Addendum 1:

Memorandum
Central Bank of Ireland technical views on topics raised in the European Commission's targeted questionnaire on the CMDI review

1. Early intervention and precautionary measures (Questions 2, 7, 8, 9)

a) Early Intervention Measures

Overlap between early intervention powers in the BRRD and supervisory powers in the Capital Requirements Directive (CRD)

There are clear and obvious overlaps between the Early Intervention Measure (EIM) as set out in the BRRD and supervisory powers contained in Articles 104 and 105 of CRD IV. This may lead to confusion regarding when it is appropriate to use one of the measures in the CRD IV and the BRRD. The Central Bank would favour amending the current legislative provisions, to remove overlaps between them; to elaborate on the optimal sequencing in which the respective powers might be used; and to provide further clarity on the factors that would inform that judgement. This would clarify the escalation of supervisory measures, remove overlaps and harmonise practices across Member States (MS).

Consideration of appropriate triggers for EIM

A key consideration in relation to EIM is the identification of appropriate triggers or criteria in the application of such measures. In assessing the appropriate thresholds, careful consideration is required to ensure the framework does not involve excessive automaticity in terms of application. There will always be a role for judgement in considering the application of EIM. In this regard, the Central Bank sees merit in including a mix of both qualitative and quantitative triggers, breach of which would result in consideration of the application of EIM. In terms of specific quantitative triggers, there is merit in ensuring that both Pillar 1 and Pillar 2 requirements are considered, and the Central Bank therefore sees merit in amending Article 27 BRRD.

b) Precautionary Recapitalisation

Precautionary recapitalisation may be an important tool in specific circumstances. However, it should only be used very sparingly and with extreme caution. It should not become a bailout mechanism disguised as something else. Further clarification relating to the operationalisation of this tool would be welcome. In particular, there is merit in enhancing and refining the existing text in relation to the following two areas:

1. *Definition of solvency for the purposes of precautionary recapitalisation*

The central role of the competent authority in a precautionary recapitalisation is with regard to confirming the solvency position of the bank in question. The BRRD is silent on what constitutes solvency for the purposes of precautionary recapitalisation. Furthermore, the BRRD does not contemplate whether a point in time assessment is sufficient or whether a forward-looking assessment is also required in determining whether an institution is solvent for the purposes of precautionary recapitalisation. Any amendment to the provisions in relation to precautionary recapitalisation should seek to better define solvency. The definition of solvency should comprise a forward-looking assessment, considering compliance with Pillar 1 and Pillar 2 requirements.

2. Clarification on expectations regarding Asset Quality Reviews (AQR) and a national stress test

The BRRD provisions on precautionary recapitalisation envisage use of a national stress test, Union or SSM-wide stress tests, AQR or equivalent exercises conducted by the European Central Bank, European Banking Authority (EBA) or national authorities, where applicable, confirmed by the competent authority. In relation to an AQR, whilst this is a useful tool in determining the actual financial position of an institution, it may not be the most appropriate tool, in terms of cost and timing, for all circumstances. Clarity and consistency regarding the acceptability and operationalisation of other equivalent tools for determining the financial position of an institution, would therefore be beneficial in order to ensure appropriate flexibility for a variety of circumstances in addition to consistency in application and interpretation across Member States. In terms of the stress test requirement, further clarification within the Level 1 text would be beneficial, particularly with regard to when a national stress test would be used and the parameters in relation to this. Any amendment to the precautionary recapitalisation provisions should clarify expectations on a national stress test, in particular whether alignment with the EBA annual exercise in terms of methodologies is expected.

c) Asset Management Vehicles

In consideration of the wider topic of precautionary recapitalisation, there has been discussion regarding the establishment of 'national asset management agencies' or even an EU-wide asset management agency. The establishment of a national or supranational asset management agency requires careful deliberation, particularly in relation to how they are financed. Whilst there may be merit in this tool, especially in dealing with systemic crises, these should not become mechanisms by which to circumvent the resolution framework and burden sharing. Such outcomes are to be avoided.

