CMDI

What is it all about?

Beyond misconceptions

July 2023

What are the benefits of placing a failing bank in resolution?

Resolution – through transfer strategies – can achieve better outcomes than liquidation

	For depositors	For the failing bank's business	For financial stability
Liquidation	Interruption of service	Loss of economic value on the liquidated activities	Possible severe impacts on the activities and the immediate viability of the customers Loss of confidence in depositor protection Possible recourse to taxpayers' money
Resolution	No interruption of service	Preservation of value of the economic activities (sold to another bank) More attractive package (assets and liabilities) for the acquiring bank	No disturbance of the activities and no risks for the immediate viability of the customers Depositor confidence maintained No recourse to taxpayers' money

What are the problems with the framework today?

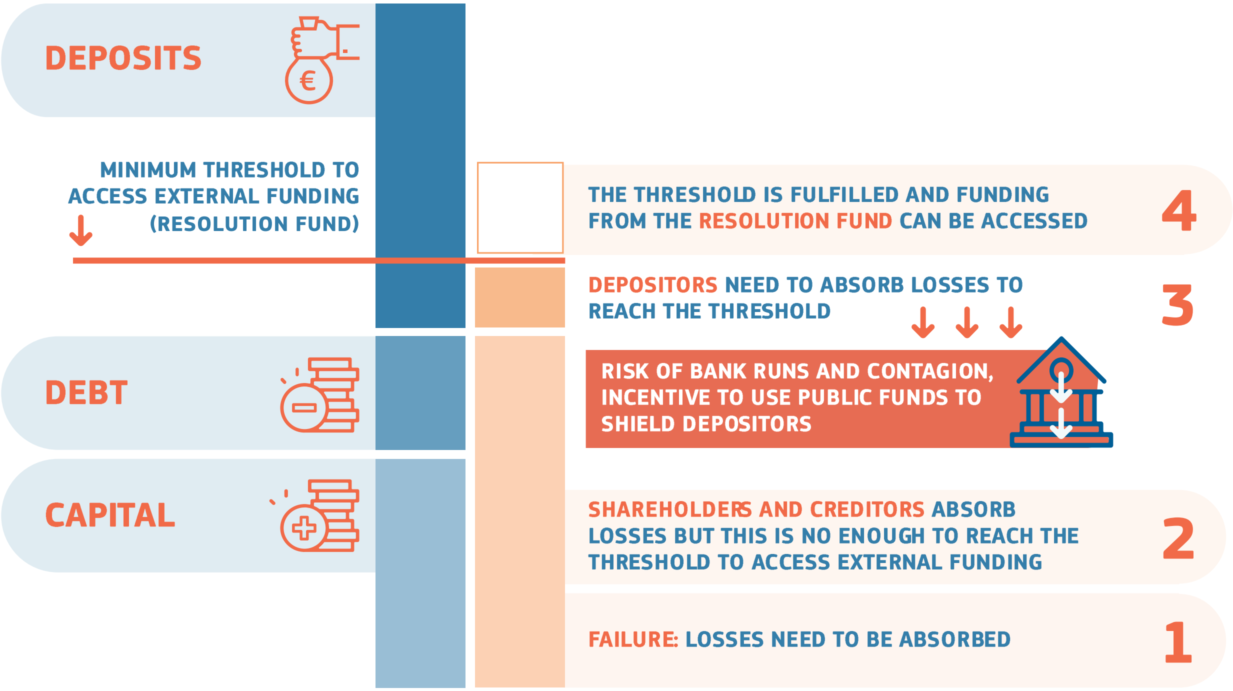
In case of failure, shareholders and creditors absorb losses to finance the execution of the resolution strategy

Complementary external funding can be provided if needed, but requires a prior 8% bail-in of total liabilities

For some medium-sized and smaller banks, this minimum 8% condition implies that depositors could also bear losses

This creates financial stability issues, loss of depositor confidence and may incentivise Member States to intervene using public funds

