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COMMISSION STAFF WORKING DOCUMENT

IMPACT ASSESSMENT REPORT

Accompanying the

Proposals for a

DIRECTIVE OF THE EUROPEAN PARLIAMENT AND COUNCIL amending Directive 2014/59/EU as regards early intervention measures, conditions for resolution and financing of resolution action

REGULATION OF THE EUROPEAN PARLIAMENT AND COUNCIL amending Regulation (EU) 806/2014 as regards early intervention measures, conditions for resolution and financing of resolution action

DIRECTIVE OF THE EUROPEAN PARLIAMENT AND COUNCIL amending Directive 2014/49/EU as regards the scope of deposit protection, use of deposit guarantee schemes funds, cross-border cooperation, and transparency

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GLOSSARY

Please note: All acronyms and relevant terms used in this impact assessment are explained in this glossary. In order to avoid duplication these are not repeated in the main body. The reader should revert to the glossary when needed.

Term or acronym	***Meaning or definition***
Alternative funding arrangements	*Member States must ensure that DGSs have adequate alternative funding arrangements in place to enable them to meet any claims against them (Article 10(9) DGSD). These alternative funding arrangements can, for instance, include temporary State financing (which will ultimately be repaid by the DGS). DGSs can also raise extraordinary contributions from those institutions covered by the DGS where they do not have enough money immediately available in their fund. DGSs can also choose to establish borrowing arrangements between themselves, provided the respective national law provisions allow them to do so.*
Alternative measures (in insolvency)	*DGS have in some Member States in the context of national insolvency proceedings the capacity to intervene with other modalities than direct payout as allowed in Article 11(6) DGSD. Such measures intend to preserve the access of depositors to covered deposits, including transfer of assets and liabilities and deposit book transfer. A condition for such measures is that the costs borne by the DGS do not exceed the net amount of compensating covered depositors at the credit institution concerned.*
AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
AMLD	Anti-Money Laundering Directive
Asset encumbrance	*An asset is encumbered if it has been pledged or if it is subject to any form of arrangement to secure, collateralise or credit enhance any transaction from which it cannot be freely withdrawn.*
AT1	Additional Tier 1 *AT1 is a component of Tier 1 Capital and it encompasses instruments that are perpetual in nature and may be automatically written-down or converted into CET1.*
Bail-in	*A bail-in is a legal procedure that may be used in bank resolution. Carrying out a bail-in means that the claims of shareholders and certain creditors in a bank are written-down or converted into capital, meaning that they are forced to accept losses incurred by the bank and to contribute to its recapitalisation.*
Bail-out	*A bail-out involves the rescue of a financial institution through the intervention of the government using taxpayers' money for funding.*
Banking Package	*The 2019 Banking package (also referred to as the "risk reduction package") amends the BRRD as regards the ranking of unsecured debt instruments in insolvency hierarchy. It also implements in the CRR II, the SRMR II and the BRRD II the minimum Total Loss-Absorbing Capacity (TLAC) requirement for EU G-SIIs and includes a revision of the MREL requirement for all banks with strengthened eligibility and subordination criteria. These amendments were adopted in 2019.*

bn	billion
BRRD	Bank recovery and resolution Directive *A directive establishing a common framework of rules and powers for EU Member States to intervene in the case of failing banks. The directive gives broad powers to national authorities to prevent, intervene early and conduct the resolution of troubled banks. Such powers include selling the bank (in whole or in parts), setting up a temporary bridge bank, and bailing-in shareholders and creditors of the bank.*
Burden sharing	*Burden sharing is generally referred to when losses in a bank are borne by the bank's shareholders and creditors*.
CCU	Central Credit Union
CDS	Credit Default Swap *A CDS is a financial swap agreement that the seller of the CDS will compensate the buyer in the event of a debt default (by the debtor) or other credit event.*
CEPS	Centre for European Policy Studies
CET1	Common Equity Tier 1 *CET1 is a component of Tier 1 Capital, and it encompasses ordinary shares and retained earnings.*
CET1 depletion	The level of CET1 equity absorbing losses prior to the determination of a bank as FOLF
CfA	Call for advice
CMDI	Crisis management and deposit insurance
CMDI framework	*References to the CMDI framework in the impact assessment relate to the harmonised EU rules in the BRRD/SRMR and DGSD, while national insolvency proceedings, which are unharmonized, are outside of the framework. However, the decision by the resolution authority whether to place a failing bank in resolution or in national insolvency proceedings is part of the CMDI framework (public interest assessment). The CMDI framework, through the DGSD, also encompasses preventive measures (under Article 11(3) DGSD) and alternative measures in insolvency (under Article 11(6) DGSD) as national options, which are only available in national laws in a minority of Member States and regulates the access conditions for these measures (such as the least cost test)*
CMU	Capital markets union *The capital markets union is a Commission initiative to create a single market for capital, in order to get investments and savings flowing across the EU so that they can benefit consumers, investors and companies, regardless of where they are located.*
Common backstop	*In the event that the Single Resolution Fund is depleted, the European Stability Mechanism can act as a common backstop. It can lend the necessary funds to the SRF to finance resolution by providing a revolving credit line. The aim of the common backstop is to strengthen the resilience and crisis resolution capacity of the Banking Union.*
Covered deposits	*The part of the eligible deposits that can be repaid by the DGS (as a rule, up to EUR 100 000).*

CRD	Capital Requirements Directive
Creditor hierarchy in insolvency (hierarchy of claims)	*The order according to which creditors must be repaid in the context of the insolvency proceedings (in accordance with national insolvency laws). While some elements of the creditor hierarchy have been harmonised at EU level, this order is largely determined by national law.*
CRR	Capital Requirements Regulation
CWP	Council working party on financial stability and Banking Union *The CWP is a preparatory body created by the Council in January 2016 (previously named Ad-hoc working party) following the Commission's proposal to establish a European Deposit Insurance Scheme (EDIS). Its functions are to address initiatives and legislative proposals to the objective of strengthening the banking union and to establish Council's position on the EDIS. The European Central Bank and the Single Resolution Board are invited as observers to its meetings.*
DG FISMA	Directorate General for Financial Stability, Financial Services and Capital Markets Union
DGSD	Deposit guarantee scheme Directive
DIF	Deposit Insurance Fund *The hybrid EDIS model is built around the idea of a coexistence of a deposit insurance fund at central level (DIF) and funds remaining within the national DGSs.*
EBA	European Banking Authority
EBA CfA report	EBA's reply to the Commission's Call for Advice on the review of the CMDI framework.
ECB	European Central Bank
EDIS	European deposit insurance scheme
EDIS liquidity support	*EDIS would provide liquidity support to a beneficiary DGS, once the latter has exhausted its funds (following one or multiple interventions). Liquidity support is an essential element to avoid that possible shortfalls in DGS funding would have to be financed by governments. Liquidity support is eventually reimbursed by the beneficiary DGS (on the basis of recoupments or replenishment contributions from the banks in its remit).*
EEA	European Economic Area
EGBPI	Expert Group on Banking, Payments and Insurance *The EGBPI is a consultative entity composed of experts appointed by EU countries that provides advice and expertise in the preparation of draft delegated acts in the area of banking, payments and insurance for the Commission and its services.*
EIM	Early intervention measures *Early intervention measures are taken by competent authorities to avert a bank failure when a bank shows signs of distress (Articles 27-30 BRRD).*
ELA	Emergency Liquidity Assistance
Eligible deposits	*Deposits that are protected by the DGS, i.e. deposits that are not*

	excluded from the repayment guaranteed by the DGS.
ESM	European Stability Mechanism
EU	European Union
Ex ante contributions to DGS	*These are regular financial contributions by the industry to build up and maintain the fund, to ensure that depositors in all Member States enjoy a similarly high level of protection.*
Ex post contributions to DGS	*These are extraordinary financial contributions to the DGS that are collected, in case the fund does not accommodate the needs, e.g. after a bank failure to replenish the fund.*
F4F Platform	Fit for the Future Platform *The F4F platform is a high-level expert group that provides input for the REFIT part of the 'Better Regulation' agenda of the Commission for stepping up the efforts on simplification, modernisation and burden reduction of EU legislation.*
FOLF	Failing or likely to fail *The first condition for resolution, relating to the imminent or inevitable inability of the bank to continue operating under normal conditions. It takes into account the financial situation of the bank as well as compliance with the requirements for authorisation.* *In case there is no public interest in its resolution, a failing bank will normally be expected to be wound up under national insolvency proceedings.*
Franchise value	*'Franchise value' means the net present value of cash flows that can reasonably be expected to result from the maintenance and renewal of assets and liabilities or businesses and includes the impact of any business opportunities, as relevant, including those stemming from the different resolution actions that are assessed by the valuer. Franchise value may be higher or lower than the value arising from the contractual terms and conditions of assets and liabilities existing at the valuation date.*
FSB	Financial Stability Board
Fully-fledged EDIS	*The term "fully-fledged EDIS" is generally used when referring to final shape of EDIS as proposed by the Commission in 2015. In this steady state, EDIS would also progressively cover potential losses. Potential losses could emerge if the DGS intervention is not fully recouped from the insolvency estate. In 2018, the Commission proposed to reach this so-called coinsurance phase of EDIS, after a reinsurance phase, in which EDIS would only provide liquidity coverage to national DGS.*
G20	*The Group of 20 (i.e. G20) is a group formed in 1999 of finance ministers and central bank governors from 19 of the world's largest economies, along with the European Union. The G20 has the mandate to promote global economic growth, international trade, and regulation of financial markets.*
Going concern	*'Going concern' is an accounting term for a bank that is assumed it will meet its financial obligations when they fall due.*
Gone concern	*'Gone concern' is an accounting term for a bank that has already failed to meet its financial obligations or is expected to do so in the near future.*

G-SIIs	Global systemically important institutions
Hierarchy of claims (or creditor hierarchy in insolvency)	*The order according to which creditors must be repaid in the context of the insolvency proceedings (in accordance with national insolvency laws). While some elements of the creditor hierarchy have been harmonised at EU level, this order is largely determined by national law.*
HLWG	High Level Working Group *The High Level Working Group (HLWG) on EDIS is an inter-governmental forum mandated by the Eurogroup in 2018 to discuss the progress on EDIS and which later broadened its scope of analysis beyond EDIS (the CMDI review, market integration and the regulatory treatment of sovereign exposures and financial stability). Representation in this group is at the level of Directors in Finance ministries. In 2020, the HLWG was mandated to develop a time-bound and concrete work plan on reaching the steady stated in the Banking Union.*
Home and host resolution authorities	*These are the resolution authorities in charge of group level or subsidiary level entities.*
Home Member State	*Member State hosting the group/parent level of a cross-border banking group.*
Home-host	*The term is generally used to describe the relationship between Member States from the point of view of the cross-border coordination and collaboration regarding policies affecting parent level entities and subsidiaries.*
Host Member State	*Member State hosting subsidiaries of banking groups established in another Member State.*
Hybrid EDIS	*The so-called hybrid EDIS model refers to a concept of EDIS where a new central fund and funds remaining within the national DGSs coexist. A central fund and possible mandatory lending among DGSs would provide liquidity support to DGSs to cover the shortfall on a given intervention. The design of hybrid EDIS is evolutionary and could in a second phase gradually evolve towards a loss-sharing phase.*
IPS	Institutional protection scheme *IPSs are defined in the Capital Requirements Regulation (Article 113(7)) as a contractual or statutory liability arrangement, which protects its member institutions and in particular ensures that they have liquidity and solvency needed to avoid bankruptcy where necessary. IPSs referred to in this document are to be understood as IPSs recognised as DGS.*
JRC	Joint Research Centre
LCT	Least cost test *The least cost test assesses whether a DGS may intervene through other actions than payout of depositors (e.g. in resolution or through the use of alternative measures). The DGS may only intervene in resolution if the cost of such intervention does not exceed the net amount of compensating covered depositors of the failing member institution. There are no detailed rules on the least cost test and Member States apply it differently.*
Limbo situation	*A situation where a failing bank for which there is no public interest in using resolution, can also not be placed in insolvency because the requirements for the latter are not met.*

m	million
Market-conform measures	*These are measures carried out by a public body at normal market conditions, therefore are not considered to constitute State aid.*
MiFID II	Markets in Financial Instruments Directive
MIS	Management information systems
ML/TF	Money laundering or terrorist financing
MREL	Minimum requirement for own funds and eligible liabilities *MREL is the minimum amount of equity and debt that a bank is required to meet so as to be able to absorb losses and restore its capital position, allowing them to continuously perform their critical functions during and after a crisis. MREL is one of the key tools in enhancing bank's resolvability.*
NCA	National Competent Authority *NCA means a public authority or body officially recognised by national law, which is empowered by national law to supervise institutions as part of the supervisory system in operation in the Member State concerned.*
NCWO	No creditor worse off *A general principle governing resolution, it provides that creditors cannot receive a worse treatment in resolution than the treatment they would have received had the bank been wound up under insolvency proceedings instead of being resolved.*
Non-preferred, non-covered deposits	*Eligible deposits, in the amount exceeding the coverage level provided by the DGS, that are not preferred in the creditor hierarchy in insolvency at EU level pursuant to Article 108(1) BRRD. These generally refer to the part of the deposits of large enterprises whose repayment is not guaranteed by the DGS, and which currently rank below preferred non-covered deposits.*
NRA	National resolution authority
OJ	Official Journal of the EU
OND	Options and national discretions *EU legislation tries to accommodate for national specificities through options and national discretions. These are provisions that Member States may choose to implement/apply if they deem it appropriate to reflect their respective national circumstances.*
Open bank bail-in resolution strategy	*The application of the bail-in resolution tool, in combination with the restructuring of the failing bank, in a way that allows that bank to meet the conditions for its authorisation and to continue carrying out its activities without requiring its exit from the market.*
Ordinary unsecured claims	*Claims that, in the creditor hierarchy in insolvency, are neither secured, preferred nor subordinated. Also referred to as 'senior claims'.*
O-SII	Other Systemically Important Institutions *O-SIIs are institutions that, due to their systemic importance, are more likely to create risks to financial stability.*

Pari passu	*When claims hold the same ranking in the hierarchy of claims according to the applicable insolvency law.*
Payout	*Repayment by the DGS of the covered deposits with a bank, once they have been determined unavailable.*
Pay-box function (of the DGS)	*The key task of the DGS is to protect depositors against the consequences of the insolvency of a credit institution. This protection implies a direct reimbursement of depositors and is called pay-box function.*
PIA	Public interest assessment *Resolution authorities perform the public interest assessment to examine whether the resolution of a particular bank that is failing or likely to fail would be necessary to maintain financial stability, to protect covered depositors and/or safeguard public funds by minimising reliance on public financial support. If the PIA is negative, no resolution actions would be taken and national insolvency proceedings would apply.*
Precautionary measures	*Capital or liquidity support provided to solvent banks through the use of public funds that may be exceptionally allowed by the BRRD without triggering the declaration that the bank is failing or likely to fail.*
Preferred, non-covered deposits	*Eligible deposits, in the amount exceeding the coverage level provided by the DGS, and that are preferred in the creditor hierarchy in insolvency at EU level pursuant to Article 108(1) BRRD. These generally refer to the part of the deposits of natural persons and micro, small and medium-sized enterprises whose repayment is not guaranteed by the DGS.*
Pre-positioned resources	*In integrated banking groups, resources such as liquidity, capital and internal MREL are pre-positioned by the parent entity on the balance sheet of subsidiaries, i.e. provided or subscribed by the parent, to comply with such requirements on an individual level as required by legislation. Pre-positioning is not required where waivers are granted by competent or resolution authorities.*
Preventive measures	*Option in Article 11(3) DGSD that allows the use of DGS funds to prevent the failure of a bank, subject to certain safeguards.*
Ranking of liabilities	*See creditor hierarchy in insolvency*
Resolution authorities	*National authorities set up in each Member States, in compliance with the BRRD and the Single Resolution Board created by the SRMR in the Banking Union, with the objective to plan, prepare and execute the orderly resolution of banks in case of failure.*
Resolution framework	*References to the resolution framework in the impact assessment relate to the harmonised EU rules in the BRRD/SRMR.*
Resolution of a bank	*Application of resolution tools and powers to a failing bank with the aim of ensuring the continuity of its critical functions while at the same time minimising the impact of the failure on the financial system and the real economy. It can lead to the restructuring of the failing bank or the transfer of its activity to a third party and subsequent exit from the market.*
RF/SRF	Resolution Fund/Single Resolution Fund *Arrangements funded by the industry through contributions paid before or following the resolution of a bank (so-called ex ante and*