2. Public interest assessment (PIA) (Questions 10, 19, 25)

Inconsistencies in interpretation and application of the PIA

The PIA is at the core of the CMDI framework. As a result, issues pertaining to the PIA drive broader challenges and inconsistencies in the overall framework. Application of the resolution framework has been limited in practice since its inception which, to a degree, is linked to deficiencies in the PIA framework. There is a lack of guidance at an EU-level on the PIA methodology and a lack of legal certainty with regards to the interpretation of a public interest. This has been evident from several cases of institutional failure to date whereby different interpretations of public interest have been adopted.

The lack of certainty regarding the interpretation and application of the PIA across MS is driving asymmetric outcomes and inconsistent applications of the CMDI framework. This risks undermining the credibility of the overall framework. It is, therefore, important to progress a consistent approach to the PIA methodology and interpretation, with the ultimate goal of achieving an equitable resolution framework which is guided by the PIA.

The Central Bank's view is that the existing level 1 text is not a constraining factor in achieving this objective. However, additional clarification should be provided to ensure the CMDI framework has the flexibility to facilitate the resolution of any type of institution, where the resolution objectives are appropriately met and there is a public interest, while ensuring that the core principle of burden sharing is maintained. Indeed, the PIA scope should not be focused solely on the scale / size of institutions, and the decision for a positive PIA determination in the planning or crisis phase should not be deducted from this factor alone (nor is this necessarily implied by the existing level 1 text).

More generally, it is critical that the framework ensures that the principle of institutions, shareholders and creditors bearing the costs of resolution is maintained, that market discipline is ensured, and moral hazard is mitigated. In this regard, the Central Bank would not be in favour of proposals around broad adjustments / exemptions of MREL in order to facilitate a wider PIA and resolution scope. MREL requirements should not be adjusted to accommodate non-bail-in, nor specific types of business structures where a public interest is determined, as the burden sharing requirements imposed by the MREL framework are core to the fundamental founding principles of the CMDI framework and it is imperative for this core element to be safeguarded.

Guidance on the PIA technical methodology

As noted, it is the Central Bank's view that the existing Level 1 text may not explicitly limit a flexible approach with regards to the scope of the PIA. In that context however, it is important to achieve a harmonised and legally certain interpretation of the PIA framework. The Central Bank's general preference is to work within the current framework, refining it to deliver an equitable and flexible resolution framework where any type of institution can be resolved, while ensuring that the core principle of burden sharing is maintained. The development of EU-level guidance or technical standards around the PIA would be beneficial. More narrowly, a new resolution objective on the topic of the preservation of DGS funds should not be required, as this should already be captured within the current PIA framework as part of the existing resolution objective *'to protect public funds by minimising reliance on extraordinary public financial supports'* (Article 31(2)(c) BRRD).

3. Failure or Likely to Fail (FOLTF) Triggers/ Article 32b/ withdrawal of licence/ winding up (Questions 11-15)

FOLTF Triggers

From the outset, it is worth noting that the purpose of the FOLTF determination is vastly different, and separate, to any decision to initiate national insolvency proceedings (NIP). While the instigation of NIP may occur as a consequence of the FOLTF determination, and as a result of the subsequent consideration of whether the resolution conditions are met, closer alignment between the two processes within the Level 1 text is not necessarily essential. Rather, the optimal way forward may be that some NIP need to be revised to incorporate the FOLTF determination as legal grounds for the resolution authority to instigate NIP. The 'likely to fail' aspect of FOLTF determinations, in particular, presents a gap which warrants revision, as some NIP need to be revised to allow for instigation in cases where the failure has not yet occurred but is likely to occur while presenting an interest, *inter alia*, to the public and/or the persons having deposits.

Article 32b

The introduction of Article 32b of the BRRD allows for the initiation of insolvency proceedings for institutions that are not subject to a resolution action. A key issue that arises relates to the interpretation of the wording "wound up in an orderly manner in accordance with the applicable national law", and how this can lead to a divergence in how winding up measures may be applied.

While it is deemed essential to ensure that 'winding up' is understood to mean that a failed/failing institution should exit the market in an orderly fashion, clarity on the meaning of the expression 'winding up', and interaction with the notion of NIP, would be welcomed.

It should be clear that insolvency proceedings which envisage/ involve the reorganisation or restructure of the institution would not apply and therefore, in essence, 'winding up' should be clarified to solely refer to the appointment of a liquidator, the purpose of which is to perform an orderly wind up of the institution's business, by sale or otherwise, thereby ensuring a managed exit from the market.