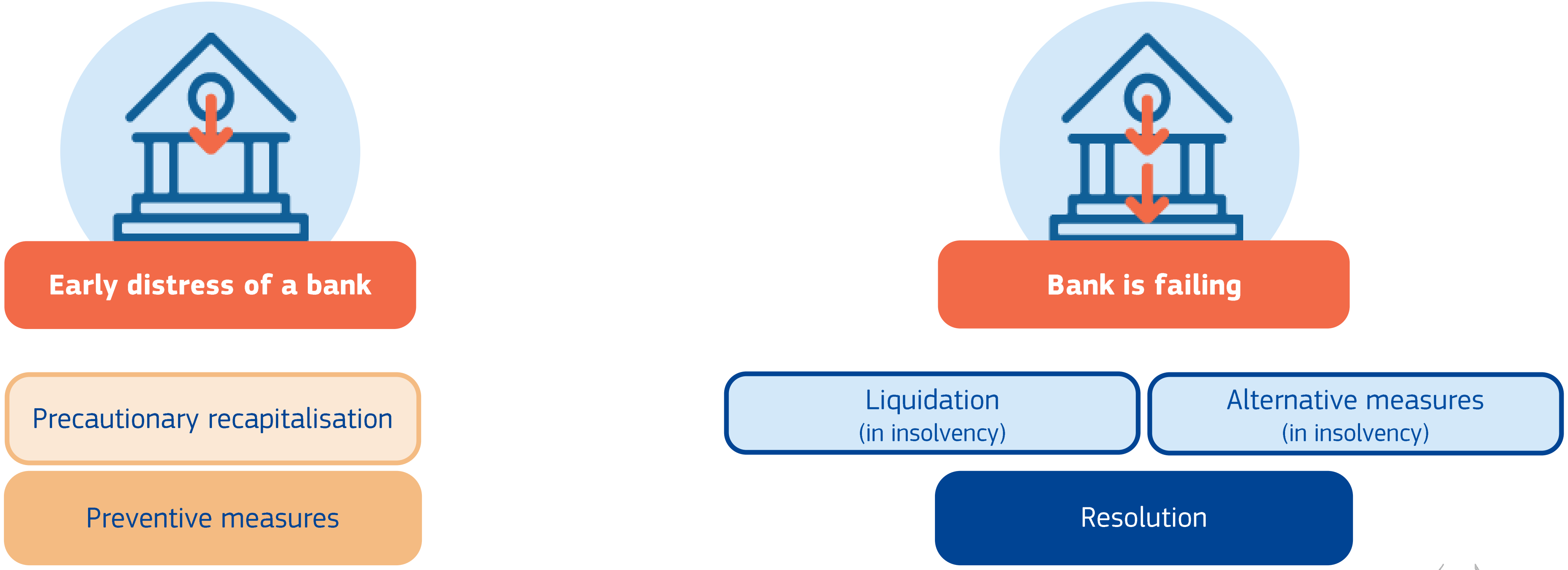
Liability structure of a bank



Is resolution the only way forward? (1/2)

The framework is composed of several tools to deal with bank failures at all stages of the crisis. Not all of them are available in all Member States (national options).

The CMDI reform maintains this **continuum** of crisis tools.



Is resolution the only way forward? (2/2)

STAGE 1- BUSINESS AS USUAL

Solvent bank but capital shortfall in adverse scenario of a stress test

Recovery indicators breached, bank implements recovery options

Precautionary recapitalisation

Activation of recovery plan

STAGE 2- FINANCIAL DISTRESS

Breach or likely breach of prudential requirements, supervisory measures not sufficient

Early intervention measures

STAGE 3-FAILURE

Failing or Likely to Fail declaration

Public interest assessment

Resolution

Liquidation (in insolvency)

