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

<table>
<thead>
<tr>
<th>For depositors</th>
<th>For the failing bank’s business</th>
<th>For financial stability</th>
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</thead>
<tbody>
<tr>
<td><strong>Liquidation</strong></td>
<td><strong>Interruption of service</strong></td>
<td><strong>Loss of economic value on the liquidated activities</strong></td>
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<tr>
<td><strong>Resolution</strong></td>
<td><strong>No interruption of service</strong></td>
<td><strong>Preservation of value of the economic activities (sold to another bank)</strong></td>
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<td><strong>More attractive package (assets and liabilities) for the acquiring bank</strong></td>
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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.
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
- **Precautionary recapitalisation**

**STAGE 2 - FINANCIAL DISTRESS**
- Recovery indicators breached, bank implements recovery options
- Activation of recovery plan
- 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**

[Diagram illustrating the stages and 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**

**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.
How is the least cost test changed?

**NET COST:**

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

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)

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: 80 billion* €
- Deposit Guarantee Schemes: 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)
- EUR 130 000 on its bank account as a result of lifetime saving

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<td><strong>Low incentive to choose resolution for smaller and mid-sized banks</strong></td>
<td><strong>Higher incentive to choose resolution for smaller and mid-sized banks (e.g. facilitate transfer to another bank)</strong></td>
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<td><strong>Insolvency (Payout)</strong></td>
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<td><strong>Alternative strategies to resolution</strong></td>
<td><strong>Resolution</strong></td>
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#### Real Economy
- **EUR 100 000 protected**
  - **Low chance to recover the rest**
- **No amount protected**
  - **Low chance to recover anything**
- **Massive disbursement**
  - Reimbursement of covered deposits
  - **Priority** to recover before all depositors
- **Replenishment of the DGS**
  - **Depend**ing on recovery rate
- **Full access**
  - (through recourse to taxpayers’ money)
- **Shielded**

#### Banking Sector
- **Deposit guarantee scheme**
- **Other banks**
- **Taxpayer**
- **Back-up the DGS in shortfall**
- **Massive intervention**

#### Public Finances
- **Back-up the DGS in shortfall**
- **Shielded**
### Common misconceptions (1/3)

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<td>“The Commission’s proposal covers all aspects of the Banking Union workplan (namely EDIS, RTSE and market integration)”</td>
<td><strong>NO!</strong> 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.</td>
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<td>“The Commission’s proposal now intends to place all banks in resolution”</td>
<td><strong>NO!</strong> 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 ».</td>
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<td>“The Commission’s proposal is highjacking safety nets and introducing EDIS through the backdoor”.</td>
<td><strong>NO!</strong> 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.</td>
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<td>“The Commission’s proposal removes the minimum bail-in of 8% TLOF for accessing resolution funds”</td>
<td><strong>NO!</strong> The access condition to the resolution funds (8% bail-in requirement) is not amended. MREL remains the first line of defence.</td>
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### Common misconceptions (2/3)

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<td>“The Commission's proposal will now force DGSs to contribute to resolution”</td>
<td><strong>NO!</strong> 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.</td>
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<td>“The Commission’s proposal now intends to protect all deposits, beyond the covered ones”</td>
<td><strong>NO!</strong> 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.</td>
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<td>“The higher recourse to resolution will be financed by taxpayers as banks will only pass on their contribution costs to their clients”</td>
<td><strong>NO!</strong> 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.</td>
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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 DGSDs 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.