Licence withdrawal at FOLTF

The potential withdrawal of the institution's licence by supervisors is also a relevant consideration in this context. However, whether it would improve the possibility of an institution effectively exiting the market within a shorter time frame is not viewed as likely.

The withdrawal of the licence at the point of FOLTF would tend to be actioned only in extreme circumstances given the availability of a variety of other supervisory powers, which can be used to ensure the protection of creditors or consumers where the institution has become, or is likely to become, unable to meet its obligations to creditors. Where powers, such as the ability to issue directions to an institution to suspend the provision of any financial services, are available to the national competent authorities, the withdrawal of a licence where non-liquidation options are appropriate/available for consideration should be precluded.

Notwithstanding that the withdrawal of a licence would be effected by the national competent authority submitting a proposal to the ECB on specific grounds, the process of which may be time consuming and open to challenge, if an authorisation was withdrawn the consequence of same would be that resolution would no longer be an option for consideration

In addition, as NIP would still need to be instigated with the legal grounds based on the underlying reason for FOLTF, the revocation of a licence on the basis of the FOLTF determination itself would be unlikely to substantially improve the possibility of the institution exiting the market in a shorter time period. The licence withdrawal process would therefore be a consequence of, rather than the determining factor in, the FOLTF decision.

Use of other supervisory measures favoured to licence withdrawal

As automaticity of authorisation withdrawal at the FOLTF stage is not recommended, consideration must be given to the extent that action can and should be taken at an early stage to reduce the risk of the institution's financial position deteriorating in advance of the FOLTF decision. Measures, including those available through national law, which prevent the destruction of value and ensure that there are sufficient levels of capital and liquidity remaining in the institution should be utilised by the competent authority, if/when the execution of a resolution action may be required (i.e. when in the public interest). If there is a possibility of such measures being introduced by way of an enhanced harmonisation of the BRRD early intervention measures and the supervisory powers available under the CRD, this would be welcomed.

4. Adequacy of tools in insolvency/ Orderly liquidation tool (Question 3, 16-18)

Lack of harmonisation of insolvency laws

The current lack of harmonisation of insolvency laws across MS may pose a challenge to the existing CMDI framework. Inconsistent PIA applications are causing level playing field issues, and divergent insolvency laws are, to some extent, causing further inconsistencies in PIA application due to the differing counterfactual insolvency scenarios across MS. This difference leads to asymmetric outcomes in terms of the insolvency procedures itself, the final outcome of the wound-up entity, and its market exit / licence withdrawal. Additional complexities and inefficiencies arise in the context of implementing cross-border insolvency procedures. Lack of harmonisation of insolvency laws in this regard is also linked to the issue of divergent creditor hierarchy rankings, both of which exacerbate the 'no creditor worse off' (NCWO) risks. Greater harmonisation in bank insolvency laws across the EU would therefore be welcome given the current uneven playing field and operational issues with implementing insolvency proceedings.

Refinement of the tools available in insolvency and in resolution

The application of tools available in both resolution and insolvency in the CMDI framework requires examination, and refinement if necessary, to promote a consistent application of the framework. Some of the challenges related to insolvency laws are driven by broader inconsistencies in the interpretation of the PIA. The existing CMDI framework can address these key overarching issues (as discussed in the 'PIA' section) and provide an equitable and flexible resolution framework guided by the public interest where any type of institution can be resolved, while ensuring that the core principle of burden sharing is maintained, but some degree of refinement may also be required with regards to the adequacy of tools in insolvency.

Orderly Liquidation Tool (OLT)

Notwithstanding that the failure of institutions with a public interest should be resolved within the resolution framework, an OLT which facilitates the transfer of deposits and loans in liquidation may have merit for institutions that do not meet the PIA, where it is guided by the DGS least cost test (LCT) in order to safeguard DGS funds in insolvency. In this regard the Central Bank considers that there may also be merit in introducing the OLT within the BRRD, as an insolvency tool. In such cases, the OLTs could potentially promote a more level playing field with regards to insolvency outcomes (e.g. NCWO risks, licence withdrawals, etc.).

