accepts treating equally SoB banks which, due to their different capacities to obtain DIF support, would require different amounts of bail-in-able liabilities in order to make an SoB transaction feasible.

JUAN POSWICK
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What Crisis Management and Deposit Insurance (CMDI) framework review?

Further strengthening the CMDI framework and focusing on medium-sized and smaller banks, whose failures can be a risk for the whole economy, is an undisputedly desirable objective. The rationale and main principles of the Commission proposal appear well grounded. However, there is a gap between the stated intents and the actual text proposal. Only precise guidelines and rules would allow truly harmonized implementation across Member States and fair funding of resolution, and, on the other hand, impact assessments would be necessary before changing important elements of a reasonably balanced system, particularly concerning the creditor hierarchy.

First, to ensure harmonization, level playing field and financial stability, a consistent, floored MREL target should apply to all banks earmarked for possible resolution, regardless of their size. This is the corner stone of a fair resolution funding system. That many smaller banks are missing market access and cannot meet MREL targets above own fund requirements does not hold. In Nordic countries indeed, banks with a balance sheet of just a few billion euros do well issue Eligible Liabilities. Furthermore, banks can also fulfil the MREL targets with CET1, at their option, and a ramp-up period should be allowed for those newly earmarked for resolution.

Then, easy use of DGSs to fund resolution and to facilitate access to the SRF should be avoided. If ever necessary, something must have gone wrong, MREL calibration, supervision, or timing of authorities' intervention. This means that such use should remain truly exceptional. No bank earmarked for resolution should expect it and, as per the Commission proposal, MREL calibration should disregard it.

If DGSs were used in a frequent, intensive way, it would undermine the depositors' confidence in the system rather than reinforce depositors' protection, it would be a sign of failure on the authorities' side, and it would unfairly burden the rest of the sector, with ensuing systemic risks. That's why a clear MREL floor for any bank earmarked for resolution is necessary. At 16% of RWAs plus combined buffer requirement and 5.5% of the leverage ratio exposure, that should not be too demanding given the actual average capitalization of EU banks. It would also ensure that, if a bank has lost all its regulatory own funds, it can still be recapitalized at the minimum level, which should allow a transfer without recourse to external support.

A consistent, floored MREL is the corner stone of fair resolution funding system.

A similar reasoning holds true for access to the SRF. Proper MREL calibration and a well-functioning framework should ensure that the SRF use to fund resolution remains exceptional too. The SRF is perceived by the investor community as a kind of disaster insurance fund, a pledge to financial stability in the banking union. Frequent and intensive use of it would undermine the confidence in whole the EU banking system, negatively impact the sector, and entail series of risks.

Also, next to minimum MREL targets, early intervention triggers should be further specified. This would prevent complacency and late interventions that entail use third party funds to finance resolution. A consistent approach should be defined such that if certain metrics are breached, e.g., if MREL plus combined buffer requirement are not met for say 9 months, without breach of own fund requirements, a supervisor review of whether the bank must take recovery action is automatically triggered. This could be coupled with a subsequent assessment after a specified period of the FOLF status and need for further action.

Next, changing the creditor hierarchy appears quite controversial. Beyond easing the Least Cost Test and so facilitating the use of DGSs, no clear benefit can be identified. It would be ineffective in stabilizing corporate deposits, and, in liquidation, it would be unfair not to give a preference to retail and SME depositors. There would be drawbacks for the industry in terms of rating of senior debt and diversification of funding sources.

While a consistent creditor hierarchy across the EU would be welcome, implications might outweigh potential benefits. It might create legal uncertainty regarding the existing stock of senior debt and generate moral hazard. Clearly, before assigning all unsecured depositors the same insolvency ranking as covered deposits, a thorough analysis and impact assessment is mandated, including 2nd and 3rd order impacts.