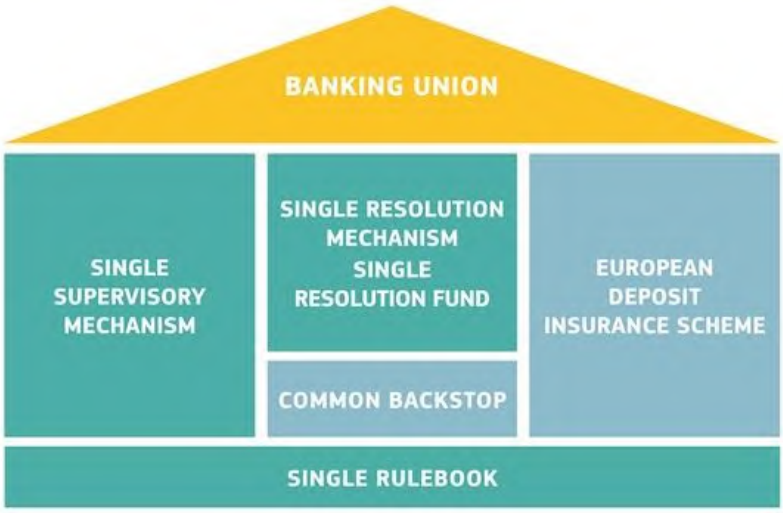
	ex post contributions) to provide financial support to the resolution of a bank in case its internal loss absorption capacity is not sufficient. The SRF is the resolution fund for the banks in the Banking Union and is financed by all banks in the Banking Union. For non-Banking Union Members States, the national resolution fund that has been established in each Member State is financed by the domestic industry/banks.
Risk reduction package	*See banking package*
Safety nets	*Industry funded safety nets, such as the national resolution funds outside the Banking Union, the Single Resolution Fund in the Banking Union and the national DGS funds, created to underpin the crisis management and deposit insurance framework to avoid or minimise the usage of taxpayer money.*
Single-tier depositor preference	*Possible option to further harmonise the ranking of deposits in the hierarchy of claims entailing removing the super-preference of covered depositors and the DGS, preferring all deposits (general depositor preference) meaning that all deposits as well as the DGS would rank above ordinary senior unsecured claims and all deposits rank at the same level amongst themselves (single-tier approach).*
Single Rulebook	*The Single Rulebook is the backbone of the Banking Union and of the financial sector regulation in the EU in general. It consists of legal acts that all financial institutions in the EU must comply with. The Single Rulebook lays down a single set of harmonised prudential rules (among other things) governing the capital requirements for banks, ensuring better protection for depositors and regulating the prevention and management of bank failures.*
SME	Micro, small and medium-sized enterprises
SNP	Senior non-preferred debt *Senior non-preferred debt is a type of subordinated instrument issued by banks which ranks junior to ordinary unsecured debt and senior to classical subordinated debt in the hierarchy of claims. Created as part of the 2019 Banking Package to assist banks in raising MREL-subordinated eligible liabilities.*
SPE	Single point of entry resolution strategy *Resolution strategy whereby resolution tools are applied to one resolution entity in a resolution group, while other non-resolution entities upstream their losses to the parent entity and are not being placed in resolution themselves.*
SRF	Single resolution fund *See RF/SRF*
SRMR	Single resolution mechanism Regulation
SSMR	Single supervisory mechanism Regulation
Super preference of DGS	*In the creditor hierarchy in insolvency, the higher priority ranking of the claims of covered deposits, and of the DGS subrogating to the claims of covered deposits in insolvency following a payout, than the ranking of preferred, non-covered deposits and non-preferred, non-covered deposits. The claims of covered deposits and of DGS must be repaid before the claims of all other deposits.*
TFEU	Treaty on the Functioning of the European Union

THB	Temporary high balances
Tier 2	*Layer of a bank's capital composed of items such as revaluation reserves, hybrid instruments and subordinated term debt.*
TLAC	Total Loss-Absorbing Capacity *International standard published by the FSB to ensure that G-SIIs have sufficient internal capacity to absorb their losses and contribute to their recapitalisation in the event of resolution in a way that ensures they can continue performing their critical functions without endangering public funds or financial stability. It was implemented in the EU for the EU G-SIIs through the Banking package.*
TLOF	Total liabilities, including own funds
Too big to fail	*Financial institutions, which, due to their size, complexity and interconnectedness, would cause serious harm to the financial system and to the real economy in case of failure. During the global financial crisis, the bail-out of several banks was needed to prevent their disorderly insolvency and contagion risks. As a consequence, financial reforms to increase the resilience of the financial system were promoted at the international and EU level, with the creation of the resolution framework being a key outcome.*
tr	trillion
Transfer resolution strategies	*Resolution action entailing the transfer of the activity and the critical functions of the failing bank to a private purchaser or to a bridge institution controlled by the resolution authority, ultimately leading to its exit from the market. The transfer of the shares of the failing bank is also possible.*
TREA	Total risk exposure amount *Calculated in accordance with Article 92(3) CRR.*
Three-tier depositor preference	*Current situation in the hierarchy of claims, where covered deposits are super-preferred and rank above preferred deposits (natural persons and SMEs above EUR 100 000) which in turn rank above other (non-preferred) deposits. According to applicable national laws in some Member States, these non-preferred deposits rank pari passu (i.e. at the same level) with ordinary unsecured claims. In other Member States, these non-preferred deposits rank above ordinary unsecured claims. See Annex 8, section 2.*
Two-tier depositor preference	*Possible option to further harmonise the ranking of deposits in the hierarchy of claims, where all deposits rank above ordinary senior unsecured claims (general depositor preference) and in terms of deposits ranking relative to each other, some deposits would rank above others (e.g. covered deposits/DGS could rank above non-covered deposits or covered deposits/DGS and preferred deposits could rank above non-covered non-preferred deposits)*

1. INTRODUCTION: POLITICAL AND LEGAL CONTEXT

In the aftermath of the global financial and sovereign crises, the EU took multiple decisive actions, in line with international calls for reform[1], to create a safer financial sector for the EU single market and provide the tools and powers to handle the failure of any bank in an orderly manner, while preserving financial stability, public finances and depositor protection. The Banking Union was created in 2014 based on a blueprint laid out in 2012[2], relying on a Single rulebook[3] for the EU: a Single Supervisory Mechanism (SSM) and a Single Resolution Mechanism (SRM) equipped with a Single Resolution Fund (SRF) (**Error! Reference source not found.**). In November 2020, the Eurogroup agreed on the creation and early introduction of a common backstop to the SRF by the European Stability Mechanism (ESM)[4]. However, the Banking Union is still incomplete[5] and misses its third pillar: a European Deposit Insurance Scheme (EDIS). The Commission proposal adopted on 24 November 2015 to establish EDIS is still pending.

Figure 1: State of play of the implementation of the Banking Union



Notes: Green = implemented, blue = pending. Implementation of the common backstop 2022-24.
Source: European Commission, Banking Union infographic.

The EU bank crisis management and deposit insurance (CMDI) framework consists of three EU legislative texts adopted in 2014 acting together with relevant national legislation: the Bank Recovery and Resolution Directive (BRRD), the Single Resolution

[1] G20 (September 2009), *Leaders' Statement*.
[2] European Commission (12 September 2012), *Communication from the Commission to the European Parliament and Council: A Roadmap towards a Banking Union*. All non-euro area Member States can opt to participate the Banking Union before joining the euro area.
[3] The most relevant legal acts of the Single rulebook are: the Capital Requirements Regulation (CRR – Regulation (EU) 575/2013), the Capital Requirements Directive (CRD – Directive 2013/36/EU), the Bank Recovery and Resolution Directive (BRRD – Directive 2014/59/EU), the Single Resolution Mechanism Regulation (SRMRM – Regulation (EU) 806/2014) and the Deposit Guarantee Schemes Directive (DGSD – Directive 2014/49/EU). The winding up Directive (Directive 2001/24/EC) is also relevant to the framework.
[4] Eurogroup (30 November 2020), *Eurogroup conclusions and statement*. The implementation will take place over 2022-2024.
[5] Furthermore, there is still no agreement on a credible and robust mechanism for providing liquidity in resolution in the Banking Union, in line with the standard set by international peers.

Mechanism Regulation (SRMR) and the Deposit Guarantee Schemes Directive (DGSD)). The 2019 Banking package (so-called "risk reduction package") included measures delivering on Europe's commitments made in international fora[6] to take further steps towards completing the Banking Union by providing credible risk reduction measures to mitigate threats to financial stability, as published in the European Commission's 2015 Communication[7].

The objectives of the CMDI framework

The CMDI framework was designed to avert and manage the failure of credit institutions of any size, while protecting financial stability, depositors (households and businesses) and aiming to avoid the risk of excessive use of taxpayer money (see Annex 4 for a description of the fundamental elements of the CMDI framework).

The CMDI framework provides for a set of instruments that can be applied in the different stages of the lifecycle of banks in distress: early intervention measures, measures to prevent the failure of a bank, a resolution toolbox when the bank is declared failing or likely to fail (FOLF) and it is deemed that the resolution of the bank (rather than its liquidation) is in the public interest in order to avoid financial instability. Conversely, national insolvency proceedings, which are outside of the CMDI[8] framework, continue to apply for those failing banks, where insolvency proceedings are deemed more suitable than resolution without harming public interest or endangering financial stability.

The CMDI framework is intended to provide a combination of funding sources to manage failures in an economically efficient manner, protecting financial stability and depositors, maintaining market discipline, while reducing recourse to the public budget and ultimately the cost to the taxpayers. The cost of resolving the bank is first covered through the bank's own resources, i.e. losses are allocated to the shareholders and creditors of the bank (constituting the bank's internal loss absorbing capacity), which also reduces moral hazard and enhances market discipline. If needed, these resources can be complemented by funds from deposit guarantee schemes (DGS) and resolution financing arrangements funded by the industry (national resolution funds (RF) or a Single Resolution Fund (SRF) in the Banking Union). These funds are built through contributions by all banks irrespective of their size and business model. In the Banking Union, these rules were further integrated by entrusting the Single Resolution Board (SRB) with the management and oversight of the SRF, which is funded by contributions from the industry in the participating Member States of the Banking Union. Depending on the tool applied to a bank in distress (e.g. preventive, precautionary, resolution or

[6] The Basel Committee on Banking Supervision and the Financial Stability Board (FSB). Financial Stability Board (2014 updated version), *Key Attributes of effective resolution regimes for financial institutions.*

[7] European Commission communication (November 2015), *Towards the completion of the Banking Union*.

[8] National insolvency proceedings are unharmonized and are outside of the CMDI framework. However, the decision by the resolution authority whether to place a failing bank in resolution or in national insolvency proceedings is part of the CMDI framework (discretionary assessment by the resolution authority of the public interest assessment). If the resolution authority decides to place a failing bank in insolvency, the latter will be treated at national level, where the assessment of initiation of insolvency proceedings takes place, according to specificities of national insolvency regimes.

alternative measures under national insolvency proceedings) and the specificities of the case, State aid[9] control may be necessary for interventions by a RF, a DGS or public funding from the State budget.

The CMDI framework also fosters depositor confidence by requiring that deposits are protected up to EUR 100 000 per depositor and per bank, regardless of whether the bank is put into resolution or liquidation under national insolvency proceedings. In insolvency under national proceedings[10], the primary function of a DGS is to payout covered depositors within seven days of a determination of unavailability of their deposits. Under the DGSD, DGSs may also have other functions. The latter are aimed at preserving depositor confidence, provided they are less costly than a payout of covered deposits in insolvency, such as: financing preventive measures, contributing financially to the resolution of a bank or, in insolvency, financing measures other than payout, i.e. a transfer of assets and liabilities to a buyer, to preserve the access to covered deposits.

A resolution framework to overcome the shortcomings of insolvency proceedings

National insolvency proceedings are not always suited to handle bank failures because banks cannot be liquidated like any other corporate business due to their unique vulnerability to deposit/bank runs, their impact on financial stability and their role in the functioning of the economy through financial intermediation (deposit-taking, provision of credit), monetary policy transmission and their role in the payment system. In view of these elements, any bank failure as opposed to ordinary corporate failures (see references in Box 6 in Annex 4) is more likely to give rise to public policy concerns, which would often lead to bail-out actions to limit the fallout of piecemeal liquidation. Resolution offers an alternative to disorderly insolvency, where there is a public interest in resolving a bank, instead of using existing insolvency proceedings. The introduction of the resolution framework, in line with the international key attributes for effective resolution regimes published by the Financial Stability Board in the aftermath of the global financial crisis[11], aimed to fill an important gap in the management of banking crises, reducing risks for financial stability, depositors and taxpayers.

The resolution framework brings a number of very important benefits. Contrary to liquidation under normal insolvency proceedings, resolution increases the efficiency in handling bank failures in terms of costs, by preserving the franchise value of bank's assets and the client relationship through restructuring/ sale of business to a buyer and avoiding cutting access of the bank's customers to their client accounts and loans (i.e. individuals/households, small and medium enterprises (SMEs), corporates, public institutions, other financial institutions which may include other banks, insurance companies, other industry players). This way, it avoids any public perception of

[9] State aid rules are intrinsically interconnected with and complementary to the CMDI framework. These rules are not subject to this review and this impact assessment. In order to ensure consistency between the two frameworks, the *Eurogroup invited the Commission in November 2020* to conduct a review of the State aid framework for banks, and to complete it in parallel with the CMDI framework review, ensuring its entry into force at the same time with the updated CMDI framework.

[10] Insolvency proceedings across the EU are unharmonised; some allow for certain transfer tools similar to resolution financed by DGSs, others only allow for piecemeal liquidation proceedings.

[11] Financial Stability Board (October 2011, updated in 2014), *Key attributes for effective resolution regimes for financial institutions*. The key attributes represent the foundation on which jurisdictions around the world built their resolution regimes following the global financial crisis.

discontinuity in the operations of the bank, thereby stemming the propagation of adverse effects on broader confidence and financial stability. Resolution also better redistributes costs by shifting away losses from taxpayers to the failing bank's shareholders and creditors and the industry overall, where industry-funded safety nets are used. It also fosters consumer confidence in the banking sector by significantly reducing the risk of spiralling contagion to other banks and mitigating the risks that bank clients may start questioning the solidity of the system and its safety nets as it could happen under insolvency proceedings.

Another merit of the resolution framework is providing predictability and level playing field when handling failing banks and enhancing preparedness (recovery and resolution planning) for crisis times, including by imposing requirements on banks to absorb possible losses internally or via the safety nets. Lastly, resolution may lower the impact of a bank's failure on DGS financial means in a liquidation under normal insolvency proceedings, which requires the DGS to payout all covered deposits (up to EUR 100 000) and bears a high risk of depleting the national DGS funds. Notwithstanding its overall benefit, another downside of the payout of covered deposits is that it can be disruptive to depositor confidence because of its impact on uncovered deposits (leaving uncovered deposits above EUR 100 000 to take losses). All these benefits of resolution strengthen financial stability, preserve value, reduce moral hazard and the risk of inflicting the cost of failure on citizens.

A resolution framework applicable to any bank

In terms of scope of application, the determination of the resolution or liquidation strategy is not automatically driven by bank size or structure of banking sectors but, instead, is made by the resolution authority on the basis of the public interest assessment on a case-by-case basis. From its inception in 2014 and rooted in the international experience of dealing with bank crises over decades, the resolution framework was created with the intention to cater for the orderly management of any bank failure, irrespective of its geographical footprint (i.e. domestic or operating across borders), its size or business model, when this best serves the objectives. Of course, resolution is widely expected by all stakeholders to be the only credible option to manage the failure of large systemic banks, because it provides a clear set of tools and adequate funding (in the form of high buffers of own funds and eligible liabilities to absorb losses through bail-in, and commensurate access to resolution funds) to avoid further contagion to the real economy or financial markets.

However, as recital 29 of the existing BRRD points out, it is crucial, in order to maintain financial stability, that resolution authorities have the possibility to resolve any bank due to their critical functions or potential systemic nature. While the idiosyncratic failures of large banks tend to be more disruptive to the financial system than failures of small banks, this is justified by the risks to financial stability (especially in the case of concomitant failures of several small/mid-sized banks during times of crisis), the destruction of economic value locally/regionally or the disruption of depositors confidence in particular for small jurisdictions (see Box 6 in Annex 4 for references regarding the impact of failing small/mid-sized banks on financial stability). For similar

reasons, all banks contributing to the safety nets should be able to benefit from them, if the conditionality to access these safety nets is fulfilled.

In practice, except for the 120 banks under direct SRB remit[12], national authorities remain responsible for the application of the resolution framework and the discretionary choice between using a resolution or a liquidation strategy to manage a failing bank. The public interest assessment takes into account considerations that go beyond the size of the bank, such as its functions that are critical for the broader economy (e.g. deposit taking, lending, payments) and their substitutability, interconnectedness to other actors in the financial system, risk profile, nature of activity, which are important when assessing the impact of a bank failure on financial stability. For these reasons, it is necessary to ensure a coherent application of the framework, which has not been the case until now.

Insolvency proceedings remain available for those banks, where no contagion risks or other significant risks to financial stability exist and where there are no critical functions, provided that the authorities assess that these banks are not in the public interest.

The test of time and the need for a reform

Notwithstanding the progress achieved since 2014, the application of resolution has been scarce, especially in the Banking Union and areas for further strengthening and adjustment were identified with regard to the CMDI framework in terms of design, implementation and most importantly, incentives for its application. These issues concern in particular the category of small and medium-sized banks that are often "too big to liquidate" under normal insolvency regimes.