OLT administration and governance

As the OLT proposal is at a relatively early stage of development, it is challenging to fully evaluate this tool. However, in the absence of a fully-fledged EDIS, any OLT which relies on national DGS funding is best placed under the remit of national authorities. Should a future model include supranational central administration using national DGS or EDIS funding, from a governance perspective it would be important for national authorities to have a determining vote in the governance process.[1]

Differentiation from Sale of Business (SoB) tool in resolution

The design of an OLT would depend on the extent to which the tool overlaps with existing measures. It is important to avoid duplication of the SoB tool already available in resolution. The OLT and SoB tools must be accompanied by principles to ensure safeguarding of public funds and the protection of eligible depositors. However, certain operational or objective elements should differ by nature, including;

(i) The OLT should not generally be used for institutions with a positive PIA, as resolution tools should be utilised in the first instance;

(ii) A negative PIA would require linking the usage of OLTs to depositor protection and the DGS least cost principle to ensure that the costs to support the transfer would be less than a full pay-out and recouping funds from the liquidation process. The least cost test should be core to the decision for utilising OLTs and its clarification and consistent application is duly warranted;

(iii) Clear parameters should be provided on in-scope liabilities for OLTs and whether they are envisaged to be limited to deposits or covered deposits (as implied by a direct interpretation of Article 11(6) DGSD). It should be noted that any stipulations or limitations on liabilities that could be transferred using OLT would not apply to the transfer of liabilities under the BRRD resolution SOB tool; and

(iv) As the OLT would differ from the BRRD SoB tool in its ability to fund transfers via the DGS, guidance on the assessment of 'available financial means' and operationalisation of DGS support for OLTs is a key difference that would require development in order to ensure that credible funding is available.

[1] In Ireland, it is worth noting that constitutional rights of creditors requires a court-led insolvency procedure and, as such, any supranational administration for use of national funds for this type of tool would likely still require the involvement of domestic courts before a resolution action could be taken.

5. Financing Resolution/ Use of the DGS / Use of the SRF (Questions 4, 6, 9, 19-23)

Legislative clarification on the use of the resolution funds

The availability of and access to adequate funding to support the completion of certain resolution actions may be critical to their operational success. The BRRD/SRMR established the national Resolution Funds (RF) and the SRF, but the conditions attached in accessing these funds and their scope of use in a resolution action are quite restrictive. All EU banks contribute to the build-up of these funds; however at present, the funds would only be used for the resolution of a relatively small subset. The current approach also leads to level-playing field concerns, as interpretations of the existing framework vary. Additionally, national DGSs have been established to ensure the protection of eligible deposits in the event of the failing of a credit institution. While provisions for certain alternative uses of the DGS have been provided for as part of the DGS Directive (DGSD), there has been limited guidance issued on any such use of the regulations.

In terms of funding resolution actions, the Central Bank is of the view that the cost of resolution action should be borne by shareholders and creditors of the bank in the first instance and that the primary source of any additional funding support should be the SRF, given that institutions have contributed to the relevant fund for this ultimate purpose. The SRF was established with the principle of facilitating resolution; however, the current access conditions could be considered impediments to effective resolution in many cases.

The national DGS should be a fund of last resort and only used for non-payout purposes where this also ensures the protection and is in the interest of covered depositors. The BRRD/SRMR should ensure that the rules governing access to the SRF are not so restrictive that it results in the DGS having to be called upon to support a resolution action of a failing institution. Any expansion into the alternative use of the DGS should also be mindful that the DGS is not viewed as an alternative to using the SRF but rather provides resolution authorities with additional options to resolve institutions where funding from the SRF is not available.

Access to funding through the SRF

A pre-condition for any failing credit institution accessing the SRF is that losses of at least 8 per cent of the total liabilities including own funds must have been absorbed by the shareholders, capital instrument holders and other eligible liabilities holders as part of the resolution. The Commission Legal Services has also provided additional legal interpretation of the Level 1 text noting that losses that have been absorbed, or should have been absorbed at the point of failure, would not count towards the 8 per cent. Considering that an institution is likely to be in a distressed state prior to any FOLTF decision being made, capital may have been utilised and losses absorbed as part of the recovery steps deployed to stabilise the institution. This could have an impact on the institutions achieving the 8 per cent of losses to access the SRF.