Finally, is it worth risking disrupting the reasonable balance achieved through BRRD2 if the issue at stake is only to extend resolution to about 30 medium-sized banks, as estimated by the SRB? While reviewing the CMDI anyway, why not aiming at a simple, efficient, predictable system for all, with the same rules and a TLAC-like calibration of MREL for any bank earmarked for resolution, and no escape from liquidation for the other ones?

KAROLIN SCHRIEVER

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Improving the CMDI framework and maintaining the diversity of EU bank models

Later this year, the Banking Union will celebrate its 10th anniversary. And there is indeed reason to celebrate which has arguably been the largest European reform project since the introduction of the euro. After all, the EU banking sector as well as the respective authorities steered considerably well through the past years of multiple crises and increasing volatility. Most notably, the advantages of the Banking Union as well as banks' own efforts are likely to have played a pivotal role in 2023, when markets largely spared EU banks from the banking turmoil that was witnessed in other jurisdictions.

After almost a decade of lessons learned, it is only natural to take a step back and re-evaluate. EU Finance Ministers therefore appropriately designated the Crisis Management and Deposit Insurance (CMDI) framework as an area that warrants legislative attention and is politically attainable.

Indeed, there is a case for measured reforms in the area of CMDI. But instead, the European Commission's proposals for a revised CMDI framework represent a fundamental change and a paradigm shift. They could bring far-reaching negative consequences for the EU's diversified banking sector, its customers and financial stability. Accordingly, there has been fundamental criticism from co-legislators and stakeholders from the outset. Nevertheless, in recent months, negotiations on CMDI have been driven forward at full speed with the end of the current legislative term approaching.

Under the current crisis management framework, an institution in economic difficulties can either be liquidated according to national insolvency proceedings or it is subject to the EU resolution regime. The latter is tailored to systemically important credit institutions that have to prepare complex resolution plans and raise MREL on the capital markets. For most of the smaller institutions however, liquidation offers a more adequate, reliable and proportionate set of instruments. Regrettably, the CMDI proposals missed the chance of providing further clarity. Instead of enhancing transparency on the outcome of the Public Interest Assessment, the proposed changes cause further confusion e.g. by introducing an unclear definition of "financial stability at regional level" that could assign virtually all institutions to the resolution regime.

Banking Union is a European success story. What it needs is evolution, and not revolution.

As a result, there is an increased need for funding to finance the use of resolution tools. As the European Commission acknowledges difficulties for smaller institutions to raise adequate levels of MREL, it proposes instead to facilitate the use of Deposit Guarantee Schemes (DGS) for the co-financing of resolutions. To allow for this, the proposals introduce far-reaching changes to the creditor hierarchy, a harmonized least cost test and an unlimited liability of DGSs. All this threatens DGSs with the risk of their financial depletion. The resulting loss of depositors' confidence would contradict the very reason of their existence.

The Deposit Guarantee Scheme Directive provides for the use of both alternative and preventive measures. These enhanced capabilities allow for business continuity between a bank and its customers and therefore give DGSs the option to be more than mere pay-boxes. Regrettably, the CMDI proposals include significant obstacles to this flexibility. In the case of preventive measures that are used by Institutional Protection Schemes (IPS), this has severe consequences. The authorization of IPSs is based on comprehensive requirements set forth in Article 113(7) CRR. The CMDI Review conflicts with these provisions threatening the bare existence of IPSs. This concerns about 2,200 credit institutions in the EU that are organized in networks, including the German Savings Banks.

It remains obscure which benefits should be expected from rendering the use of preventive measures virtually impossible – after all, the European Court of Justice confirmed their use as recently as 2021. It rather seems that the CMDI review is seen as a means to set the ground for a European Deposit Insurance Scheme (EDIS) by facilitating a future integration of national DGSs into a European fund.

A focus on upgrading the existing framework would have allowed for meaningful progress. The European Banking Authority has issued no less than three opinions identifying various improvements to the functioning of DGSs. There is also a need to end the risk of 'limbo situations' for failing institutions, and there is room for better coordination between responsible authorities. Also, the Commission's 2013 banking communication finally needs to be brought in line with the crisis management framework. These are only a few areas where the efficiency of the resolution and deposit protection systems could be improved.