To date, and as shown in Chapter 2, Annex 5 (evaluation) and evidenced in Annex 9, most failing small and mid-sized banks were managed under national regimes often involving the use of taxpayer money (bailouts) instead of the required bank's internal resources (bail-in)[13]. This goes against the intention of the framework as set up after the global financial crisis, which involved a major paradigm shift from bail-out to bail-in (required amount of burden sharing) and industry-funded safety nets, such as the SRF in the Banking Union, so far unused in resolution. In this context, the opportunity cost of the resolution funds financed by all banks is considerable.

The resolution framework underperformed with respect to key overarching objectives, notably facilitating the functioning of the EU single market in banking by ensuring level playing field, handling cross-border and domestic crises and minimising recourse to taxpayer money.

The reasons are mainly due to misaligned incentives in choosing the right tool to manage failing banks, leading to the non-application of the harmonised resolution framework, in favour of other avenues. This is overall due to the broad discretion in the public interest assessment, difficulties in accessing funding in resolution without imposing losses on

[12] As of 1 January 2021, the SRB was directly responsible for 120 banks (significant banks and cross border less significant banks) in the Banking Union. National resolution authorities in the Banking Union deal with about 2.200 less significant institutions (SRB, *Annual Report 2021*). In total, there were approximately 4.600 banks in the European Union in 2020 (European Banking Federation, *Facts and Figures 2021*).

[13] Burden sharing by shareholders and subordinate debt holders was implemented under State aid rules, but not corresponding to the 8% total liabilities and own funds required by the BRRD/SRMR.

depositors and easier access to funding outside of resolution, raising risks of fragmentation and suboptimal outcomes in managing banks' failures, in particular of those smaller and mid-sized banks that are often too big to liquidate under normal insolvency regimes.

The review of the CMDI framework (BRRD/SRMR/DGSD) and the interaction with national insolvency proceedings should provide solutions to address these issues and enable the framework to fully achieve its objectives[14] and be fit for its purpose for all banks in the EU irrespective of their size, business model and liability structure, if required by prevailing circumstances. The revision should aim at ensuring a coherent application of the rules across Member States, delivering level playing field, while protecting financial stability and depositors, containing contagion and reducing recourse to taxpayer money. In particular, the CMDI framework could be improved to facilitate the resolution of small and medium-sized banks as initially expected, by mitigating the impacts on financial stability and the real economy without recourse to public funding, but also fostering confidence of their depositors that consist primarily of households and SMEs[15].

The objectives of the reform would bring the EU framework closer to the frameworks of international peers, especially the United States (US). The extensive experience and excellent track record of the US Federal Deposit Insurance Corporation, spanning over many decades, where failing smaller and mid-sized banks are routinely transferred to a buyer with the support of a common fund financed by the contributions of the industry, can reveal how some features of the CMDI framework could be improved (see Annex 8, section 11)[16].

The CMDI reform and the broader implications for the Banking Union

Together with the CMDI reform, a complete Banking Union, including its third pillar, EDIS, would offer a higher level of financial protection to Europe's households and businesses, foster trust and strengthen financial stability as necessary conditions for growth, prosperity and resilience in the Economic and Monetary Union and, more generally, in Europe. The Capital Markets Union complements the Banking Union as both initiatives would help finance the twin transition (digital and green), enhance the international role of the euro and strengthen Europe's open strategic autonomy in a changing world, particularly considering the current challenging economic and geopolitical environment.

[14] See Chapter **Error! Reference source not found.** on the objectives.

[15] As such, the reform envisaged does not have a direct impact on households and businesses such as SMEs e.g. on the credit supply and lending behaviour of banks. However, to the extent that the reform would improve the crisis management for smaller and medium-sized banks with a view to strengthen depositor protection, depositors such as households and SMEs could indirectly benefit from a more efficient bank crisis framework that would limit the impact of a bank failure on financial stability and the real economy. See also section 8 of Annex 8.

[16] Between 2000 and 2020, the FDIC intervened through transfer tools, with deposit insurance fund support, to preserve access to deposits in failed banks in 95% of cases and paid out covered deposits in piecemeal liquidation in only 5% of cases. The FDIC estimates that, between 2008 and 2013, the use of transfer tools saved USD 42 bn, or 43%, compared with the estimated cost of using payout of covered deposits in insolvency.

On the one hand, European banks have proven robust so far, including in terms of capital adequacy and liquidity buffers. Moreover, the reforms undertaken to implement the first pillars of the Banking Union in the aftermath of the 2008 global financial crisis have helped in strengthening the position of European banks. Any fallout was managed with the available toolkit (either provided by the CMDI framework such as moratoria, resolution tools, or tools under national insolvency frameworks) even when the circumstances of the failure were particularly unusual[17].

On the other hand, the profitability and cost-efficiency of European banks is arguably structurally weak and asset quality concerns may resurface amid increased credit risk fuelled by the deterioration in the macroeconomic outlook and the energy crisis triggered by geopolitical tensions.

Therefore, more adverse conditions are possible in the future, making the need to proceed with the current reform of the CMDI framework, improve its use and to step-up the efforts for the completion of the Banking Union more pressing and compelling. Under the status quo, a large proportion of failing banks would continue to be restructured or liquidated outside the harmonised resolution framework, under existing heterogeneous national regimes, where in some cases only disorderly and costly insolvency proceedings or solutions involving taxpayer money exist. This would weaken consumer confidence in the EU banking sector and the predictability and level playing field of our single market for banking, and of the Banking Union in particular.

In June 2022, the Eurogroup was not able to reach a political agreement on a comprehensive work plan to complete the Banking Union[18]. Instead, the Eurogroup invited the Commission to table legislative proposals for reforming the EU framework for bank crisis management and national deposit insurance. This was one of four workstreams discussed in the context of the Banking Union completion workplan (in addition to EDIS, the regulatory treatment of exposures to sovereigns and enhanced cross-border market integration). The other workstreams have been put on hold until the next institutional cycle.

In parallel, the European Parliament also stressed in its 2021 annual report on the Banking Union, the importance of completing it with the establishment of an EDIS and supported the Commission in putting forward a legislative proposal on the CMDI review.

This impact assessment covers the analysis of policy measures for the review of the CMDI framework. While EDIS was not explicitly endorsed by the Eurogroup, it would have made the CMDI reform more robust and delivered synergies and efficiency gains for the industry. Some of these elements are included in this impact assessment for technical completeness and illustration of the internal consistency among the elements of a robust framework, also reflecting technical discussions which took place on EDIS in the past years in expert groups, Council working parties and inter-governmental fora.

Such a legislative package would be part of the agenda for the completion of the Banking Union, as emphasised in President von der Leyen's Political Guidelines, which also included the implementation of EDIS.

[17] See information on the Sberbank case in Annex 9, section 5.
[18] Eurogroup (16 June 2022), *Eurogroup statement on the future of the Banking Union*.

This impact assessment report reflects analyses based on information and data up until 31 January 2023 and does not include references to subsequent developments.

2. PROBLEM DEFINITION

This section outlines the problems identified in the evaluation of the current framework. It explains how the problems have been identified, what their drivers are, and why action is necessary. More details are available in the evaluation in Annex 5, including an assessment of the CMDI functioning against various criteria.

The most relevant evidence underpinning the analysis of problems and their drivers in this chapter includes, among others: analysis of past cases of bank failures, quantitative analysis illustrating banks' difficulty to access safety net funding, the divergent approaches to the public interest assessment, the issues with the creditor hierarchy, divergences between failing or likely to fail and insolvency triggers or the shortcomings regarding early intervention measures. These are complemented by references to external analyses pointing to the lack of clarity regarding the least cost test for DGS uses and the inability of DGS funds to intervene in resolution (EBA opinions), other assessments of business model specificity of small and mid-sized banks (ECB) and DGS funds robustness (Joint Research Centre). This evidence is referenced throughout the impact assessment and in the relevant annexes. A complementary, more exhaustive summary of the evidence used in the impact assessment is also provided in Annex 1, sections 3 and 4.

Main considerations related to the limited use of resolution and why it is a problem

The evaluation of the current rules shows that the introduction of the CMDI framework in 2014 brought important benefits in terms of maintaining financial stability, significantly improving depositor protection and contributing to boosting consumer confidence in the EU banking sector (illustrated by a reduction in bank runs and an overall increase in depositing money in banks). However, its practical application failed to achieve some important objectives or achieved them only partially, namely, simultaneously, protecting taxpayer money and depositors, while ensuring level playing field and a fair treatment of creditors across the EU single market (see Annex 5).

In particular, recent experiences show that the resolution framework is not entirely fit to handle the failure of small and medium-sized banks, whose business model, predominantly funded with deposits, may affect authorities' incentives to use the resolution framework as initially intended. This problem is particularly relevant when external funding (e.g. RF/SRF) is necessary to support the failure of the bank, for instance to facilitate a sale to a buyer, and when this access to funding is not possible within the resolution framework without imposing losses on deposits. Managing these bank failures outside resolution is not a problem per se. However, the concern is that these choices were driven by the difficulty to access appropriate funding in resolution (despite its availability), while on the contrary, other avenues entailed a recourse to public funding to avoid disorderly failure.

The evidence in this chapter as well as in Annex 5 (evaluation) and Annex 9 (list of past cases) shows that, most failing small and mid-sized banks were managed under national regimes (preventive and alternative measures in insolvency) often involving the use of

taxpayer money (bailouts, sometimes by local public authorities), instead of the industry-funded safety nets, such as the SRF in the Banking Union, which will amount to approximately EUR 80 billion by 2024. In total, more than EUR 58 bn were provided by national or regional governments to bail-out banks (as shown in Chapter 2, section 2.2) since 2015, when the resolution framework started to apply. More than 60% of banks in distress in the EU were managed outside of the resolution framework. For banks within the Banking Union, this number exceeds 70%. When considering only cases from 2016 onwards, when the bail-in tool started to apply, the proportion of measures other than resolution rises to 75% of the cases for the EU and to 84% for the Banking Union (Chapter 2, section 2.1).

The scarce application of resolution, and the preference by resolution authorities to look for alternative avenues often with the support of public money, are mainly due to the misalignment of incentives to choose the appropriate tool to address a bank failure.

Major concerns have been raised about imposing losses on depositors, such as households and owners of small businesses in a region and the impact this would have on financial stability, depositor protection, thereby creating incentives to find alternative solutions (see Box 1 below, Annex 8, section 1 and Annex 4, Box 6). The prevalence of deposits in the liability structure of these banks increases the likelihood of imposing losses on depositors to comply with the conditions to access RF/SRF when the resolution avenue is chosen. Many stakeholders (Member States, citizens/depositors) consider that imposing losses on depositors, beyond the protection of EUR 100 000 granted by the DGS, would have financial stability implications which may fuel concerns on the protection of deposits in the system as a whole. It may lead to bank runs and increase the risk of contagion to other institutions. Resolution authorities have therefore been reluctant to use measures, such as the bail-in tool in resolution that aims to absorb losses through the bank's shareholders and creditors, when it would lead to imposing losses on depositors (such as households and SMEs). This may particularly be the case for small and mid-sized banks that are anchored in the local/regional economy and where the bail-in of depositors could inflict substantial damage to the (local) real economy. Faced with a trade-off between preserving financial stability and limiting the impact on the real economy on one hand, and using taxpayer money on the other hand, authorities (European, national or regional) may therefore have delayed the start of the crisis management procedures in search of alternatives causing the financial situation of the bank in distress to further deteriorate. The choice of such alternatives often resulted in preferring certain objectives (protecting financial stability and depositor protection) over others (avoiding the use of public funds and level playing field and fair treatment of depositors and taxpayers in the single market). This shows that, for certain small and mid-sized banks, the CMDI framework cannot simultaneously fulfil all the four objectives agreed by co-legislators in the framework at its inception in 2014, and which are in line with the international consensus on the attributes of effective resolution regimes. Resolution authorities were faced with choosing which objectives to protect – financial stability and depositors over public budgets and level playing field, leading to a sub-optimal performance of the framework and risks to its credibility. Therefore, the CMDI framework needs to be amended to avoid such trade-offs in the future and

facilitate the simultaneous achievement of the objectives of protecting financial stability, depositors as well as taxpayer money and level playing field for all banks.

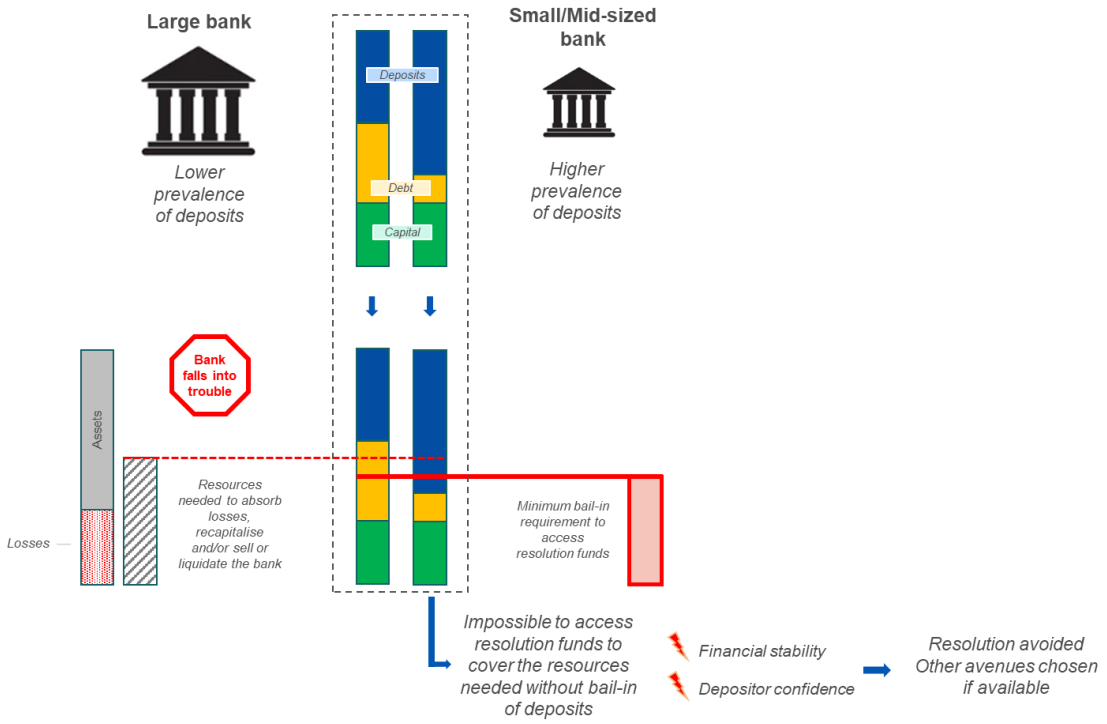
Box 1: Why resolution has not been applied in some cases

This stylised example shows how the business model of a bank can impact its ability to meet the minimum conditions to access the resolution fund, in cases where external funding is needed to support the execution of the resolution strategy.

The higher prevalence of deposits in the balance sheet of small/medium-sized banks amplifies the risk that the depositors would have to be bailed-in to fulfil the minimum access conditions (in the form of a bail-in of at least 8% of the bank's total liabilities and own funds).

The possible impacts on financial stability and depositor confidence may incentivise the search by the supervisory and resolution authorities for other avenues than resolution. Importantly, the counterfactual of resolution would be the piecemeal liquidation and payout of the covered deposits, which can be very costly for a DGS, while at the same time not fully averting impacts on depositor confidence and the real economy because all other uncovered deposits would be exposed to losses, until a possible (partial) recovery under the prevailing insolvency proceeding.

Figure 2: Stylised example – bail-in of depositors



Source: Commission services

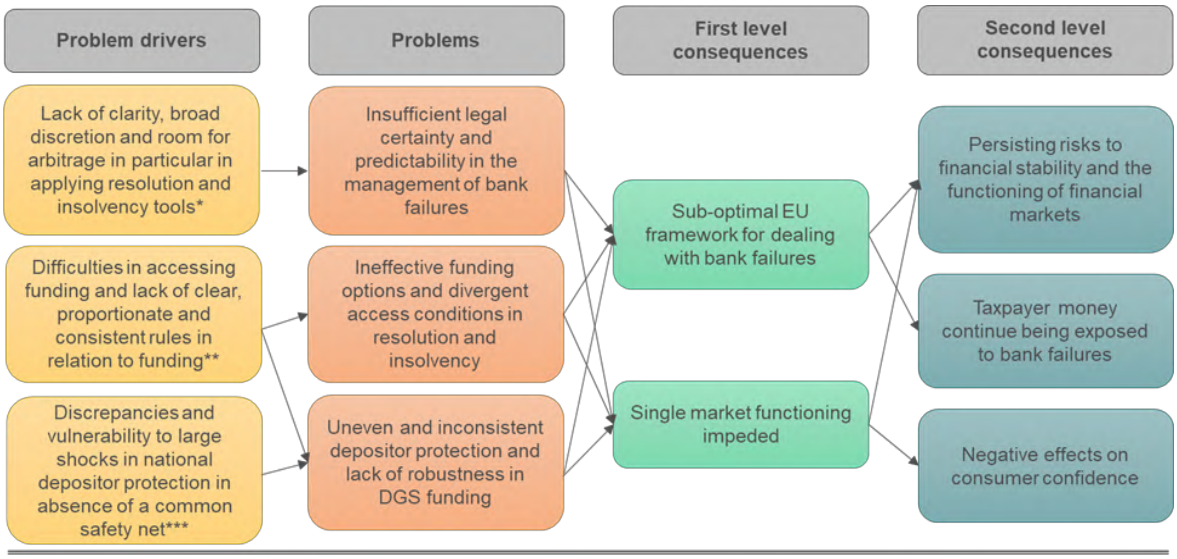
The evaluation shows that the misalignment of incentives when deciding which tools to apply to a failing bank can be explained by several drivers ranging from the flexibility and room for arbitrage that exist when choosing the right tools, the divergences in conditions to access financing by the safety nets (DGS, RF/SRF) or benefit from public support and the resulting vulnerabilities of the depositor protection in the EU.