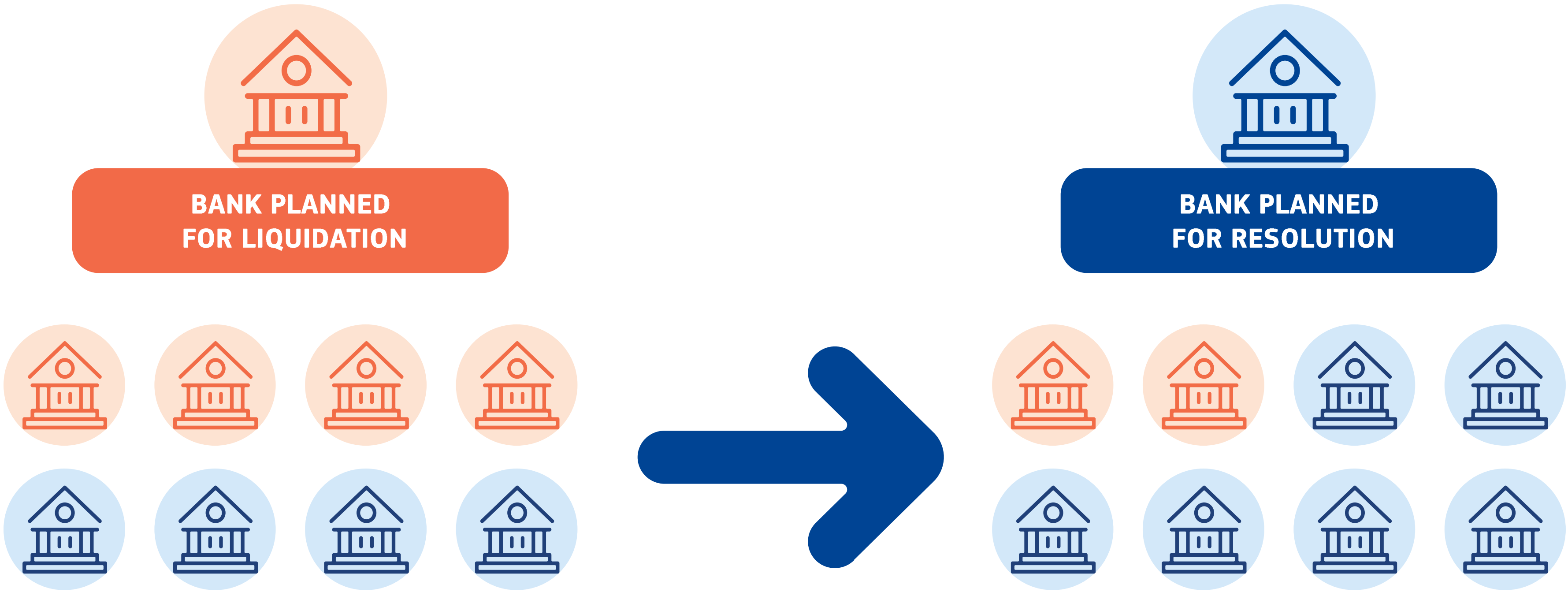
Alternative measures (in insolvency)

PREVENTIVE MEASURES

What will change with the scope of resolution?

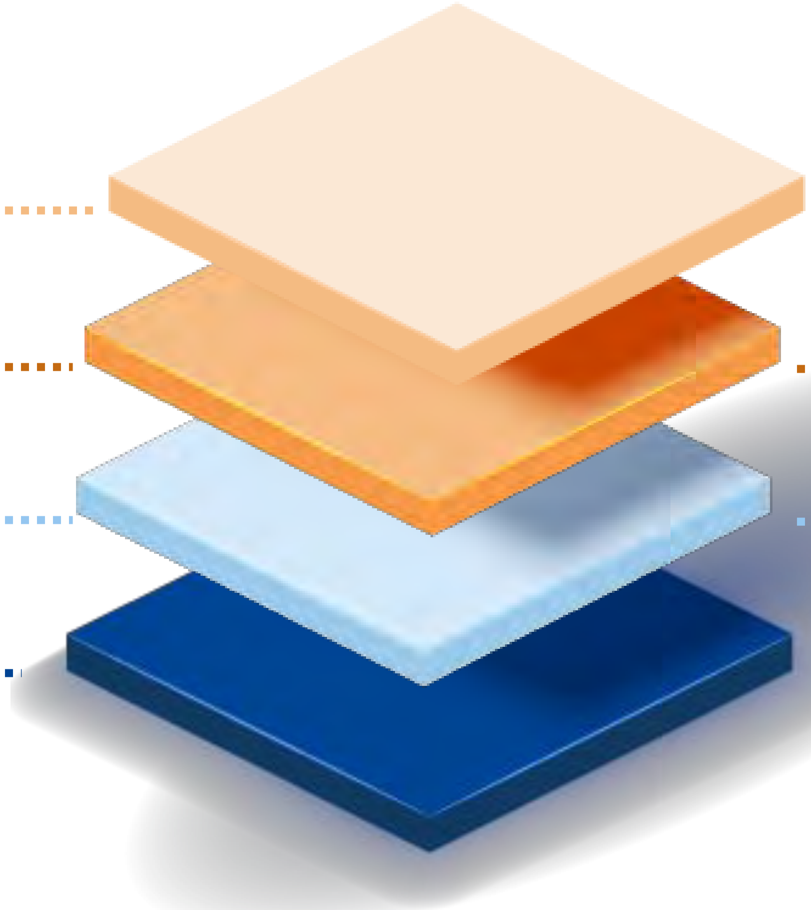
The CMDI reform facilitates the recourse to resolution, when it is in the **public interest**

No presumption for resolution: not all banks will be planned for resolution, it remains subject to the discretion of resolution authorities



What will change with the funding? (1/2)

Resolution needs to be financed through different internal and external **layers of funding**



Resolution funds

Deposit guarantee schemes

Bank's other eligible Liabilities (bail-in)

Bank's capital & MREL buffers

What are the problems?