The past ten years and recent crises have demonstrated that Banking Union is a European success story. What it needs is evolution, and not revolution.

JOHANNES REHULKA
Managing Director & Secretary General - Austrian Raiffeisen Association

Careful consideration is the order of the day

In case of a review of the CMDI framework the fundamental objectives of the framework should always be kept in mind. After the financial crisis it was the political intention to adopt a resolution framework to wind down banks which's failure could have a negative impact on a member state or the common currency. According to one of the basic principles of the legal framework resolution tools shall only apply to those larger (cross border) institutions whose resolution is in the public interest. There are no strong arguments to generally assume a public interest in the resolution to smaller and medium-sized banks in Europe.

Small and non-complex institutions and the majority of mid-sized institutions should be liquidated in a normal insolvency proceeding as these procedures fulfill the objectives of the crisis management framework at least to the same extent in comparison to the resolution process. Furthermore there would be no obvious advantages of resolving smaller and medium-sized banks rather than liquidating them as the fulfillment of MREL requirements and the execution of the bail-in tool was exceptionally designed for major cross-border banks with direct access to the capital market.

These considerations are even more true for small and non-complex banks which do not have a direct access to capital markets at all. For these institutions the application of the resolution framework would not make sense.

One of the most important point for the functioning of deposit guarantee schemes is the highest rank in insolvency proceedings for DGS. Based on the current legal text deposit guarantee schemes (DGS) and covered deposits have been granted the highest rank in insolvency proceedings (so called 'super preference'). This is the only way trust in the DGS system can be maintained and an effective payout procedure by DGS can be ensured without causing additional costs for DGS-members, which are the banks. If a bank goes bankrupt a DGS will payout the deposits up to 100.000 Euro within seven days. This swift payout ensures the trust of depositors in a safe financial system.

To uphold the financial stability the DGS in return has the highest rank in insolvency procedure. This ensures that the DGS fund is refilled by backflows out of the insolvency mass. If the highest ranking for DGS would be removed, they would receive reduced backflows in liquidation. Consequently, DGS would be financially exploited and their ability to function seriously weakened. In light of these considerations it's of fundamental importance that the highest rank for deposit guarantee schemes and covered deposits in insolvency proceedings remains unchanged.

DGS shall not be weakened by the resolution framework.

The use of DGS funds for resolution purposes is also a highly sensitive issue. Based on the current framework the liability of a deposit guarantee scheme in the event of its use for resolution purposes may not exceed the amount corresponding to 50% of its target level (maximum of 0.4% of covered deposits). According to the Commission this liability limit should be eliminated and the use of national deposit guarantee funds for resolution purposes shall in future reach up to the amount that would have to be paid in the event of an insolvency (up to the target level of 0.8% of covered deposits). Implementing such a measure contains an inherent risk of a redirection of DGS means as the main purpose of DGS funds is to payout depositors.

According to the Commission's proposal Institutions could rely on the fact that in the event of a resolution comprehensive financial means would be drawn from the DGS anyway. This weakens financial market stability due to the fostering of moral hazard and as a result this measure would not lead to more depositor protection and depositor trust, but rather to less. The proposed approach would cause deep uncertainty among customers who trust in proven, existing deposit guarantee schemes. This would achieve exactly the opposite of what the Commission postulates as the objective of its CMDI review package.

Moreover, according to the Commission's proposal all the financial resources of the deposit guarantee fund (0.8% of covered deposits) shall also be used by the resolution authorities to achieve the 8% bail-in minimum amount. Hitherto, a mandatory bail-in minimum amount of 8% has to be reached prior to the use of the financial means of the resolution fund.

This clearly demonstrates that the Commission's draft also leads to a further complete dilution of the bail-in tool which was already not applied consistently enough in the past by the resolution authorities in the event of a crisis.

For all these reasons, the contribution of deposit guarantee funds for resolution purposes should remain at a maximum of 0.4% of covered deposits.