While the 8 per cent loss absorbing requirement should be retained, consideration should be given to the recognition of 'historical' losses absorbed by shareholders and capital instrument holders in the period leading up to the FOLTF determination, and in particular, losses which may have been incurred, but not yet reflected in CET1 at the point of failure. This approach would acknowledge the burden sharing achieved and actions taken by the failing institution during the recovery stage, and would also acknowledge that institutions have a limited pool of loss absorbing capacity available to be utilised during both the recovery and resolution phase. This expansion in the calculation of allowable losses would also assist in managing the risk of a competent authority making a FOLTF decision earlier than necessary to facilitate access to the SRF for the failing institution.

It is also worth noting that the current narrow interpretation of criteria to access the SRF risks the creation of an uneven playing field. Indeed, everything else being constant, and assuming that FOLTF decisions would be less likely to be made at higher levels of equity capital, banks with relatively high levels of equity may be restricted in terms of eligibility to access the SRF at the point of failure, whereas banks with a mix of equity and MREL debt would be more likely to be eligible to access the SRF. It is not clear why this outcome would be preferred or deemed to enhance financial stability within the EU.

Beyond issues of eligibility, there is also the broader question around the overall financial resources of the SRF. It is acknowledged that the SRF does not have an unlimited pool of financial resources available to support resolution actions. The capacity of the SRF to fund a more systemic banking crisis across should be considered, taking into account current and projected target level funding. An impact assessment should be completed on the SRF which would review, but not be limited to, the following:

i. The ability and capacity of the SRF to provide funding in a stressed systemic crisis, including the sufficiency of the current funding to resolve failed institutions; and
ii. The ability of multiple institutions to adhere to the loss absorbing requirement to access the SRF, at a time of system wide stress.

Expansion of the remit for access to the DGS

Article 11(6) of the DGSD provides for a national discretion with regard to the alternative use of the DGS funds. While this discretion was included in the transposition of the DGSD in a number of Member States, including Ireland, limited additional EU-level guidance has been provided on the application of this provision, with several significant matters still to be addressed to ensure effective implementation.

The level of available funding within the DGS is an important element in considering its alternative use as part of a resolution action. It is clear from the BRRD that the maximum contribution to assist resolution actions is limited to 50 per cent of the DGS target level, which in the context of a cost of such an action may not be seen as a significant/primary funding resource. For Article 11(6) of the DGSD, reference is made to the DGS 'available financial means'. Pending any future EDIS, such 'available financial means' at a point in time, based on participant contributions, may limit the utility of the discretion in practice due to a lack of available funds.

A narrow definition of the 'available financial means'[2] would significantly impact the operationalisation of any action under Article 11(6), also bearing in mind the additional financial support that would be available if a full pay-out was required to be completed on a failed institution. In order to ensure the workability of Article 11(6), consideration should be given to the expansion of the 'available financial means' in line with the net funding that would be afforded in a pay-out activation of the DGS, to repay eligible depositors, and based on and within the amounts determined under a least cost test.

The OLT referred to in this memo may also provide clarity on the potential alternative use of the DGS and ensure consistency of such implementation across MS.

6. Ability to issue MREL/Adjustments (Questions 24-25)

Challenges in meeting MREL requirements

The build-up of MREL towards compliance may, at times, present difficulties for institutions. However, it is important to understand what the underlying factors inhibiting MREL build-up and/or issuance are and whether the applicable resolution tools are appropriate for this cohort of institutions.

a) **Adverse market conditions**

Adverse market and economic circumstances can affect the issuance capacity of most banks; however, such situations should only be used to justify extensions of transitional periods in exceptional circumstances and for a time-limited period, as already foreseen under the current framework. Indeed, such flexibility was utilised during the significant market disruption at the onset of the COVID-19 shock. It is also important to distinguish between impaired market conditions and broader economic uncertainty. In the current environment, the Central Bank sees no reason to deviate from a continued focus on the build-up of MREL-eligible instruments with intermediate targets in a reasonable timeframe as one of the core principles of the resolution framework. The ultimate responsibility of the resolution authority is to ensure the resolvability of the bank. Constraints to issuance of market-based loss absorbing capacity should be taken into account,

[2] For example, the January 2020 EBA opinion to the EU Commission brings certainty to the definition, but narrows the scope. The EBA proposed "*that the DGSD be amended to unequivocally state that funds or low-risk assets stemming from or being financed by borrowed resources should not be included in a DGS's calculation of its available financial means*".

but should not be the main driver in determining a resolution strategy.