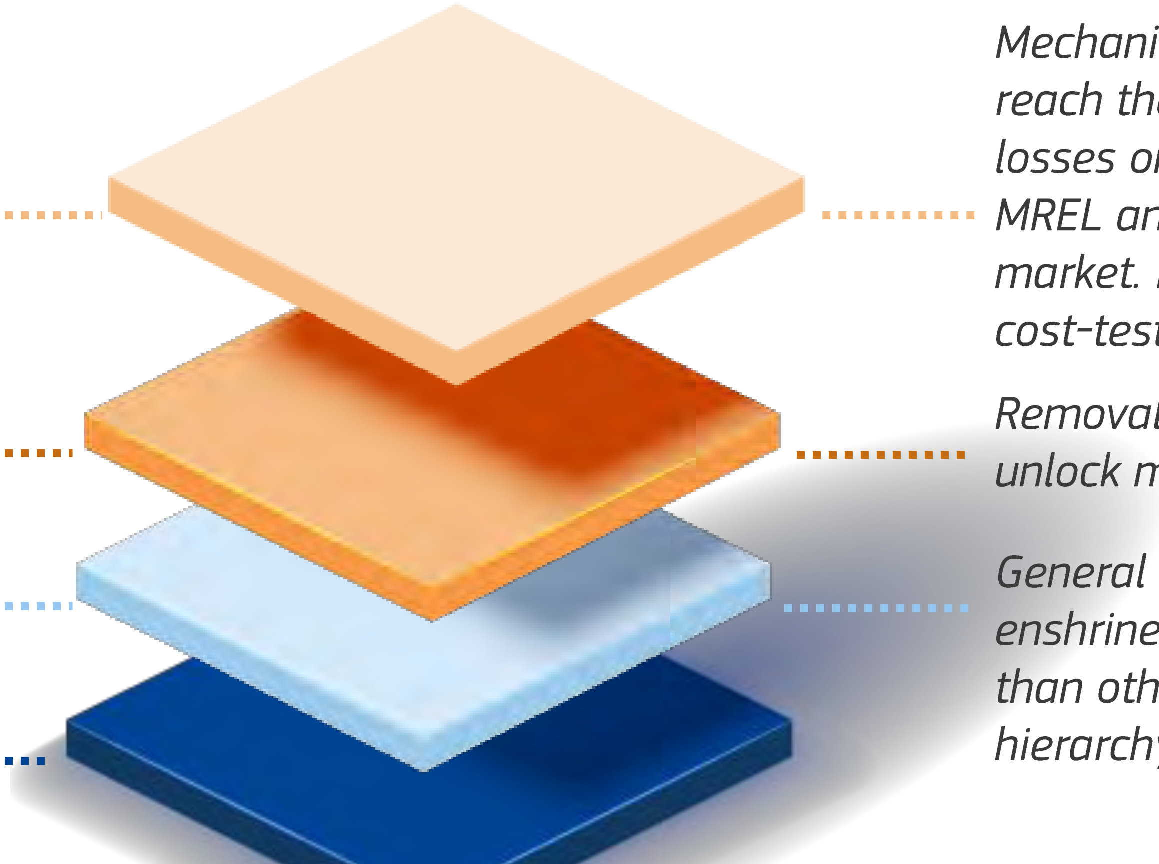
Capacity to access resolution funds without bail-in of depositors is limited

Capacity of DGS to intervene in resolution is limited because of its super preference in the hierarchy of claims

Reluctance to bail-in depositors

What will change with the funding? (2/2)

Privately funded safety nets should be put to good use to reinforce the toolbox, as a **complement** to banks' internal loss absorption capacity



What are the solutions?