These drivers directly affect the predictability of the framework, creating inefficiencies in the management of bank failures. On this basis, the framework does not appear adequate to handle the failure of certain institutions in respect of all the objectives, be it on an idiosyncratic basis or under a systemic scenario with multiple bank failures, where these problems would be exacerbated.

The problem tree

Figure 3 displays the problem tree, covering the three main high-level problems identified as well as the problem drivers and their related consequences.

Figure 3: The problem tree[19]



*Notes: * PD 1.1. Lack of clarity and framing of the BRRD precautionary measures and the DGSD preventive measures*
PD 1.2. Discretionary application of the PIA
PD 1.3. Divergence in the hierarchy of claims in national insolvency laws

*** PD 2.1. Structural difficulty in fulfilling the minimum conditions to access the RF/SRF for certain banks*
PD 2.2. Divergent access requirements for the resolution fund and for funding outside resolution
PD 2.3. Limited scope to grant DGS funding in resolution and insolvency

**** PD 3.1. Discrepancies in national depositor protection across Member States*
PD 3.2. Insufficient means of national DGSs

Source: Commission services

The *first problem* groups together all issues related to the current lack of legal certainty and predictability in the application of the framework. Most importantly, the decision of public authorities whether to resort to resolution or insolvency tools for failing banks may differ considerably depending on the solutions available for a specific failing bank in the national framework. The *second problem* focuses on unresolved funding issues (sources, access conditions) and is central to the application of the framework[20]. The

[19] The focus here is on the main problem drivers, but other relevant causes for the scarce application of the CMDI framework are detailed in Annex 8 (e.g. inadequate early intervention framework and timeliness of determining the bank as failing or likely to fail and diverging triggers for national insolvency proceedings).
[20] The problems are presented following the lifecycle of events taking place in a bank in distress but such a sequence is not indicative of the relative importance of each problem in relation to the others.

third problem highlights the need to improve depositor protection, including the potential lack of sufficient resources in case several banks in a Member State were to fail.

The persistence of these problems suggests that the CMDI framework in its current form is unable to ensure adequate and proportionate solutions for all bank failure regardless of the size and business model, while preserving overall consistency of outcomes and a level playing-field, aligning incentives and limiting risks to financial stability, moral hazard, and exposure of taxpayer funds. Also, the problems related to depositor protection and handling of the failure outside the harmonised framework impair the functioning of the single market and affect depositor confidence, which could lead to bank runs and undermine financial stability.

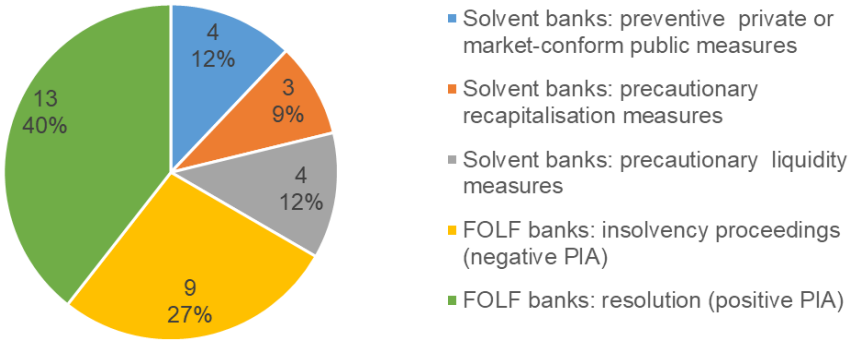
2.1. Problem 1: Insufficient legal certainty and predictability in the management of bank failures

The resolution framework introduced strategies, powers and tools to restructure failing banks while protecting depositors, financial stability and taxpayers. However, so far resolution has only been scarcely applied, in particular in the Banking Union under the SRMR. Instead, other tools have been more frequently used such as insolvency proceedings involving DGS funds, precautionary recapitalisation or measures to prevent the failure and the exit of the bank from the market altogether. These measures often involved the use of taxpayer money (bail-outs), instead of the bank's internal resources (bail-in) to the extent required by the resolution framework[21] and industry-funded safety nets, such as the Single Resolution Fund (SRF) in the Banking Union (EUR 80 bn by 2024), so far unused. Since 2015, more than 60% of banks in distress in the EU were managed outside of the resolution framework. For banks within the Banking Union, this number increases to more than 70%. When considering only cases from 2016 onwards, when the SRMR and the bail-in tool started to apply, the proportion of tools other than resolution rises to 75% of the cases for the EU and to 84% for the Banking Union. **Error! Reference source not found.** depicts the tools applied in past cases of banks in distress in the EU from 2015 to date. For a complete list of cases, please see Annex 9. It is worth noting that a number of these cases dealt with "legacy issues" which occurred since the start of the financial crisis in 2008 or before[22].

[21] Burden sharing by shareholders and subordinate debt holders was implemented under State aid rules, but not corresponding to the 8% TLOF required by the BRRD/SRMR.

[22] While legacy issues may have played a role in past cases and can be expected to have a lesser impact going forward, this does not impair the validity of the considerations made in this chapter, nor puts into question the need to reform the framework to ensure efficacy in managing potential future crises.

Figure 4: Variety of tools applied in bank crises cases from 2015 to date in the EU (as a percentage of all cases and absolute number)



Notes: Banks that received different support measures throughout the time are counted for every tool applied. Out of the 13 FOLF banks that went into resolution (positive public interest assessment), seven were Banking Union cases (out of which four occurred before the entry into force of the minimum 8% TLOF bail-in requirement and before the SRB became responsible for the handling of these cases). In ten out of those 13 cases national resolution funds were used. Beyond these 13 cases, most other cases of support measures encountered (18 out of 20 cases) were Banking Union cases.

Source: European Commission

Although certain aspects of the framework are still in a transitional period[23] and despite the variety of tools to manage failing banks or to intervene before failure, its scarce application can be linked to the conditions to activate such measures that vary substantially across Member States, are subject to discretion and sometimes lack clarity or leave room for arbitrage, increasing legal uncertainty, uneven protection of depositors, ineffective and inefficient use of funds available.

In particular, a number of problem drivers emerge: (i) lack of clarity and adequate framing of the application of DGSD preventive measures and BRRD precautionary measures, (ii) broad legal discretion in the application of the public interest assessment to place a bank in resolution (under the EU framework) *versus* insolvency (under national rules) and (iii) divergence in the hierarchy of claims in national insolvency laws[24].

The variety of tools allowed are preserving a margin of manoeuvre to account for legacy situations[25]. This ensures that the framework remains flexible and proportionate to address various types of bank failures. At the same time, the divergences mentioned above create a risk of inconsistent solutions across Member States and reduce the predictability of the framework. Moreover, the possibility to use public budgets (i.e. taxpayers' funds) outside resolution, which in principle should be avoided or strictly limited to avoid risks of moral hazard, begs the question whether the framework could better achieve its objectives. This would promote a more consistent approach to the

[23] For example, the build-up of resolution buffers is expected to be completed on 1 January 2024 according to the revised BRRD/SRMR.

[24] Throughout this document, the terms 'hierarchy of claims', 'creditor hierarchy in insolvency' and 'ranking of liabilities' are used as synonyms and describe the same concept (see glossary).

[25] In particular, certain banks had accumulated over the years a significant amount of non-performing loans, largely as a legacy of the financial crisis.

management of bank failures, including in terms of increased level playing field at EU level.

2.1.1. Lack of clarity and framing of the BRRD precautionary measures and the DGSD preventive measures

The current set of DGSD rules provides for measures to support a bank before it faces serious deterioration in its financial situation and the triggering of resolution or insolvency, the so-called preventive measures.

Currently, Article 11(3) DGSD enables the use of DGS funds for preventive measures as a national option and discretion (OND). Not all Member States have transposed it into national law[26].

These measures to prevent the failure of a bank are subject to conditions ensuring their sufficient soundness from a financial perspective, and that the DGS resources are not used excessively. The safeguards[27] should also ensure the correct interaction with the FOLF determination. However, the current legislative text provides insufficient clarity on such conditions and safeguards[28]. In past interventions, DGSs granted support to banks which were rather close to a situation of failure implying an inefficient use of DGS funds or a circumvention of resolution/liquidation. While the current rules do not prevent this, there is scope to reflect on possible improvements in the legislative framework to reinforce the role of these measures as preventive actions, which should, in principle, intervene when a bank's financial conditions deteriorate but still far from a failure.

Moreover, the DGS intervention could be qualified as either private or public for the purpose of State aid control by the Commission. Such an assessment is made on a case-by-case basis, taking into consideration elements such as the governance and decision-making procedure of the DGS and circumstances relating to the measure. The determination whether a DGS intervention constitutes State aid or not, has an impact on the legal treatment of the DGS intervention, under the BRRD. In particular, the qualification of the intervention as State aid would *de facto* impede the intervention of the DGS in a preventive capacity, as this would trigger a determination of FOLF under the BRRD, i.e. the bank would have to be resolved or put into insolvency. Evidence shows that some preventive measures were assessed as being private (i.e. EUR 5.35 bn funded by the private arm of a DGS fund or through market conform measures) and therefore neither qualified as State aid (see section 3.2.13 of Annex 6 and Annex 9) nor triggered FOLF under BRRD.

The BRRD further provides for a set of precautionary measures[29] (in the form of recapitalisation or guarantees/liquidity) which can be granted to solvent banks to address hypothetical financial issues identified in a stress test or equivalent exercise. BRRD provides for strict conditions and safeguards to grant support in this form, to ensure that

[26] See Annex 5 (evaluation), section 7.1.3.3, nine Member States transposed these provisions.
[27] These include the requirement that the cost of the measure does not exceed that of fulfilling the mandate of the DGS as well as a requirement that the DGS has appropriate procedures in place for selecting and implementing the measures and to monitor affiliated risks.
[28] See Annex 5 (evaluation), section 7.1.3.3.
[29] Which are also mirrored in the SRMR.

the support does not benefit a bank that is too close to failure and to avoid (for precautionary recapitalisation) that the support is used to cover losses that were already incurred by the bank or are likely to be incurred.

Past practice in the application of these measures has provided the opportunity for the Commission to identify issues which may require an interpretative effort and hence would require legal clarification, particularly with respect to the concept of solvency, the determination of the amount of support allowed (by virtue of distinguishing between incurred, likely and unlikely losses) as well as to the additional clarity needed as to the use of precautionary recapitalisation to support impaired asset measures (see section 7.1.3.3 in Annex 5 (evaluation) and section 9 in Annex 8 for more information on the legal clarity issues identified for precautionary measures).

Improving the clarity of the legal provisions would help limit the risk that support for preventive and precautionary measures would allow existing creditors to exit their claims on the bank shortly before FOLF is triggered and resolution/insolvency is applied, which may in turn result in a higher use of financing sources (RF/SRF in resolution or DGS funds under insolvency proceedings).

2.1.2. Discretionary application of the public interest assessment

As highlighted in the evaluation (see Annex 5, section 7.1.3.4), the BRRD and SRMR leave a margin of discretion to resolution authorities when carrying out the public interest assessment (PIA). While a certain degree of flexibility when assessing the different factors relevant for the PIA is needed, the divergent applications and interpretations may not fully reflect the logic and intention of the legislation. In the Banking Union, the test was so far applied rather restrictively and resolution action was taken only on three occasions[30]. Resolution was used more frequently outside the Banking Union and in some Banking Union Member States when it took place under the direct governance of national resolution authorities (ten out of 13 cases)[31].

In essence, the PIA compares resolution and the normal insolvency proceedings available at national level against a set of objectives which include (i) the impact on financial stability (a wide-spread crisis may yield a different PIA than an idiosyncratic failure), (ii) the assessment of the impact on the bank's critical functions and (iii) limiting the use of extraordinary public financial support[32].

Regarding the notion of critical function, there are divergences in interpretation among resolution authorities on whether the impact of its interruption should be assessed for the

[30] Two of these cases concern the resolution of entities under the Sberbank Europe AG group which was carried out by the SRB. As further explained in Annex 9 due to the very special circumstances the group was faced with (experiencing significant deposit outflows due to the reputational impact of geopolitical tensions) there was a deviation from the resolution plan (which provided for the preservation of the group structure) and different solutions (resolution/liquidation) where applied to different banking entities of the group.

[31] Out of the ten cases: (i) six cases concern non-Banking Union Member States and (ii) four cases occurred, within Banking Union Member States, before the entry into force of the minimum 8% TLOF bail-in requirement and before the SRB became responsible for the handling of these cases.

[32] This notion includes any support granted to preserve or restore a bank's viability, solvency or liquidity and which is qualified as State aid. It also extends to support granted at supranational level which, if it was granted at national level, would be qualified as State aid (for example from the SRF).

economy of an entire Member State or at local/regional level. However, the BRRD and SRMR (particularly if read in conjunction with the relevant delegated act)[33] are not meant to exclude the impacts *within* a Member State (i.e. in a region/locally) or to restrict the assessment of the financial stability to (at least) an entire Member State.

Moreover, with the objective of an efficient use of external sources of funding in mind, the requirement to compare the use of funding in resolution and in insolvency could be clarified as this would help deliver a broader choice of resolution tools which are often more cost-effective compared to insolvency. In particular, when resolution provides a possibility to use DGS resources more effectively and efficiently than in insolvency (for example because it would be cheaper for the DGS to contribute to resolution than to insolvency, where the only possible use of a DGS would be to pay out covered depositors), this element should provide additional grounds for a positive PIA finding via the application of the framework. Furthermore, the objective to limit the cost for taxpayers could benefit from a further distinction between the use of public funds from the State budget and the use of the RF/SRF or the DGS, which are financed by all banks.

2.1.3. Divergence in the hierarchy of claims in national insolvency laws

The BRRD harmonised at EU level certain rules concerning the order according to which creditors must be repaid (hierarchy of claims) in national laws governing bank insolvency proceedings, especially regarding covered deposits, preferred non-covered deposits[34] and subordinated classes of instruments. However, certain divergences in the hierarchy of claims remain, in particular, when it comes to the ranking of ordinary unsecured claims, other deposits and exclusions from bail-in. This creates the potential for uneven treatment of creditors, including depositors, in resolution and in insolvency, across Member States. Such divergences have the potential to create an uneven playing field in the single market and complicate the no creditor worse off (NCWO) assessment, which ensures that creditors are not worse off in resolution than under insolvency proceedings, especially for cross-border groups including across Member States participating in the Banking Union[35].

More precisely, the NCWO principle imposes that the allocation of losses to shareholders and creditors under the resolution scenario should not exceed the losses that those shareholders and creditors would otherwise have incurred under a normal insolvency proceeding, which would be counterfactual. If it does, those shareholders/creditors should be compensated. Hence, when applying resolution tools, the outcome of the NCWO assessment together with the identification of the relevant counterfactual,

[33] Commission Delegated Regulation (EU) 2016/778 of 2 February 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to the circumstances and conditions under which the payment of extraordinary *ex post* contributions may be partially or entirely deferred, and on the criteria for the determination of the activities, services and operations with regard to critical functions, and for the determination of the business lines and associated services with regard to core business lines, OJ L 131, 20.5.2016, p. 41.

[34] The part of deposits from natural persons and micro, small and medium-sized enterprises (SMEs) that is eligible for DGS protection but that exceeds the DGSD coverage level (Article 108(1)(a)), as well as deposits that would be eligible deposits from natural persons and SMEs were they not made through branches located outside the Union of banks established within the Union.

[35] See Annex 8, section 2 for more details on the issue pertaining to the divergences in depositor ranking.

depending on the specific national insolvency regime, can lead to varying conclusions in terms of treatment of creditors across Member States, which is especially relevant as it could create difficulties and creditors' unequal treatment in cases of cross-border group resolution.