b) Bank business/ funding model

It has been noted that some small to medium-sized institutions may experience challenges in issuing MREL-eligible instruments. Notwithstanding this, the Central Bank does not support the assertion that these banks may not be capable of closing the MREL shortfall sustainably or that exceptions should apply to such institutions. If the lack of market access is primarily a result of a bank's business and / or funding model, then there may be merit in taking account of this when setting transitional periods in order to allow the bank to make the necessary structural changes to deal with MREL shortfalls.

c) Transitional periods

There is currently no clear guidance at EU-level on how to operationalise the extension of transitional periods with regards to the assessment of the *"prospect that the entity will be able to ensure compliance in a reasonable timeframe"*. The absence of such guidance could lead to level playing field issues, particularly if the extensions are applied to institutions with structural barriers to compliance in light of their business and / or funding models.

MREL adjustments/ Level playing field and harmonisation of application

To ensure a level playing field and harmonised application, future development of the legislative framework could also address the issue of MREL adjustments for non-bail-in resolution strategies. Open-bank bail-in may not be credible as a preferred resolution strategy for some banks; however, some form of write-down and conversion/bail-in should take place in all resolution events in order to ensure adequate burden sharing by existing shareholders and creditors and to ensure the safeguarding of public funds.

There may be merit in having an adjustment to the recapitalisation amount of MREL when some form of sale is identified as the preferred resolution strategy. However, it is the Central Bank's view that such an adjustment should not be automatic. It should only be on the basis of an institution-specific assessment based on objective criteria, taking into account a number of factors, such as the business model of the institution to be sold, the number and condition of potential purchasers or market conditions.

MREL determination for liquidation candidates

The current approach of defining MREL for banks which do not meet the PIA criteria and are therefore likely to be wound up under normal insolvency proceedings should be maintained. This gives resolution authorities the scope to impose an additional MREL requirement above the minimum loss absorption amount in order to appropriately and proportionately adapt the MREL requirement if there are firm-specific concerns.

7. Treatment of retail clients under the bail-in tool (Questions 26-28)

Significant holdings of MREL by retail investors could act as a barrier to resolvability. It is therefore important that a consistent approach be taken to reduce this risk.

Prevention of a build-up of significant holdings of MREL debt by retail clients

It is the Central Bank's view that focus should be on the prevention of a build-up of significant holdings of MREL debt by retail clients in the first instance. In the context of the resolution framework, this is the underlying aim of the new Article 44a BRRD and, where applicable, such build-ups may also be identified through resolvability assessments in the resolution planning process and addressed therein. Further measures contained in the existing MiFID investor protection framework[3], strong local consumer protection measures, and proactive measures already taken by banks will serve to limit the holding of these liabilities by retail investors.

Remaining challenges and scope for adjustment

The default provisions of Article 44a BRRD, namely the suitability protections at Articles 44a (1)-(4), are considered to be highly complex from an implementation standpoint. This complexity has been noted in a number of ESMA Q&As[4]. Therefore, the Article 44a(5) derogation providing for the requirement to set a minimum denomination amount (MDA) for in-scope instruments is considered to be the most straightforward and prudent solution and may serve as a model for a harmonised solution in this area. MDAs should be sufficiently high to limit access of all but the most sophisticated/high net-worth retail investors to exposures which may be subject to losses in resolution. If adopted and implemented across MS as a harmonised minimum standard, this would provide a high level of protection to retail investors while also addressing cross border implementation and level playing field issues[5].

Statutory exclusions

Shareholders should bear losses first in resolution, followed by other creditors. A statutory exclusion from bail-in for retail client holders of MREL debt may give rise to moral hazard issues where retail investors opt to hold such relatively high yield instruments on the basis that they would be excluded from bail-in in case of resolution. Statutory exclusions for retail clients from bail-in may therefore similarly defeat the purpose

[3] (Particularly relevant are the new MiFID II requirements on (i) product governance, (ii) sale of complex debt instruments and (iii) assessment of suitability, and ESMA's supervisory convergence work on these topics.
[4] E.g. https://www.esma.europa.eu/sites/default/files/library/esma35-43-349_mifid_ii_qas_on_investor_protection_topics.pdf
[5] Where rules diverge in different MS the markets for MREL may be distorted. Consumer protection issues also arise where retail investors in one MS may seek to purchase bail-inable instruments in another MS with less stringent requirements. In resolution scenarios, a duty of protection of financial stability in other MS is owed, so weak protections in other MS may complicate a domestic resolution case where there is cross border investment.

of many of these instruments, which is to provide loss absorbency in resolution. Therefore, statutory exclusions from bail-in for retail client holders of MREL debt should not be pursued except in cases of exceptional adverse market impacts.