Mechanism to use DGS to bridge the gap to reach the resolution funds without imposing losses on depositors. Only for banks with MREL and resolution plans that exit the market. DGS contribution capped by least-cost-test

Removal of the super-preference of DGS to unlock more funds in the least-cost-test

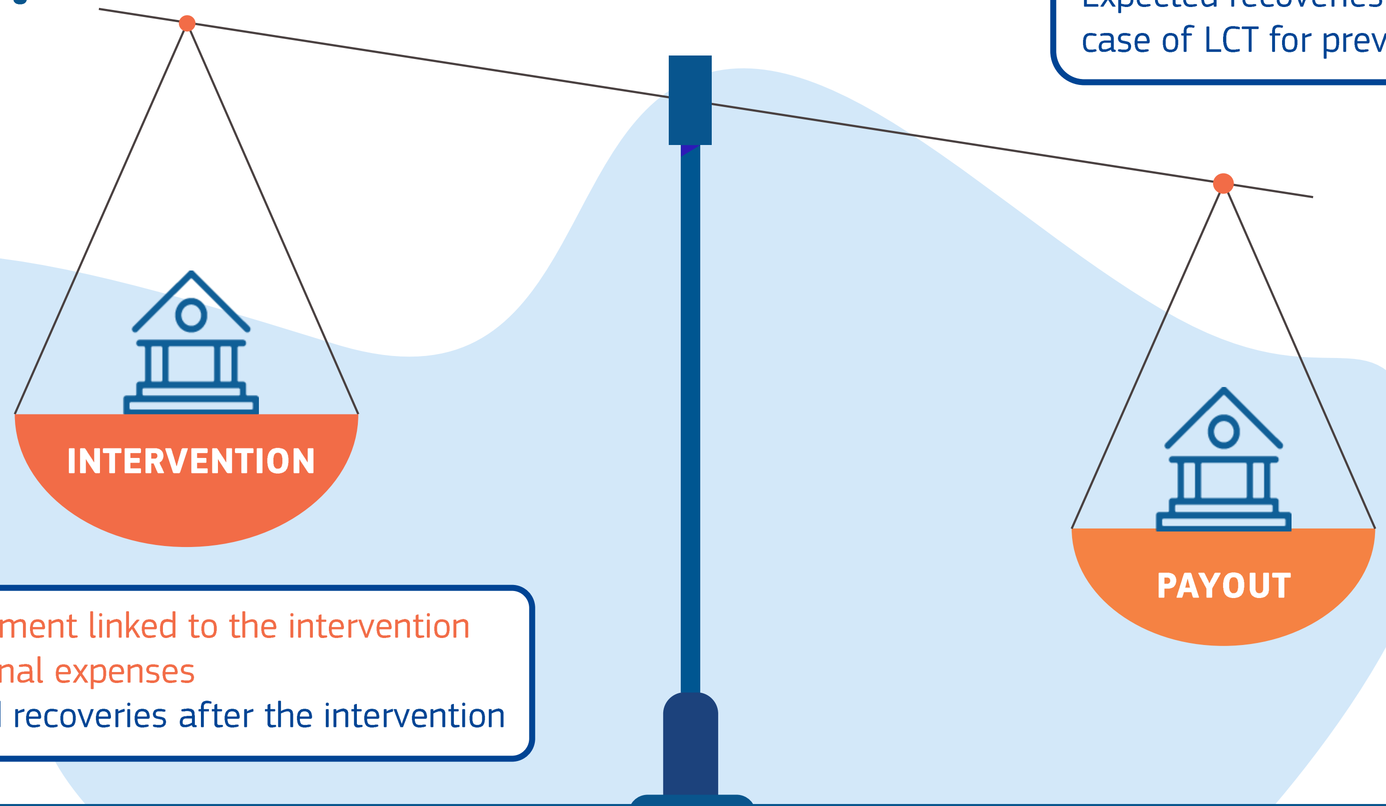
General depositor preference to enshrine that deposits rank higher than other liabilities in the hierarchy of claims

European Commission

How is the least cost test changed?

NET COST:

Gross cost of reimbursing depositors
Operational expenses
Quantifiable indirect costs of payout
Expected recoveries (with a 15% haircut in case of LCT for preventive measures)



Disbursement linked to the intervention
Operational expenses
Expected recoveries after the intervention

Easier funding of resolution strategies

More cost-effective use of DGS money
(still no use of DGS funds for resolution when this is costlier than payout)

What is the state of play of industry safety nets?

Levels of safety nets financed by the banking sector
in the Banking Union by 2024

Single Resolution Fund	Deposit Guarantee Schemes
80 billion* €	55 billion* €

** Amounts expected by the end of the build-up phase*

Safety nets barely used in resolution

How will the change of funding help solving the problems?