2.2. Problem 2: Ineffective funding options and divergent access to funding conditions in resolution and outside resolution

The evaluation of the framework identified a second problem, i.e. the divergent conditions for accessing funding in resolution and outside resolution. When funding from the safety nets (RF/SRF and DGS) is used to complement the bank's internal loss absorbing capacity, the requirements to access such funding are very different (i.e. the least cost test to access the DGS fund in and outside resolution as well as the minimum 8% bail-in rule to access the RF/SRF are very divergent and impact creditors, including deposits differently). More specifically, funding outside resolution is generally more easily accessible than in resolution, in particular for certain banks, as explained more in detail in section 2.**Error! Reference source not found.**[36]. Funding issues are driven by (i) structural difficulties in fulfilling the minimum conditions to access the RF/SRF by certain banks[37], (ii) divergent requirements to access funding from the resolution fund as compared to other sources of funding outside resolution, and (iii) the lack of clear, adequate and consistent rules in accessing DGS funding in resolution and insolvency. Based on available information, there are indications that this second problem led to the use of public money in crisis management[38].

2.2.1. Difficulty in fulfilling the conditions to access resolution funds for certain banks

To facilitate the execution of resolution strategies and the application of resolution tools[39], banks are required to hold sufficient loss-absorbing capacity composed of own funds and eligible liabilities (MREL). More specifically, they are required to hold a sufficient and proportionate amount of liabilities, which are easily bail-inable. The resolution authority determines the MREL requirement on a bank-by-bank basis depending on the chosen resolution strategy and envisaged resolution tools. For instance, in the case of open bank bail-in, the MREL requirement is calibrated to ensure that bank is able to bear the losses and, to get recapitalised and restructured so it can continue its

[36] See also the evaluation in Annex 5, in particular section 7.1.2.3.

[37] See Annex 7 on the data underlying the difficulties to reach the minimum target of bailing in 8% of the bank's total liabilities including own funds.

[38] See Annex 5 (evaluation), section 7.1.

[39] The CMDI framework created several resolution tools that define the resolution strategy, which resolution authorities may use as stand-alone or in combination when dealing with failing banks with a positive PIA: (i) open bank bail-in (activities are restructured and the bank is recapitalised via the bail-in of shareholders and creditors to continue its activity on the market) and transfer strategies including (ii) sale of business strategy (part or the entire business is sold to a/several buyer(s) and any remaining part could be liquidated or transferred to an asset management vehicle), (iii) bridge bank strategy (part of the activities are temporarily transferred into a different bridge entity until a buyer is found) and (iv) asset separation vehicle used in combination with another tool (problematic assets/liabilities are transferred into a vehicle that manages their work-out to generate proceeds). The MREL requirement needs to be proportionate to the chosen resolution strategy and tools, e.g. MREL requirements for open bank bail-in strategies may be higher than requirements for transfer strategies.

activity. Resolution authorities may provide complementary financing support, if needed, through the use of the RF/SRF, provided that certain conditions are met. Among these, key conditions to access the RF/SRF for solvency support are: imposing losses on shareholders and creditors for not less than 8% of total liabilities including own funds (TLOF) and a limitation on the contribution from the fund, which cannot exceed 5% TLOF[40] per bank. While not clearly mentioned in the legal text and remaining subject to legal interpretation, it is considered that accessing the RF/SRF for liquidity support does not require a minimum bail-in of 8% TLOF.

As developed in the evaluation in Annex 5, the need to access resolution funding may arise for any bank (whether executing an open bank bail-in or a transfer as resolution strategy) and the conditions to access the RF/SRF under the current framework do not sufficiently account for distinctions on grounds of proportionality based on the resolution strategy, size and/or business model. The ability of banks to fulfil the access conditions to the RF/SRF depends therefore only on the stock and the type of bail-inable instruments available in their balance sheets at the time of the intervention, while it should be based on a case-by-case assessment of the bank and the resolution strategy.

Overall, banks have considerably increased their MREL capacity and, by 2024, they will be expected to comply with the requirements set in BRRD II. The build-up of MREL is gradual and a necessary transition to address the legacy risks. However, evidence (see analyses in Annexes 7 and 13) suggests that, for some (smaller) banks in certain markets, the difficulty to build up MREL is of a structural rather than of a transitional nature[41]. Analyses underpinning this conclusion focused on: (i) the structure of banks' liabilities, in particular assessing the amount of liabilities that are bail-inable and whether deposits would need to be subject to bail-in in order for the bank to be able to reach the 8% TLOF and access the RF/SRF [42] (ii) the level of MREL shortfalls and (iii) market information on issuances by certain smaller/medium-sized banks[43]. For some banks, considering their specific liability structure, certain deposits[44] would need to be bailed-in in order to access the RF/SRF, which may raise concerns of financial stability and operational feasibility considering the economic and social impact in a number of Member States. This is particularly the case, for example, where banks are relying significantly on deposit funding and where bail-in may have a profound impact on certain portions of the real economy.

[40] Article 44(5) BRRD requires a minimum bail-in of 8% TLOF and provides for a maximum RF contribution of 5% TLOF (unless all unsecured, non-preferred liabilities, other than eligible deposits, have been written down or converted in full) when a resolution authority decides to exclude or partially exclude an eligible liability or class of eligible liabilities, and the losses that would have been borne by those liabilities have not been passed on fully to other creditors, or when the use of the RF indirectly results in part of the losses being passed on to the RF (Article 101(2) BRRD).

[41] Nevertheless, it needs to be kept in mind that the non-issuance of MREL instruments by such banks, which are presently earmarked to be placed in insolvency rather than resolution, may be an active/deliberate choice of the institution.

[42] This point (i) is developed in Annex 7.

[43] These points (ii) and (iii) are developed in Annex 13.

[44] Such as deposits not covered and not preferred, i.e. deposits of large corporates, governments, other financial institutions, other institutions.

According to the empirical evidence presented in Annex 7 (section 3.2.1), out of a sample of 187 banks that would go into resolution if they failed as of Q4 2019, deposits in 44 banks in 18 Member States would have to bear losses for an aggregate amount of EUR 14.16 bn under the baseline scenario (status quo) in order to reach 8% TLOF and be able to access the RF/SRF. As explained in section 8 of Annex 8, retail and SME deposits are predominant in smaller and medium-sized banks across the EU. Such considerations may explain the reluctance of some resolution authorities to impose losses on depositors, leading to sub-optimal crisis management choices outside resolution financed by public budgets.

2.2.2. Divergent access requirements for the resolution fund and for funding outside resolution

Precautionary measures, preventive measures and liquidation aid under national insolvency proceedings are different forms of public support available outside resolution. In past cases, these measures have been used quite extensively (see Annex 9).

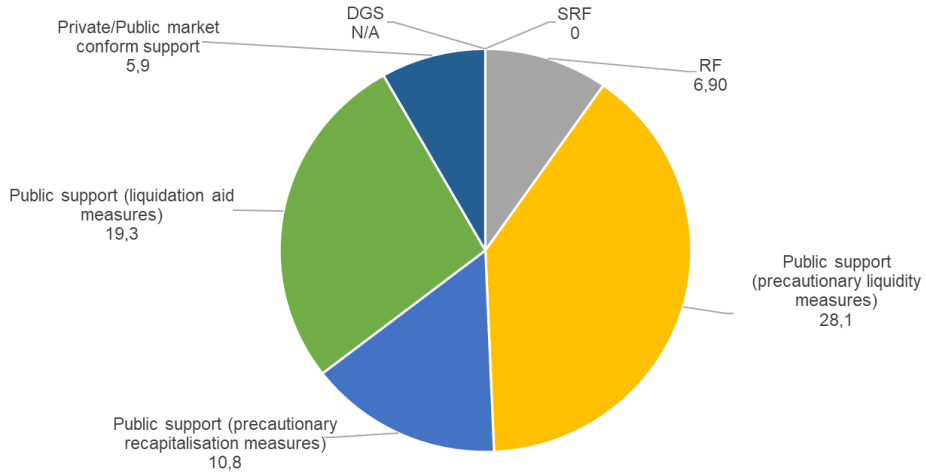
Following the entry into force of the resolution framework in 2015, available evidence shows that European banks benefitted from public support amounting to over EUR 58.2 bn mainly under insolvency proceedings and in the form of precautionary aid measures[45], in addition to the burden sharing required by the State aid rules (Figure 5).

All these measures are subject to burden sharing requirements[46] pursuant to State aid rules, requiring that, after losses are first absorbed by equity, contributions by hybrid capital holders and subordinated debt holders may be necessary. This requirement is generally less demanding for bank debt holders than the corresponding requirements under BRRD, which entails that losses are absorbed by shareholders and creditors, potentially including depositors (e.g. through bail-in) for a minimum of 8% TLOF before the resolution fund can be accessed.

[45] EUR 28.1 bn were provided as precautionary liquidity measures in the form of guarantees under the BRRD, and EUR 30.1 bn as capital/guarantee measures, of which EUR 10.8 bn as precautionary recapitalisation under the BRRD, EUR 17.5 bn as liquidation aid under national law in the form of cash injection and guarantees, and EUR 1.8 bn as public aid in resolution under the BRRD (the latter public aid measure concerns a case, which occurred before the entry into force of the minimum 8% TLOF bail-in requirement).

[46] With the exception of liquidity support measures, which are meant to be of temporary nature and have a less distortive effect, and as a result are subject to more lenient State aid requirements (including as regards the requirements for adequate burden sharing) compared to more permanent measures such as recapitalisation or impaired asset measures.

Figure 5: Sources of complementary external funding in crisis, cases between 2015 and 2022 (in EUR bn)



Notes: The contribution from the RFs amounting to EUR 6.9 bn, includes the amount of EUR 1.4 bn contributed jointly by the Polish RF and DGS in the case of resolution of Getin Noble bank SA (see Annex 9 for more details on this case). Information on the amounts contributed by RFs and DGSs in some of the bank cases are not publicly available.

Source: European Commission calculations

In the case of preventive and precautionary aid (such as precautionary recapitalisation or preventive measures), the framework provides for specific conditions to be met to ensure that these are granted to banks which are in financial difficulties but are still solvent and not failing. These conditions are well intended to ensure consistency with the overall logic of the resolution framework and to avoid that the burden sharing rules under State aid, in cases where they lead to a lower requirement create an opportunity to resort to these measures to "escape" the more demanding bail-in requirement under BRRD.

However, as mentioned in section 2.1.1, some banks were declared FOLF shortly after receiving precautionary support on grounds, *inter alia*, of being solvent as confirmed by the competent supervisor.

Liquidation aid in national insolvency proceedings can also be useful to provide financial support to banks to the extent necessary to ensure their orderly exit from the market. However, the issue observed is that the availability of such support under different and generally more advantageous conditions from the point of view of the bank's creditors[47] may create room for arbitrage and incentivise resolution authorities to look for solutions outside the resolution framework, particularly in light of the discretionary nature of the PIA[48]. This effect is exacerbated by the fact that, resolution authorities, when applying the PIA, rarely compare the need for external funding in resolution (through the resolution fund or DGS) and in insolvency (liquidation aid), leading to the choice of inefficient tools to manage the bank's failure.

[47] Paragraphs 40-42 of the 2013 Banking Communication set out the minimum burden-sharing requirement for equity, hybrid capital holders and subordinated debt holders in those cases.
[48] See also the Box 9 in Annex 5 (evaluation), section 7.1.2.3 point b, explaining the differences between the CMDI framework and the Banking Communication.

2.2.3. Limited scope to grant DGS funding in resolution and insolvency

Under the current framework, DGS funds can be used to finance some interventions both in resolution and in insolvency. Article 109 BRRD provides for the use of DGS funding in resolution, in addition to the resolution fund. The provision sets out several conditions for the DGS intervention. The DGS support in resolution is limited to an amount equal to the losses borne by covered deposits if they were exposed to bail-in or if they could bear losses under another resolution strategy. In addition, the DGS's liability is limited to the amount of losses that the DGS would have borne when paying out covered deposits under an insolvency counterfactual (least cost test). The combination of these rules, coupled with the limitations posed by the super-preference for the DGS in the ranking of liabilities in insolvency (which entail that in most cases DGS would not be exposed to losses in the counterfactual insolvency[49]) makes the use of DGS in resolution more costly, creating several issues in applying the framework concerning the use of DGS in resolution. The DGS can only provide an amount up to the losses it would bear in case of a hypothetical payout in insolvency. These losses are given by the difference between the amount disbursed by the DGS in case of a payout and the amount the DGS would recover from the sale of the bank's assets in insolvency. Given the very high ranking of the DGS in the hierarchy of claim (super-preference of DGS claims), the DGS has the possibility to recover part or all of its expenditure in the hypothetical insolvency, depending on circumstances (i.e. nature and features of insolvency regimes, quality of assets being liquidated). As a result, and as explained in the evaluation, this provision has never been used in practice[50].

The DGS may also finance a transfer of business in insolvency proceedings (Article 11(6) DGSD), to the extent that this is necessary to preserve access to covered deposits and if it complies with the least cost test and State aid rules. The conditions to grant DGS funding in resolution and insolvency are not entirely aligned, which makes the use of DGS funds subject to uncertainty. Also in this case, the DGS' super preference substantially limits the possibility for the DGS to provide funding.

Finally, the opportunity to use DGS funding in resolution or insolvency produces different consequences depending on whether the potential intervention is in a Banking Union or non-Banking Union context. For non-Banking Union Members States, both resolution and DGS funds are financed by the domestic industry, possibly facilitating a combined use of these funds. However, in the case of Banking Union Member States, the SRF is financed by all banks in the Banking Union while the financing of DGS fund is national, hence only by domestic banks, creating an "asymmetry" in the burden of the costs in case DGS would "substitute" the SRF. Moreover, a risk of shortfall in DGS funds (see problem 3 below) may occur and illustrates the potential benefits possible through pooling DGS funds at central level.

[49] See section 6.1.1.4 in Chapter 6 and sections 4.1.1 in Annex 7.

[50] It should however be mentioned that, in an effort to tackle some these limitations under the current text, the Commission services have supported a more extensive reading of the provision in Article 109 BRRD. See more details in the Annex 5, Section 7.1.2.3.

2.3. Problem 3: Uneven and inconsistent depositor protection and lack of robustness in DGS funding

The third problem identified in the evaluation relates to discrepancies in depositor protection across Member States both in terms of scope of protection and payout processes and in terms of vulnerability to shortfalls due to a lack of a robust and central/common safety net in the absence of EDIS[51]. The DGSD, recast in 2014, includes a high number of national options and discretions, which entitles depositors in certain Member States to different levels of protection. Beyond this inconsistent application[52] of the rules, depositor protection and confidence in the Banking Union could be undermined by the lack of an appropriate common safety net to national DGSs and equal treatment of all depositors. National DGSs still remain vulnerable to asymmetric shocks, which may put DGS funds at risk and create pro-cyclical effects for the banking sector as additional contributions may need to be raised in some Member States depending on the shock. By contrast, pooling national resources at a central level would deliver diversification effects and increase the robustness of depositor protection, possibly even lowering the burden on the industry in terms of replenishment needs.

The drivers behind this problem can be summarised as follows: (i) discrepancies in national depositor protection across Member States and (ii) insufficient means of national DGS to weather the impact of a large financial shock.

2.3.1. Discrepancies in national depositor protection across Member States

Gaps and fragmentation in the deposit protection and in the functioning of national deposit guarantee schemes persist due to the inconsistent application of the DGSD across Member States and various ONDs. This creates divergences in the robustness of DGS funds and uneven playing field in the protection that depositors enjoy in different Member States. The EBA published four opinions[53] highlighting the need for clarification in the DGSD[54] and reducing discrepancies in national depositor protection. The main discrepancies – also assessed in the evaluation and Annex 6 – are explained below.

In terms of scope of protection, the main problem relates to the divergence in coverage of temporary high balances (deposits above EUR 100 000) which are also protected under the DGSD. The coverage level varies among Member States and ranges from EUR 200 000 to an unlimited amount, creating uneven playing field. Other ONDs leading to discrepancies refer to the types of depositors, such as client funds of other

[51] This was for example indicated by some speakers at the High-level conference on the CMDI review in March 2021 as well as by some respondents of the consultations. See also Annex 5, Section 7.1.4 and Annex 6.

[52] See Annex 6 for further details on the inconsistent application of the DGSD and the recommendations developed by EBA in this regard.

[53] EBA opinions on DGS payout (30 October 2019), on the eligibility of deposits, coverage level and cooperation between DGS (8 August 2019), on funding and uses of DGS funds (23 January 2020) and the interplay between the AMLD and DGSD (11 December 2021).

[54] The EBA opinions were discussed with Member States in the EGBPI and many suggestions were supported (see Annex 6).

financial institutions or public authorities which are protected differently across Member States[55].

In addition, the robustness of the DGS funding varies across Member States due to differences in the national implementation of alternative funding arrangements, which could be relied on in case the DGS funds were depleted. The lack of additional resources in some Member States could impact the ability to pay out depositors (or conduct alternative interventions to support a bank) and endangers consumer confidence and financial stability.