8. Level of harmonisation of creditor hierarchy in the EU and impact on No Creditor Worse Off (NCWO) principle (Questions 29-30)

The challenges of fragmentation

Different bank creditor hierarchies across the EU add complexity to the application of resolution bail-in tools, particularly on a cross-border basis. Greater harmonisation of the creditor hierarchy would ensure consistency in terms of managing the NCWO principle with attendant potential benefits for access to loss absorbency in resolution. However, legislators should be mindful that any changes to the creditor hierarchy or scope of bail-in that would, in practical terms, reduce the available loss absorbency in an FOLTF bank and this should be balanced by a proportionate increase in the availability of other loss absorbency options, which may necessitate adjustments to the MREL framework.

Protecting the DGS

Much of the discussion in this area centers on implementing a preference for certain liabilities in insolvency, over others. However, in some cases such proposals could create an additional and outsized burden on current DGS capacity, where the 'super priority' of the DGS (i.e. DGS' position near the top of the insolvency hierarchy) is diminished. Under such a scenario, where a DGS pay-out has occurred, the DGS might face an increased risk of not being fully payed back if the resources of the insolvent entity were first distributed and absorbed by other more preferred creditors.

As a starting principle, approaches should be found to simplify the management of the NCWO principle, which do not result in increasing the burden on the DGS or extending DGS pay-out events, beyond the current scope.

Introduction of a single-tiered ranking for all deposits

The introduction of a single-tiered ranking for all deposits (i.e. the inclusion of non-covered/other deposits in the same class as covered deposits) in addition to harmonisation, would, in the Central Bank's view, increase the risk to the DGS, and create additional difficulties as all deposits would rank *pari passu*, and therefore be subject to the NCWO principle in resolution. This is not an issue with the current 'three-tiered' approach[6]. Therefore the introduction of a single-tier preference should be avoided.

From a technical standpoint, some deposits are very similar to other unsecured liabilities, such as bonds. A legally robust definition and criteria should be developed to differentiate between such deposits and other unsecured liabilities. This may simplify the speedy identification of liabilities that are selected by the resolution authority for bail-in and help reduce the risk that unsecured liabilities will be excluded from bail-in[7].

Similarly, there may be merit in looking at the scope of deposits within the current multi-tier model, with consideration given to a limited degree of preference to deposits not covered by Article 108(1) BRRD. This would allow the bail-in tool to be applied to unsecured creditors and also to deposits not covered by Article 108(1) BRRD, if the bail-in of those deposits would not impact on financial stability.

Granting of statutory preference in insolvency for liabilities excluded from bail-in[8]

There may be benefits to a higher preference in insolvency for liabilities excluded from bail-in in resolution, in terms of managing the NCWO principle and increasing loss absorbency in resolution (i.e. by freeing up 'other unsecured creditor' classes to absorb losses).

The current rationale of the insolvency creditor hierarchy, both as set out in the BRRD and at a national level, tends to prefer those 'creditors' who should be protected on public policy[9] grounds i.e. covered deposits and DGS. NIP are still the default option for bank failure. It is worth noting that the objectives of insolvency and resolution respectively are significantly different. The public policy grounds for preference in insolvency do not always hold true for those liabilities excluded from bail-in. These liabilities are excluded from bail-in, *inter alia*, due to the potential negative impacts their bail-in might otherwise pose for financial stability, or the continuation of critical functions in positive public interest assessment cases. These risks are minimal or nonexistent in insolvency, even where the position of these creditors in the hierarchy may mean they suffer losses.

Any contemplation of a new statutory preference in insolvency for certain liabilities (not already preferred nationally) to be excluded from bail-in, in order to fix problems with the resolution framework, may not be proportionate, especially given their nature (e.g. intergroup or to CCPs). NCWO issues should be addressed in ways that do not protect or prefer creditors in insolvency where there is no public policy reason to do so.