LOCAL MUNICIPALITY

EUR 300 000 on its bank account to offer services to the local community

COMPANY

More than EUR 100 000 on its bank account to cater for working capital (pay salaries, supply chain)

SAVERS

EUR 130 000 on its bank as a result of lifetime saving

		BEFORE THE REFORM		**AFTER THE REFORM**	
		Low incentive to choose resolution for smaller and mid-sized banks		*Higher incentive to choose resolution for smaller and mid-sized banks (e.g. facilitate transfer to another bank)*	
		Insolvency (Payout)	Alternative strategies to resolution	Insolvency (Payout)	Resolution
REAL ECONOMY		**EUR 100 000 protected** - **low** chance to recover the rest	Full access **(through recourse to taxpayers' money)**	EUR 100 000 protected - **higher** chance to recover the rest	Full access
		No amount protected - **low** chance to recover anything	Full access **(through recourse to taxpayers' money)**	EUR 100 000 protected - **higher** chance to recover the rest	Full access
BANKING SECTOR	Deposit guarantee scheme	Massive disbursement: - reimbursement of covered deposits - **priority** to recover before all depositors	**Shielded**	Massive disbursement - reimbursement of covered deposits - **no priority** to recover before all depositors	**Possible disbursement** - lower amount than insolvency
	Other banks	Replenishment of the DGS - **depending** on recovery rate	**Shielded**	Higher replenishment of the DGS - **depending** on recovery rate	**Possible need of replenishment** of the DGS - lower amount than insolvency
PUBLIC FINANCES	Taxpayer	Back-up the DGS in shortfall	**Massive intervention**	Back-up the DGS in shortfall	**Shielded**

Common misconceptions (1/3)

"The Commission's proposal covers all aspects of the Banking Union workplan (namely EDIS, RTSE and market integration)"	**NO!** The Commission's proposal focuses on CMDI. Through its proposal, the Commission intends to prepare the ground for further progress towards the completion of the Banking Union.
"The Commission's proposal now intends to place all banks in resolution"	**NO!** The Commission's proposal only aims to restate the original intention of the legal framework, which subjects the fate of a failing bank to the 'public interest assessment'. Resolution is neither deemed to be « for all » nor « for the few ».
"The Commission's proposal is highjacking safety nets and introducing EDIS through the backdoor".	**NO!** Safety nets, whether they are national or supranational, are there to be used and the industry contributes to them as financial stability and depositor confidence are a common good and their cost should rightly fall on the banking sector.
"The Commission's proposal removes the minimum bail-in of 8% TLOF for accessing resolution funds"	**NO!** The access condition to the resolution funds (8% bail-in requirement) is not amended. MREL remains the first line of defence.

European Commission

Common misconceptions (2/3)

"The Commission's proposal will now force DGSs to contribute to resolution"	**NO!** Intervention of DGSs in resolution is already possible in the current framework and remains subject to decision of the resolution authority. The Commission's proposal makes this intervention possible in practice for banks that are too big to be liquidated.
"The Commission's proposal now intends to protect all deposits, beyond the covered ones"	**NO!** Only covered deposits will remain mandatorily protected and excluded from bail-in. The coverage level is not changed and no systemic risk exemption is introduced. But resolution authorities will have the means to include additional deposits into the transfer and shield them from losses, where necessary.
"The higher recourse to resolution will be financed by taxpayers as banks will only pass on their contribution costs to their clients"	**NO!** Industry money and public funds are different. Competition limits pass-through, and incentives for the banking sector differ if the banks' mutualised funds or a direct taxpayer bail-out are expected.

Common misconceptions (3/3)

"The Commission's proposal will apply to all types of IPSs and all funds of IPSs".	**NO!** IPSs which are not recognised as DGSs are not subject to the DGSD and neither are funds collected by IPS recognised as DGS for other mandates than deposit protection. The CMDI proposal does not change this.
“IPSs should be carved out from the Commission’s proposal, in line with the Eurogroup statement”	**NO!** The Eurogroup of June 2022 agreed to take due account of national specificities, including by preserving a functioning framework for IPS, but also to maintain a level playing field among Member States. Under current rules, IPSs recognised as DGSs already have to comply with all DGSD provisions applicable to other DGSs.
“The Commission's proposal does not consider IPSs’ specificities and impairs the functioning of IPSs”	**NO!** The proposal ensures that that the IPSs can continue providing the preventive measures to their members. The proposal foresees a longer implementation time for harmonised rules on preventive measures with even longer time for IPSs recognised as DGSs. This should give DGSs and IPSs sufficiently long time to put in place all procedures to ensure the most cost-effective use of the money collected for depositor protection. IPSs will also continue to cover their members for other purposes than depositor protection.