Furthermore, when it comes to the use of preventive and alternative measures foreseen under Articles 11(3) and 11(6) DGSD, divergences in the least cost tests applied across types of intervention and Member States, hamper the predictability of the framework. They create inconsistencies around the requirements for the various possible uses of DGS funds (including in resolution), which are unclear and differently interpreted among Member States. As regards preventive measures, Article 11(3)(c) DGSD provides that costs of fulfilling the statutory or contractual mandate of the DGS should not be exceeded. Some Member States use the same least cost test for both preventive and alternative measures, while others did not develop a least cost test methodology for preventive measures (see Annex 6, section **Error! Reference source not found.**). This has the potential of creating an uneven playing field in depositor protection across the EU.

As also identified in the evaluation (see Annex 5, section 7.4), the interplay between the DGSD and other pieces of EU legislation raised coherence issues. As regards the interplay with the Anti-Money Laundering (AML) Directive, the EBA highlighted the need to clarify the roles and responsibilities of the DGS and other stakeholders during a payout and strengthen their cooperation and exchange of information to minimise the risk of payout to depositors suspected of money laundering. As regards the Payment services and E-money Directives, the DGS protection of client funds of non-bank financial institutions such as payment and e-money institutions or investment firms, varies across Member States and requires further clarification and harmonisation.

2.3.2. Insufficient means of national DGSs

Member States are steadily building up their DGS means to reach 0.8% of total covered deposits by 2024, as required under the DGSD. Despite this continuous build-up, DGSs remain vulnerable to asymmetric shocks. Such shocks may put a national scheme under stress, making it difficult to settle individual depositor claims within the statutory time or to intervene through other possible use of DGS funds. In such situations, a DGS may find it difficult to call upon pro-cyclical extraordinary *ex post* contributions from its members to make up for the shortfall. Alternative funding arrangements could include private or public sources, making eventually the sovereign the ultimate guarantor to national DGSs. Some national DGSs faced in the past considerable funding needs, representing a significant share of their available financial needs, resulting in continued reliance by

[55] For example, Member States may ensure that the deposits of small local authorities (Article 5(2) DGSD) or deposits held by personal pension schemes and occupational pension schemes of small or medium sized enterprises (Article 6(1) DGSD) are protected up to EUR 100 000.

national DGSs on the state as a backstop for depositor protection, which strengthens the bank-sovereign nexus (see Annex 5, section **Error! Reference source not found.**).

There is a high risk that DGS interventions could be impaired under a severe crisis[56]. The lack of consumer confidence in this context may also trigger deposits outflows, conducive to bank runs. Under a severe crisis in one bank or Member State, depositors could be incentivised to transfer their funds in another bank or even another country, potentially exacerbating financial difficulties of the initial bank or national banking sector[57].

The absence of a common deposit guarantee scheme (i.e. EDIS) at Banking Union level which would optimise the allocation of financial means, represents a significant drawback for DGS resilience and an all-encompassing depositor protection. Failing to unlock the unused benefits inherent in the pooling of funds at a central level and larger firepower for industry-funded safety nets represents a lost opportunity to significantly increase the efficiency of national DGS protection and lower the burden on the industry in terms of *ex ante* contributions or *ex post* replenishment requirements. The absence of EDIS also deprives depositors from a seamless guarantee of protection regardless of the bank and country where they are located, potentially weakening consumer confidence. As experienced in the 2008 financial crisis, a strong bank-sovereign nexus may create risks to financial stability through contagion and negative consequences for the single market. The costs of an incomplete Banking Union lacking EDIS are high, while the benefits for taxpayers and the industry are not materialising to their full potential.

2.4. How will the problems evolve?

As the problem analysis shows, there is a need to improve several aspects of the current framework to address the inconsistencies, improve clarity and predictability of outcomes, foster the use of industry-funded sources (RF/SRF and DGS), avoid using public funds for the orderly handling of bank failures, to ensure that the original objectives of the CMDI framework of preserving financial stability, minimising the use of public funds and strengthening depositor confidence are reached. The improvement of the framework is particularly relevant, at this juncture, for better preparing the European banks for the adverse conditions that may potentially arise in the medium term, such as the ones stemming from asset quality deterioration as a result of a weaker macroeconomic outlook.

Failing to address the above shortcomings, as also analysed in the evaluation, exposes the framework to the risk of unbalanced outcomes, without exploiting its full potential and the possibility to resolve any credit institution, when this would yield a better outcome than insolvency. If solutions based on the use of industry-funded safety nets are not made

[56] See Annex 10, section **Error! Reference source not found.**, presenting the findings from the Joint Research Center (JRC) analysis. There is a probability of 87% at aggregate level in the Banking Union that DGSs would not have available funds to fully reimburse all covered depositors in at least one bank in case of a crisis comparable to the one of 2008 (see also JRC's report (Annex 12, Tables 16 and 18)).

[57] Depositor outflows were experienced in the 2008 global financial crisis due to uncoordinated increases in coverage levels across the Union, leading the co-legislators to introduce a harmonised coverage level in the DGSD adopted in 2009 (see recital 19 DGSD). Outflows continued to be observed e.g. in the case of Cyprus following the financial crisis, see Annex 8.1.

more proportionate and accessible, these resources will remain idle, even though banks will continue to raise contributions and issue MREL eligible liabilities. At the same time, this may lead to prolonged recourse to public finances (which at this juncture face competing priorities), persisting bank-sovereign links and risks of moral hazard.

Ensuring the coherent and cost-effective application of the framework is even more important, given the continued absence of EDIS means risks to the robustness and resilience of depositor protection (including under large economic shocks) as well as to the funding toolkit of the framework. It deprives the European consumer of a mutualised safety net financed by industry contributions, which would also reduce the continued tension on public finances.

Ultimately, the Banking Union is not complete without reforming the crisis management and deposit insurance, its second pillar, and implementing EDIS, its third pillar. An incomplete Banking Union bears costs and risks, including risks in terms of financial stability, market fragmentation, under-performing banking sector, where failing banks are not always exiting the market, leading instead to regular calls for public support. The completion of the Banking Union together with the deepening of the Capital Markets Union are pivotal to ensure financial stability, foster market integration and support a genuine Economic and Monetary Union. The latter two are fundamental steps towards enhancing the EU's open strategic autonomy and the international role of the euro.

3. WHY SHOULD THE EU ACT?

3.1. Legal basis

The regulatory requirements for crisis management and deposit insurance are already set at EU level (both via Regulation and Directive). Consequently, the legal basis for the CMDI review is the same as the legal basis of the original legislative acts, namely Article 114 TFEU for the BRRD and SRMR, and Article 53(1) TFEU for the DGSD.

3.2. Subsidiarity: Necessity and added-value of EU action

The rationale for a specific and harmonised EU resolution regime for all banks in the EU was laid out at the inception of the framework in 2014[58] and its main features reflect international guidance and the key attributes for effective resolution regimes developed by the Financial Stability Board in the aftermath of the global financial crisis.

The principle of subsidiarity is embedded in the existing CMDI framework, as its objectives could only be achieved at Union level through EU action – the harmonised resolution and deposit insurance framework. This is underpinned by recital 131 of BRRD I, which stipulates that the effect of a failure of any institution in the whole Union justifies action at EU level: *"Since the objective of this Directive, namely the harmonisation of the rules and processes for the resolution of institutions, cannot be sufficiently achieved by the Member States, but can rather, by reason of the effects of a failure of any institution in the whole Union, be better achieved at Union level, the Union may adopt measures, in accordance with the principle of subsidiarity as set out in Article*

[58] See Chapter 1, Annex 4 and Annex 5 (evaluation).

5 of the Treaty on European Union. In accordance with the principle of proportionality, as set out in that Article, this Directive does not go beyond what is necessary in order to achieve that objective."

The intention of the existing CMDI framework has always been to provide a common toolbox to deal effectively with any bank failure, irrespective of its size, business model or location, in an orderly way, preserving financial stability of the EU, the Member State or the region in which it operates, and protecting depositors without relying on public funds. In this context, recital 29 of BRRD I outlined that '*due to the potentially systemic nature of all institutions, it is crucial, in order to maintain financial stability, that authorities have the possibility to resolve any institution*'.

The review aims to amend certain provisions of the BRRD, SRMR and DGSD and for technical completeness, also considers one policy option including EDIS (see Chapters 5 and 6). The problems identified in Chapter 2, unveiled that the European CMDI framework should be improved, in particular when it comes to its application to small and medium-sized banks, as otherwise it may not reach its objectives (see Chapter 4).

The following considerations justify the need for EU action with regard to the CMDI reform and highlight that the review fully complies with the principle of subsidiarity.

First, the merits of having in place a resolution framework that could potentially be applied to any bank, irrespective of its size, remain unchanged. Placing small and mid-sized banks under national insolvency proceedings (also applicable to non-financial corporates) may not always be appropriate for managing their failure, as explained in Chapter 2. Moreover, a system where the EU harmonised resolution framework would only cover larger banks with cross border activities, while national regimes would cover domestic, small/mid-sized banks would not be conducive to a level playing field in the single market as it would risk creating a two-tier system for banks in the EU, making small and domestic banks that are too big to liquidate more risky/unattractive for consumers and businesses relative to larger ones, because their failure would be managed under national insolvency laws, which do not guarantee the continuation of critical functions, the protection of client relationship and of the bank's franchise asset value and may inflict losses on uncovered deposits.

Second, the non-application of the harmonised resolution framework in one Member State may have cross border repercussions. In the EU single market, and in particular in the Banking Union, it is key to enhance preparedness for crisis time and to equip resolution authorities with a common toolbox and harmonised set of powers to preserve the level playing field and competitiveness among industry players, depositors and taxpayers across the single market. The value-added of EU action also consists in enhancing preparedness for crisis – thanks to the requirement for banks to set-up internal loss absorbing buffers, remove impediments to resolution and the set-up of industry-funded safety nets complementing these internal bank buffers – to avoid recourse to public funds for all banks and not only cross-border ones. The possibility to access the EU harmonised CMDI framework acts as a safeguard at the level of each Member State, but also for the EU as whole, to ensure that the management of a bank's failure does not put at risk financial stability, the integrity of the single market, the resilience of the European Monetary Union. Risks to financial stability, depositor confidence or the use of

public finances in one Member State may have far-reaching impacts on a cross border basis and may ultimately contribute to a fragmentation of the single market and an intensification of the sovereign-bank nexus.

Third, acting at EU level to reform the CMDI framework will not prescribe the strategy that should be taken when banks fail. The determination of choosing an EU harmonised resolution strategy/tool or the national liquidation strategy is at the discretion of the resolution authority on the basis of the public interest assessment, which is tailored to each specific failure case and not automatically driven by considerations such as the bank size, the geographical outreach of its activities and structure of the banking sector. This makes, *de facto*, the public interest assessment the subsidiarity test in the EU. Overall, other considerations beyond size, such as functions that are critical for the broader economy (deposit taking, lending, payments) and their substitutability, interconnectedness to other actors in the financial system, risk profile and nature of activity are important for resolution authorities when assessing the impact of a bank's failure on financial stability and the public interest to resolve the bank.

Fourth, the decision-making process regarding the choice between EU harmonised measures *versus* national specific measures to tackle a failing bank remains at the discretion of the authority in charge and aims to address a variety of cases depending on the circumstances. Outside the Banking Union, decisions on whether to apply the resolution framework or national procedures are taken at a national level (by the national resolution authority). Within the Banking Union, decisions are made via the Single Resolution Mechanism – a dual mechanism where the SRB (Banking Union level authority) works closely and cooperates with national resolution authorities in joint resolution teams. Decisions are centralised at Banking Union level for the largest banks (120 banks under the direct SRB remit) and left at national level for the less significant ones (about 2200 less significant institutions (SRB, *Annual Report 2021*)), therefore fully preserving the capacity of these national authorities to put a bank in liquidation if the objectives would not be best met using resolution. Thus, while a case-by-case basis needs to be used for assessing whether a bank undergoes resolution or not, it is critical that the possibility for all banks to undergo resolution is preserved, due to the, potentially, systemic nature of all institutions, as already foreseen in BRRD I and also evidenced in Annex 4, Box 6.

Fifth, Member States may still consider liquidation for the smaller banks under the reformed CMDI framework. In this respect, national insolvency regimes (unharmonised) remain in place when an insolvency procedure is deemed superior to resolution. For some small banks, liquidation is likely to apply. The continuum of tools is preserved in this way, including tools outside resolution: preventive and precautionary measures, resolution tools, alternative measures to payout in insolvency and payout of depositors in case of piecemeal liquidation in insolvency. Among those tools, only the resolution tools and payout of depositors in liquidation are available to all banks in all countries.

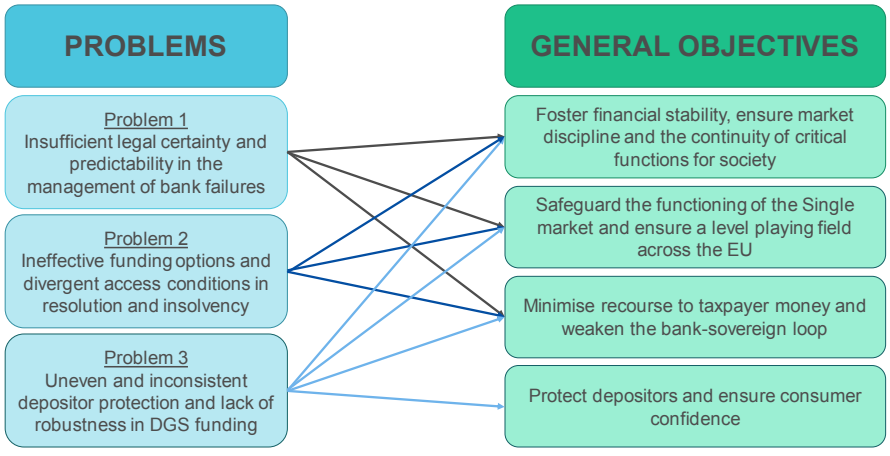
The reforms envisaged with regard to the DGSD, which provide for improvements to depositor protection, also comply with the subsidiarity principle. This is due to the fact that the harmonisation of insurance coverage, scope, eligibility of depositors and payout delays can be better achieved at EU rather than at national level, to ensure a level playing

field and fair and equal treatment of depositors across the EU. This was also underlined by the EBA in its opinions on the DGSD.

Importantly, Member States[59] and the European Parliament agree that the CMDI framework needs to be fixed in a way that EU action via the harmonised resolution framework can be used for any bank where needed. Despite the widely shared intention of protecting taxpayer money embedded in the CMDI framework since 2014, some Member States have continued to make recourse to taxpayer money when handling failing banks, since the establishment of the framework, as evidenced in Chapter 2 and Annex 5. This is not because they find it politically or economically acceptable to do so, but because they had to choose between protecting financial stability and depositors on one hand and protecting taxpayer money on the other hand. Appropriate level of MREL must remain the first line of defence for all banks that are put in resolution. At the same time, certain small and mid-sized banks find it challenging to access resolution funding, which some banks can only attain if deposits bear losses. However, inflicting losses on deposits would pose a significant risk to financial stability, as depositors would lose confidence in the banking sector and likely provoke bank runs and spiralling contagion, which can reverberate also into the real economy, as seen during the global financial crisis. More concretely, the failure of a small/mid-sized banks active in a local region and community may cause losses to its clients regarding their claims exceeding the coverage level of EUR 100 000 when placed under national insolvency proceedings (households, SMEs, corporates, local and regional public institutions such as schools, hospitals, other financial institutions).

Figure 6 shows the repercussions the identified problems have on the general objectives.

Figure 6: Implications of the identified problems on the general objectives



Source: Commission services

The objectives pursued by the existing legislative acts can be better achieved at EU level rather than by different national initiatives:

- Foster financial stability, ensure market discipline and the continuity of critical functions for society: Due to the strong interlinkages between national financial sectors and the risk of spill-overs, the objective of financial stability in bank crisis

[59] Eurogroup (June 2022), *Eurogroup Statement on the future of the Banking Union*.

management and deposit insurance can be better achieved by EU action compared to individual national actions.

- Safeguard the functioning of the single market and ensure a level playing field across the EU: Given the freedom of banks to establish and provide services in other Member States, EU action is preferable to prevent distortions to the single market and ensure a level playing field, which is a pre-condition for a symmetric impact of the ECB's single monetary policy. Action at EU level can for instance ensure that credit institutions operating in more than one Member State are subject to the same requirements concerning DGSs, which avoids unwarranted compliance costs for cross-border activities. EU action also fosters convergence of supervisory and resolution practices across the EU. An intervention at EU level also promotes further market integration by ensuring that cross-border bank failures can be resolved in a predictable, effective and equitable manner. At the same time, also smaller banks that primarily operate on domestic markets should – in the spirit of the single market – be treated in a similar manner, regardless their location, while respecting proportionality.