[6] The relative ranking of deposits laid down in Article 108(1) BRRD, whereby covered deposits rank above eligible deposits of natural persons and SMEs, which in turn rank above the remaining deposits.
[7] Article 44(3)(a) BRRD.
[8] Article 44(2) BRRD.
[9] That is, as a matter of public policy, distinct from 'public interest assessment' benchmark for resolution.

9. Depositor Protection/ EDIS (Question 20, 31-39)

The Central Bank is supportive of measures to enhance depositor protection across the EU, and further harmonise practices across individual DGS. In terms of the specific areas highlighted in the targeted consultation questionnaire, the following points are worth highlighting:

- **Enhancing depositor protection in the EU:** The introduction of the DGSD was instrumental in bringing greater harmonisation of the coverage level afforded to depositors across MS. In general, the Central Bank does not see a need for an increase in the standard protection of €100,000 per depositor, as this covers the significant majority of personal eligible depositors across the EU.
- **Temporary High Balance coverage:** Given that MS' decisions on the coverage of such deposits reflect national circumstances, harmonization may cause practical difficulties. As the extent of the coverage is minor in terms of overall liability, there is merit in keeping national discretion with regard to THBs.
- **Treatment of underlying beneficiaries:** Further clarification would be warranted under Article 7(3) DGSD for cases where depositors have personal deposits with the same institution where beneficial holdings are held by various account managers. It is important that the treatment of such deposits, i.e. whether they are aggregated with a depositor's own deposits for the purposes of calculation of total coverage or separately covered, is harmonised across MS in order to provide equal depositor treatment.
- **Clarity on see-through approach for excluded deposits:** There is a potential lack of clarity between Article 7(3) and Article 5(1) DGSD, relating to the treatment of sums placed by investment firms and financial institutions with a credit institution on behalf or for the purpose of their clients. In these cases, the account holder is excluded from eligibility for DGS protection. The EU Commission should enhance DGSD clarity on how the see-through approach applies to deposits placed by these account holders.
- **Keeping depositors informed:** The provision of annual information to depositors, which provides information about the relevant DGS, has been successful in its intention and ensures that depositors remain conscious of coverage and can make informed decisions about where they deposit funds.
- **Information on exclusions:** In general, the depositor information provisions are broadly sufficient, however, it may be beneficial to require further information specified on the depositor information sheet in relation to exclusions.
- **Digital communication:** The use of digital communications where possible to improve the successful provision of comprehensive information to depositors should be advocated; however, where this is

not possible, it is imperative that depositors receive physical communications as an alternative.

Making depositor protection more robust: EU DGSs are advancing towards compliance with reaching an available financial means (AFM) of 0.8% of covered deposits by July 2024. Regarding the application of the DGSD, there are a number of areas where further clarification from the co-legislators would be welcome:

- Expectations regarding the circumstances when contributions should be collected post-2024.
- Continued flexibility regarding the strategy for DGS investing of its AFM.
- The treatment of DGS funds when deposited with Eurosystem Central Banks in circumstances when negative interest rates apply. This is in the context of avoiding unnecessary depletion of the funds, requiring additional industry contributions.
- Provisions to ensure consistency regarding the transfer of contributions from one DGS to another when a credit institution moves jurisdiction.
- National authorities' flexibility in the sequence of use of the different funding sources of a DGS.

The creation of a common deposit insurance scheme in the Banking Union – EDIS

The Central Bank remains supportive of the EU Commission's initial proposal for a fully mutualised EDIS scheme, which remains the most comprehensive way of addressing the component of bank-sovereign risk that is channeled through reliance on national DGSs. An EDIS that is solely focused on providing liquidity support to national DGSs, with limited or no form of loss sharing, leaves open the risk of a national DGS being overwhelmed in extreme loss scenarios, and therefore diminishes the contribution of EDIS to breaking the bank-sovereign link.

The consultation document seeks feedback on certain design features, such as allocation of funds between national DGSs and a central EDIS fund, coverage of option and discretions under the DGSD, governance and interest rates etc. While certain technical design features may merit further examination, the Central Bank's overarching priorities in this respect are that the operational complexity of any final design of the EDIS is minimised, and that there remains a clear pathway to full-loss mutualisation at a future point, in line with the EU Commission's original proposal.