- Minimise recourse to taxpayer money and weaken the bank-sovereign loop: For banking groups that are active in a cross-border context, national solutions, without coordination among Member States, would be costlier for citizens and taxpayers than if the failure of banking groups was governed by comprehensive and harmonised rules and arrangements and in the case of Banking Union banks, managed centrally at EU level. On another scale, banks active on a more local/regional level are often interlinked with the local economic fabric and may constitute a risk for the local real economy, including households and SMEs that hold deposits in such banks. In addition to banks' loss absorbing capacity, national safety nets (resolution funds and DGS) financed by the industry could be used in a complementary way to better achieve the framework's objectives. If losses were not covered by prudential capital buffers of individual institutions and safety net funding, this may lead to recourse to public funds (sometimes at sub-regional level) aiming to safeguard financial stability and protect depositors. Also, for smaller banks operating primarily on domestic markets, national procedures available and the reliance on the sovereign should not create an unlevel playing field among and also within Member States. The lack of action at EU level for less significant banks and their perceived exclusion from a mutualised safety net would also potentially affect their ability to access markets and attract depositors when compared to significant banks. Consequently, national solutions to tackle bank failures would worsen the sovereign-bank link and undermine the idea behind the Banking Union of introducing a paradigm shift from bail-out to bail-in.

- Protect depositors and ensure consumer confidence: By harmonising the financing by DGSs, depositor confidence is maintained and cross-border distortions of competition are avoided (the same holds for possible competition distortions within Member States). Otherwise, during a crisis time, bank customers might shift their funds from banks with less depositor protection to other ones with more protection (within the same Member States or in another

one). This may potentially lead to fund outflows with potential adverse financial stability and real economy consequences. Moreover, the harmonisation of coverage, scope, eligibility of depositors and payout delays pursued in the DGSD review cannot be sufficiently achieved if Member States were to act independently from each other and can be consequently better achieved at EU level.

4. OBJECTIVES: WHAT IS TO BE ACHIEVED?

4.1. General objectives

The review of the CMDI framework will aim to achieve an adequate balance among the following general objectives:

(1) Contribute to financial stability, ensure market discipline and the continuity of critical functions for society;
(2) Safeguard the functioning of the single market and ensure a level playing field across the EU;
(3) Minimise recourse to taxpayer money and weaken the bank-sovereign loop;
(4) Protect depositors and ensure consumer confidence (see **Error! Reference source not found.**2, Annex 5).

4.2. Specific objectives

The impact assessment will consider the following specific objectives:

(1) Further enhance legal certainty and predictability and strengthen a level playing field as regards the coherent application of the tools available in bank resolution and insolvency;
(2) Facilitate access to safety nets in case of bank failure and improve the clarity and consistency of funding rules;
(3) Further align the national approaches to depositor protection, including in terms of coverage, and upgrade the capacity of national DGSs' to withstand local shocks.

5. WHAT ARE THE AVAILABLE POLICY OPTIONS?

5.1. Approach to design of policy options

The CMDI and the State aid frameworks for banks are strongly inter-related. Jointly reformed, they would create a system of European rules and incentives, where the availability of tools and funding sources (subject to conditions for access), combined with discretionary assessments by resolution authorities, determine the choice of crisis

management strategies and procedures to deal with failing banks[60]. The creation of a common safety net for the protection of deposits, for example via EDIS[61] would support national DGS funds in need, enhance the funding sources available to handle failing banks (beyond the internal loss absorption capacity and the RF/SRF) and achieve synergies in the framework. However, EDIS is not part of the preferred option for reforming the CMDI framework due to lack of political feasibility, in the absence of an endorsement by Member States and the European Parliament.

Given the critical interplay among key policy aspects (e.g. the availability of funding, the scope of resolution through the PIA, outcome of the least cost test), the approach to formulating policy options needs to be a holistic one. It bundles together relevant design features of the framework to deliver consistency in the resulting packages of options. The aim is to provide a coherent and logical articulation for each encompassing package of policy options. However, each package delivers different degrees of effectiveness and efficiency in achieving the key objectives, as envisaged and assessed in Chapter 6. Interchanging elements across option packages could create inconsistencies and reduce the intended improved effectiveness, efficiency and coherence of the framework.

Such approach is also indispensable to remedy the inconsistencies (as well as the incentives for using the framework and avoid fragmentation in the single market) which, as described above, have often occurred because the individual legislative texts (comprising the EU bank crisis management and deposit insurance framework) were originally proposed and negotiated on a standalone basis and not assessed jointly[62].

5.2. Review of the 2013 Banking Communication on State aid rules

The Commission has direct enforcement powers in relation to State aid rules which derive from the Treaty (Article 107 TFEU). In the context of the global financial crisis, the Commission clarified its assessment of compatibility of State aid measures, in several Communications, including, among others, the 2013 Banking Communication. The State aid framework for banks is closely interlinked with, and complementary to, the CMDI framework. In particular, it governs the burden sharing requirements, a condition to use public funds qualified as State aid for resolution[63], preventive and precautionary measures or alternative measures in insolvency. The two frameworks are applied consistently by the Commission. For example, the Commission checks if a public or private support qualified as a State aid measure violates intrinsically linked provisions of the CMDI framework and cannot authorise it, if it does so. Despite their natural interlinkages, the two frameworks are meant to tackle different issues: State aid rules' main purpose is to limit competition distortions from such support to banks, while the CMDI framework's primary objective is to limit risks to financial stability from the

[60] See Annex 5 (Evaluation) and Chapter 2 for details on how the triggers, funding availability and funding conditions form a system of rules and incentives defining the possible outcomes when dealing with banks in crisis conditions.
[61] See glossary and Annex 10.
[62] Nevertheless, the review of the State aid rules is not covered as part of the CMDI review, see section 5.2.
[63] If the public funds do not qualify as State aid within the meaning of Article 107(1) TFEU then burden sharing is not applicable.

disorderly management of bank failures while avoiding or minimising the use of public funds.

In November 2020, the Eurogroup invited the Commission to carry out and finalise its review of the State aid rules for banks, in parallel to the review of the CMDI framework, ensuring their entry into force at the same time as the revised CMDI framework. Such timeline aims at ensuring consistency between the two frameworks, adequate burden sharing of shareholders and creditors to protect taxpayers and depositors and preserve financial stability[64]. In June 2022, the Eurogroup took note of the intention of the European Commission to finalise the review of the State aid framework for banks, to ensure consistency between the State aid framework and the renewed CMDI framework.

Having the objective of coherence in mind, it is important to underline that the CMDI framework is subject to co-legislation, which will require time before implementation, and its outcome as compared to the Commission proposal is uncertain, while an update of the State aid rules requires a Commission Communication, which, when decided by the Commission, could take effect immediately.

Notwithstanding the interactions between the various components of the current legislative framework, the reform of the State aid rules is not part of the present impact assessment nor of the subsequent legislative proposal. A separate process to assess the need for a review of the State aid rules is ongoing, in parallel to the review of the CMDI framework, also in light of different procedures to amend the relevant acts[65].

Provided coherence is maintained within the packages of policy options, all the options envisaged for CMDI would bring an improvement compared to the baseline (status quo), irrespective of the changes to the State aid rules (or status quo) which may take place. An enhanced alignment between the frameworks would usefully complement the changes proposed to the CMDI rules.

5.3. What is the baseline from which options are assessed?

Under the baseline option, the existing CMDI framework as well as national regimes for handling failing banks would continue to apply without any legislative changes and would function without a common deposit guarantee scheme in the Banking Union in the absence of an agreement on a Banking Union work plan including EDIS by the Eurogroup in June 2022 and of progress on the EDIS file in the European Parliament [66].

Despite ongoing developments in the interpretation and methodological approach to the PIA[67], broad discretion in its application would continue to be exercised by resolution

[64] Eurogroup (November 2020), *Statement of the Eurogroup in inclusive format on the ESM reform and the early introduction of the backstop to the Single Resolution Fund*. The intention of the Eurogroup is to ensure that the outcome of the State aid rules review is aligned with the outcome of the negotiations of the CMDI review by co-legislators.

[65] In March 2022, the Commission has launched a *Call for Evidence* together with a *public* and *targeted* consultation to seek stakeholder feedback on the evaluation of State aid rules for banks in difficulty. The input collected and a study will feed into the evaluation that the Commission aims to publish. .

[66] The 2015 Commission proposal on fully-fledged EDIS is still on the table, but in practice, not discussed by the co-legislators.

[67] SRB (May 2021), the SRB revised its approach to PIA, *System-wide events in the public interest assessment*.

authorities, with the risk of maintaining the divergence across the EU on the scope of banks placed in resolution or insolvency. This means that similar bank failures would continue to be managed under divergent frameworks. Some may continue to be handled under the harmonised resolution framework, while others would be bailed-out with taxpayer money, thus continuing to create issues for the EU's single market in banking and the equal treatment of banks' shareholders, creditors and customers.

In terms of funding, the framework would continue to rely on two existing safety nets under divergent access conditions: the RF/SRF in resolution and the national DGS funds covering different types of interventions (preventive measures, resolution, payout of covered deposits and alternative measures in insolvency). The condition to access the RF/SRF[68] for liquidity support would remain subject to interpretation. Access to the RF/SRF for certain smaller and medium-sized banks for solvency support would remain challenging in view of the minimum bail-in access condition of 8% TLOF (despite their contribution to the RF/SRF). Tapping the DGS for contribution to various interventions would continue to be difficult and unclear from a legal point of view, due to divergent access conditions across Member States, in particular the least cost test (as shown in Chapter 2 and the evaluation). Persisting differences in the hierarchy of claims would continue to make the level of depositor protection vary per Member State, creating difficulties for resolution authorities when assessing the risks for creditors being worse off in resolution than in insolvency[69], while the super-preference of the DGS would make it almost impossible for DGS funds to be used in resolution or insolvency under the least cost test (see in Annex 7).

In addition, the current room for regulatory arbitrage would remain unchanged, leaving the possibility to apply restructuring measures under national insolvency laws financed through DGS alternative measures or through taxpayer money because of the more favourable conditions for banks' creditors than under resolution, rather than merits in terms of effectiveness and efficiency.

At the current juncture, in the context of the challenging macroeconomic outlook fuelled by the energy crisis and the geopolitical situation, the need to improve the CMDI framework is pressing if the likelihood of failures were to increase in case distress in our banking sector started to materialise. Under the status quo, even those failing banks for which resolution would be in the public interest, would continue to be restructured or liquidated outside the harmonised resolution framework, under existing heterogeneous national regimes, where in some cases only disorderly and costly insolvency proceedings or solutions involving taxpayer money exist. This would weaken consumer confidence in the EU banking sector and the predictability and level playing field of our single market for banking, and of the Banking Union in particular.

More concretely, first, the handling of banks' failure would remain inefficient from a cost perspective, as taxpayer money would continue to be used despite the build-up of considerable MREL buffers and very significant safety nets (e.g. the SRF is forecasted to exceed EUR 80 bn by the end of 2023 in the Banking Union and the aggregate amount of

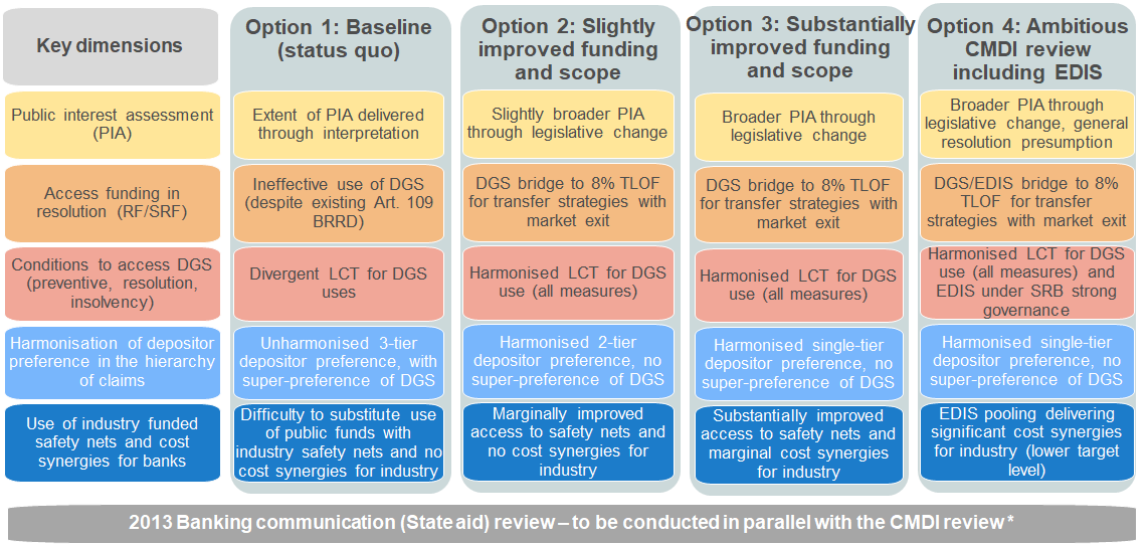
[68] Minimum bail-in rule of 8% TLOF for solvency support, while no minimum bail-in rule for liquidity provision.
[69] See Annex 8, section 2.

national DGSs to exceed EUR 56 bn across the EU). Also, the franchise value of the failing bank's assets and its client relationship would deteriorate, leading to overall loss of value. Second, costs would not be sufficiently redistributed from taxpayers to shareholders and creditors, despite this being one of the main objectives of the BRRD/SRMR and the Banking Union created in the aftermath of the global financial crisis. Third, the baseline option would not foster consumer confidence in the banking sector, in particular when the certainty of outcomes cannot be guaranteed, which may create spiralling contagion to other banks and the risk that bank clients may start questioning the solidity of the system and its safety nets, with no improvement over what could happen under insolvency proceedings.

The European Parliament and the Council have also acknowledged this risk and repeatedly called on the Commission to deliver the CMDI legislative package with high urgency.

5.4. Overview of the policy options

Figure 7: Overview of policy option packages and the interaction of their key elements



Source: Commission Services

** Eurogroup statement of 16 June 2022.*

5.5. Common elements across the packages of options

Some changes proposed are common across all option packages (except the baseline). These include elements related to: depositor protection, early intervention measures, triggering of failing or likely to fail status of a bank (FOLF) and winding-up under insolvency.

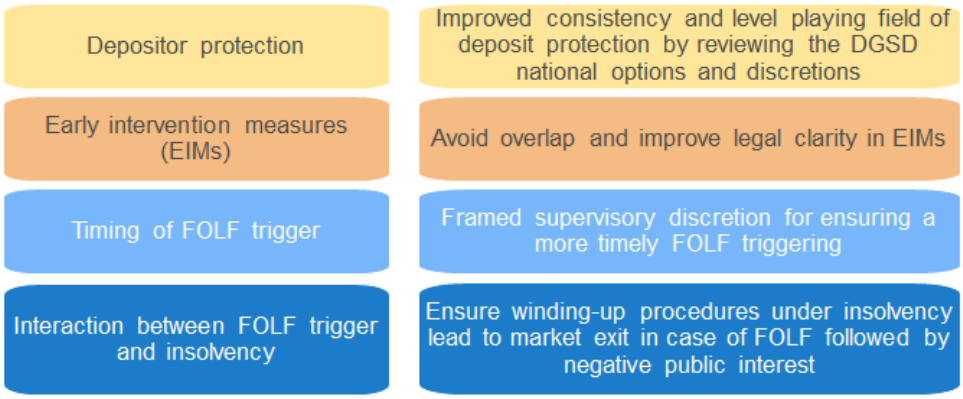
The packages of options closely follow the advice provided by the EBA for the CMDI review through the set of four opinions dedicated to the review of the DGSD functioning and the response to the call for advice on funding in resolution.

As shown in the evaluation in Annex 5 and the problem definition, these aspects would require amendments to improve the framework, however they are not driving the distinctions among the option packages. Alternatives to the proposed policy changes on the common elements have been analysed and evaluated in Annexes 6, 7 and 8 and

subsequently, the preferred option for the common elements was integrated in this impact assessment (section 6.3). As shown in these annexes, the analysed alternatives to the preferred policy options would not have addressed the problems of clarity and predictability of the framework to the same extent as the preferred options. Including all possible variations for these elements in the packages of options as alternative options would have resulted in a very large number of possible combinations. Some of these would have been rather arbitrary and would have complicated the reading of the options without adding value in terms of coherence and consistency.

In view of these considerations, the main report will focus on the core elements driving the main differences across the coherent packages and which are described in Chapter 6: the scope of resolution (PIA), the funding solution and access conditions to the industry-funded safety nets, DGS interventions and related conditions and possible cost synergies for banks. In the absence of EDIS, the governance and decision making process on the use of funds between national and European authorities (SRB) would not change in principle under this initiative.

Figure 8: Elements common across all option packages (see also section 6.3 and Annex 8)



Source: Commission Services

5.6. Options discarded at an early stage

Additional policy options were analysed and discarded at an early stage: (i) resolution as the sole procedure for banks needing restructuring, (ii) set-up of a parallel harmonised national regime in insolvency – an orderly liquidation tool, (iii) withdrawal of the 2015 Commission EDIS proposal without a replacement and (iv) incompatible permutations between elements in the option packages presented in Chapter 6. The assessment of these additional options together with a rationale for their discarding is presented in Annex 14.

6. WHAT ARE THE IMPACTS OF THE POLICY OPTIONS AND HOW DO THEY COMPARE?

In this section, each package of policy options considered is assessed against how it addresses the identified problems and problem drivers (see Chapter 2) along the criteria

of effectiveness (general objectives), efficiency (benefits-costs), political considerations, feasibility[70] and coherence with EU rules.

Each of the three packages of policy options (other than the baseline) strives to create an incentive-compatible framework where the application of resolution tools and of alternatives outside resolution is achieved in a more consistent manner, increasing legal certainty and predictability, levelling the playing field to safeguard the functioning of the single market, facilitating access to common safety nets, protecting depositors and ensuring consumer confidence, while reducing the contingency for taxpayer funds. Depending on the degree of ambition embedded in their design, the packages of options achieve these objectives to a different extent, also with a varying degree of political feasibility.

The key features analysed under each option in relation to the mentioned criteria and which drive the differences across the option packages, are: the clarification of the resolution scope through the PIA, the conditions to access industry-funded safety nets, the use of DGS funds and the harmonisation of its access conditions across various types of interventions, implementing a depositor preference in the hierarchy of claims and synergies through cost reductions for the industry. These dimensions are the most important in the overall comparison of option packages because they touch on the core issues identified in Chapter 2 and they determine the coherence and interdependence between the sub-elements of the consistent packages of options.

The policy option packages 2 and 3 are assessed against the background of the 2015 EDIS proposal under the assumption that political negotiations remain on hold[71], while the policy package 4 is a technical option included for completeness, assuming the implementation of EDIS as the third pillar of the Banking Union (although EDIS has not yet been politically endorsed by the Council or European Parliament).

The most relevant evidence underpinning the analysis of policy options in this chapter includes, among others, analysis of past cases of bank failures, data provided by the EBA in its opinions on the functioning of the DGSD in the current framework, empirical evidence by the EBA in its reply to the Commission's call for advice on funding issues in resolution and empirical evidence provided by the Commission's JRC regarding key policy options pertaining to the DGSD related policy options. A complementary, more detailed summary of the evidence used in this impact assessment is also provided in Annex 1, sections 3 and 4.

6.1. Assessment of policy options

6.1.1. Option 2 – Slightly improved resolution funding and commensurate resolution scope

[70] Political considerations and feasibility are important aspects in the assessment of the option packages. In particular, certain elements of a potential reform – such as the use of funds, conditions to access funding or the completion of the Banking Union with its third pillar, EDIS implying mutualisation of funds are inherently political, as shown also by the interrupted negotiations of the 2015 proposal.

[71] I.e. 2015 EDIS proposal not withdrawn and no new hybrid EDIS proposal tabled.

This option entails a revision of several elements of the CMDI framework, where slightly more resolution funding would be made available and, therefore, a commensurate larger scope of banks would be placed in resolution compared to the baseline. However, the outcome in terms of fixing the issues identified and reaching the objectives listed in chapter 4 will be marginal in comparison with options 3 and 4.

6.1.1.1. Public interest assessment

Under this option, a widening of the PIA scope would be achieved through legislative change to ensure that, following this assessment, resolution would be applied to more institutions than under the baseline option, when this best achieves the objectives of preserving financial stability, protecting deposits and taxpayer funds. While retaining the discretionary nature of the PIA decision by the resolution authority, the PIA legal amendments would include additional considerations for the achievement of the resolution objectives such as: (i) a regional dimension in the assessment of critical functions of the bank and of risks to financial stability (in addition to national one as in the current framework), (ii) the need to preserve DGS resources and (iii) the possible granting of State aid in insolvency[72]. However, under this option, the amendments to the PIA would not include a positive presumption of public interest/resolution unlike under option 4. Option 2 would improve, to some extent, the legal certainty in applying the PIA and determining the scope of banks going in resolution and better frame the discretion of resolution authorities. However, higher risks of divergences across the EU are likely to remain in the absence of sufficient access to funding. Such a relative expansion of the resolution scope to more small/medium-sized banks under this option is coherent with a relatively less robust funding solution when compared to options 3 and 4. As described in the next section, the funding solution of option 2 may fail to effectively underpin a broader application of resolution tools to more smaller/medium-sized banks due to the lack of sufficient funding to sustain resolution actions. The number of additional banks that were earmarked for liquidation strategy under the baseline and would go in resolution under this option cannot be estimated upfront, as the PIA remains a case-by-case assessment by resolution authorities, retaining elements of discretion and is highly dependent on the financial condition of the bank at the moment of failure as well as on its access to funding (bank's loss absorption capacity and safety nets) to conduct a successful resolution. Moreover, the strategy set out for a bank by the resolution authority at the planning stage (resolution *versus* liquidation) is a presumptive path based on backward looking information which allows deviations to take account of the specific situation at the moment of failure (e.g. idiosyncratic *versus* systemic crisis, level of losses, available loss absorbing capacity in the bank, existence of a buyer, access to funding from safety nets if needed, impact on deposits and on financial stability).

6.1.1.2. Conditions to access industry-funded safety nets

[72] SRB (May 2021), SRB's updated approach to PIA, *System-wide events in the public interest assessment.* The SRB already took steps to clarify the PIA in its internal policy. Also, please refer to Chapter 2, section 2.1.3 and the evaluation Annex 5, section 7.1.3.4.

Broadening the scope of PIA and placing more banks in resolution without facilitating access to more funding in resolution, in particular for small/medium-sized banks with a large deposit base, would increase the risk to financial stability or recourse to taxpayer money. Therefore, the design of these two features, scope expansion and funding, have to be approached consistently and holistically.

The core access condition to the RF/SRF (minimum bail-in of 8% TLOF) remains in place to ensure protection of the fund against moral hazard[73]. Under this option and only in case of transfer strategies[74], depositors (including beyond covered ones) could be shielded from taking losses in order to meet this requirement, provided that such discretionary exclusion from bail-in is justified on financial stability grounds, as already foreseen by the framework. To achieve this objective, once the first line of defence against losses – the internal loss absorbing capacity of the bank (except deposits) is used, the DGS would intervene[75] to support transfer strategies with market exit and cover losses that would have otherwise been allocated to depositors to meet the 8% TLOF requirement in order to access the RF/SRF. The DGS can intervene to this effect, if allowed, and up to the amount determined by the least cost test to ensure that the intervention is less costly than in a payout of covered deposits. Subject to conditions and safeguards (only transfer strategies with market exit and least cost test - see also Box 2 for further details), this adjustment would facilitate the use of RF/SRF (a combination of DGS and RF/SRF) for a larger number of smaller/medium-sized banks with a large deposit base, while maintaining a strict access condition to the fund, avoiding moral hazard and at the same time allowing resolution authorities to shield depositors from taking losses when that is a threat to financial stability[76].

As shown by the statistical analysis in Annex 7 (section 3.2.1), under a baseline scenario[77], deposits (non-preferred, preferred and in a few cases also covered) in 96 banks (26.1%) located in 20 Member States would suffer losses when reaching the 8% TLOF threshold up to an aggregate amount of EUR 18.3 bn, based on balance sheet data as of Q4 2019. In three Member States, deposits in more than half of the banks in the sample would be affected. When only institutions which already had resolution strategies under the 2019 PIA decision were considered, deposits in 44 banks would be affected up to an aggregate amount of EUR 14.2 bn in 18 Member States. Under more severe scenarios of equity depletion in the run up to a crisis, the share of affected banks would

[73] A minimum bail-in of 8% TLOF must be applied to the bank's shareholders and creditors (which may include depositors) before accessing the resolution fund for solvency support.
[74] See Annex 13 section 4 for an overview of resolution strategies by types of banks (size, business model).
[75] The DGS can intervene in resolution under Article 109 BRRD, which could offer alternative funding for smaller/medium-sized banks. See section 6.1.1.3.
[76] Shielding deposits from taking losses as part of the resolution process may encourage the application of resolution to more banks and facilitate the process of finding potential buyers interested in taking over (parts of) the failed bank. The objective of shielding depositors from losses was in some of the past cases, one of the reasons why tools other than resolution were used to deal with these cases, since the same outcome could not be achieved with sufficient credibility and legal certainty as part of the resolution action under the current framework. The review would address this.
[77] Baseline scenario in Annex 7 refers to status quo assumptions: no equity depletion in the bank at moment of failure and existing depositor preference (including super-preference of DGS) in the hierarchy of claims. See section 3.2.1 in Annex 7. Other (combined) scenarios are also explored there.

increase significantly[78]. This would be mitigated to an extent when changing the tiered depositor preference in the hierarchy of claims to a two-tier depositor preference (see section 6.1.1.4) by virtue of prioritising all deposits *versus* other senior ordinary unsecured claims.

The revisions under this option would improve the access to funding in resolution and introduce more proportionality for banks that would be resolved under transfer strategies, by protecting deposits from bail-in[79], addressing in an effective manner the problem pertaining to funding identified in Chapter 2.

Box 2: The DGS bridge mechanism to reach the RF/SRF

All packages of policy options other than the baseline propose the possibility to use the national DGS funds as a bridge to reach the RF/SRF in specific cases and under framed conditions in order to address problem 2 (described in Chapter 2). For certain banks with a high prevalence of deposits, reaching 8% TLOF may only be possible when imposing losses on depositors, despite compliance with the minimum requirement for own funds and eligible liabilities (MREL)[80]. Hence, the DGS funds would contribute to supplement the bail-in of the bank's internal loss absorbing capacity (i.e. shareholders and creditors other than deposits) to reach 8% TLOF and enable access to the RF/SRF, while shielding deposits from losses, if necessary.

The DGS' intervention in resolution to act as a bridge to reach the RF/SRF would be framed by the following important safeguards:

(i) Only applied when the resolution authority would have considered, on a case-by-case basis, and only at resolution execution stage, that bailing-in deposits would create financial stability issues and would consider the need to exempt those deposits from bearing losses under Article 44(3) BRRD. In these cases, the DGS could intervene only to replace losses that would have otherwise been borne by depositors (covered and non-covered). Conversely, the framework would retain the possibility for resolution authorities to bail-in deposits rather than use the DGS fund, if appropriate;

(ii) Only if allowed under the reformed least cost test (see also Box 3) and only up to the maximum between the amount allowed by the least cost test and the gap required to reach 8% TLOF;

[78] From 96 banks with an aggregate EUR 18.30 bn affected deposits (44 banks with resolution strategy and an aggregate EUR 14.16 bn affected deposits) under the baseline scenario, to 246 banks with an aggregate EUR 83.1 bn affected deposits (117 banks with resolution strategy and an aggregate EUR 71.6 bn affected deposits) under the next more severe CET1 depletion scenario assuming 75% depletion of buffers).

[79] Shielding deposits, including non-covered ones, from bail-in is likely to improve the odds of finding a buyer interested in acquiring the bank or parts of it (deposit book). Imposing losses on the uninsured part of deposits increases the likelihood of runs and contagion, which is very likely to deter potential buyers from purchasing (parts of) the failing bank.

[80] Under the BRRD, deposits may be MREL eligible liabilities if they fulfil all eligibility criteria including the remaining maturity over one year. Many smaller/mid-sized banks comply with their MREL requirement by also relying on deposits (see *EBA MREL report as of December 2020*, in particular Figures 9, 10, 14, 15 and 17 which show that wholesale deposits (uncovered) are part of MREL resources for banks with a total balance sheet size of up to EUR 50 bn). However, in a failing or likely to fail situation, it is likely that deposits would be excluded from bail-in on financial stability grounds (under Art 44(3) BRRD), leaving a gap compared to the MREL requirement.

(iii) Only applicable to banks with transfer strategies leading to market exit, to avoid distorting competition with banks that would be restructured and planned to remain on the market;

(iv) Only applicable to banks for which the resolution plan foreseen the application of a resolution strategy and not wind-down under national insolvency proceedings, to avoid incentives to resolve banks earmarked as liquidation entities and which would not have built-up their MREL buffers;

(v) Only for banks where the bail-in of liabilities consisting of shareholders and creditors other than deposits cannot reach 8% TLOF.

In light of the above conditions, in practice, it is likely that this tool could be used for smaller and medium-sized banks because they are more likely candidates for transfer strategies and often rely on deposit funding.

Using DGS as a bridge to reach the 8% TLOF threshold to access RF/SRF is expected to have numerous positive impacts. The primary purpose of the DGS bridge, as also shown in the detailed description of policy options in Chapter 6 (sections referring to the resolution financing arrangements and the hierarchy of claims under each option) and in the analyses performed in Annex 7, section 4, is to enable access by more small and mid-sized banks to resolution funding under the harmonised CMDI framework, so that more such banks' failures can be handled more efficiently under resolution, where there is a public interest. It will reduce the cost of managing a bank failure, by using resolution as the less costly procedure compared to insolvency. It will reduce the risk of imposing losses on deposits, a factor that has been identified as one of the key reasons for avoiding the application of the resolution framework in the past. This mechanism would therefore make resolution a more credible option to handle a bank failure compared to other avenues that often relied on taxpayer money.

The least cost test acts as a critical safeguard to ensure that the DGS bridge mechanism reaches its goal and enables access to RF/SRF for more banks. However, the least cost test is mainly dependent on the ranking of the DGS in the hierarchy of claims and limited by the super-preference of DGS (see also Box 3). It is therefore very important to bundle together changes that remove the super-preferred ranking of DGS in the hierarchy of claims with the DGS bridge mechanism to ensure that the potential to place more banks in resolution when this best meets the objectives is materialising.

It must be also clearly acknowledged that the least cost test will not allow the use of DGS in all cases where it may be required to avoid inflicting losses on deposits in a sale of business strategy, and that a tail scenario of cases will remain, where resolution funding remains out of reach, potentially leading to bailing in deposits.

Importantly, strict access conditions to the resolution fund (RF/SRF), in the form of a mandatory bail-in of at least 8% TLOF, are key to ensure a level playing field and avoid moral hazard. The proposal does not weaken the 8% TLOF threshold and does not disincentivise banks to hold sufficient amount of MREL for the following reasons:

(i) Incentives to reach MREL are built into the governance of the framework. Resolution authorities calibrate MREL requirements for all banks with resolution strategies, including smaller/mid-sized banks where appropriate, according to the existing legal provisions. Failure to comply may be addressed through several measures (e.g. restrictions to distribute dividends/ variable remuneration,

supervisory measures, penalties, procedure to remove impediments to resolvability, early intervention measure or failing or likely to fail determination) as well as market stigma when disclosing the MREL requirement and capacity to the markets via market discipline. In other words, there are strong safeguards already in the law to ensure that each bank would receive an appropriate MREL requirement that would be enforced;

(ii) MREL requirements do not incorporate the 8% TLOF for smaller and medium-sized banks, therefore a possible bridge to the 8% would not impact MREL as such. The 8% TLOF access condition to the resolution fund is linked to a minimum amount of bail-inable liabilities, not MREL eligible ones (which are a subset of bail-inable liabilities). MREL requirements depend on the resolution strategy chosen by the resolution authority, and the legislation does not introduce a minimum level of MREL that would correspond to 8% TLOF for all banks (it is only the case for the largest ones, with limited exceptions). In fact, most of the small/mid-size banks are subject to transfer strategies, which generally imply a lower level of MREL than for bail-in strategies in order to cover losses and ensure market exit[81]. Therefore, by construction, there is no link between the 8% TLOF threshold and MREL levels for smaller/mid-sized banks already in the current framework. This does not mean, however, that these banks should never access the resolution fund, and they are in fact contributing to its build-up;

(iii) There would be a very big price to pay (market exit) to use the DGS bridge mechanism, therefore the latter cannot be considered as providing incentives not to build sufficient buffers (MREL) for a crisis. The use of DGS as bridge facility would be limited to cases where banks are subject to a transfer strategy that leads to a market exit in case of failure. It would also be at the discretion of the resolution authority (no automaticity). Furthermore, since the failed bank will disappear and not be resurrected after resolution should DGS funds be used, this mechanism de facto prevents any perceived advantage with regard to MREL calibration or the use of DGS funds compared to other banks that would continue operating after being restructured;

(iv) Moral hazard is, on the contrary, rather encouraged outside resolution via the implicit subsidy provided by the availability of public funds in insolvency. By allowing a more credible use of resolution via the DGS facility for specific banks, the reform aims to disincentivise the recourse to taxpayer money, which may affect market expectations *ex ante*, leading to more market discipline and lowering moral hazard;

(v) Higher exposures to possible replenishment contributions for the industry as a whole could result in peer pressure and further reduce moral hazard. Making use

[81] 8% TLOF is part of the MREL calibration only for global systemically important institutions (G-SIIs) and top-tier banks (total assets above EUR 100 bn) as per BRRD II provisions. This BRRD II calibration of MREL is targeted at open-bank bail in strategies, where the failing banks do not exit the market after resolution, hence they need sufficient loss absorption and recapitalisation buffers. The latter component (recapitalisation amount) is needed to a lesser extent for other resolution strategies leading to exit, which preserves proportionality.

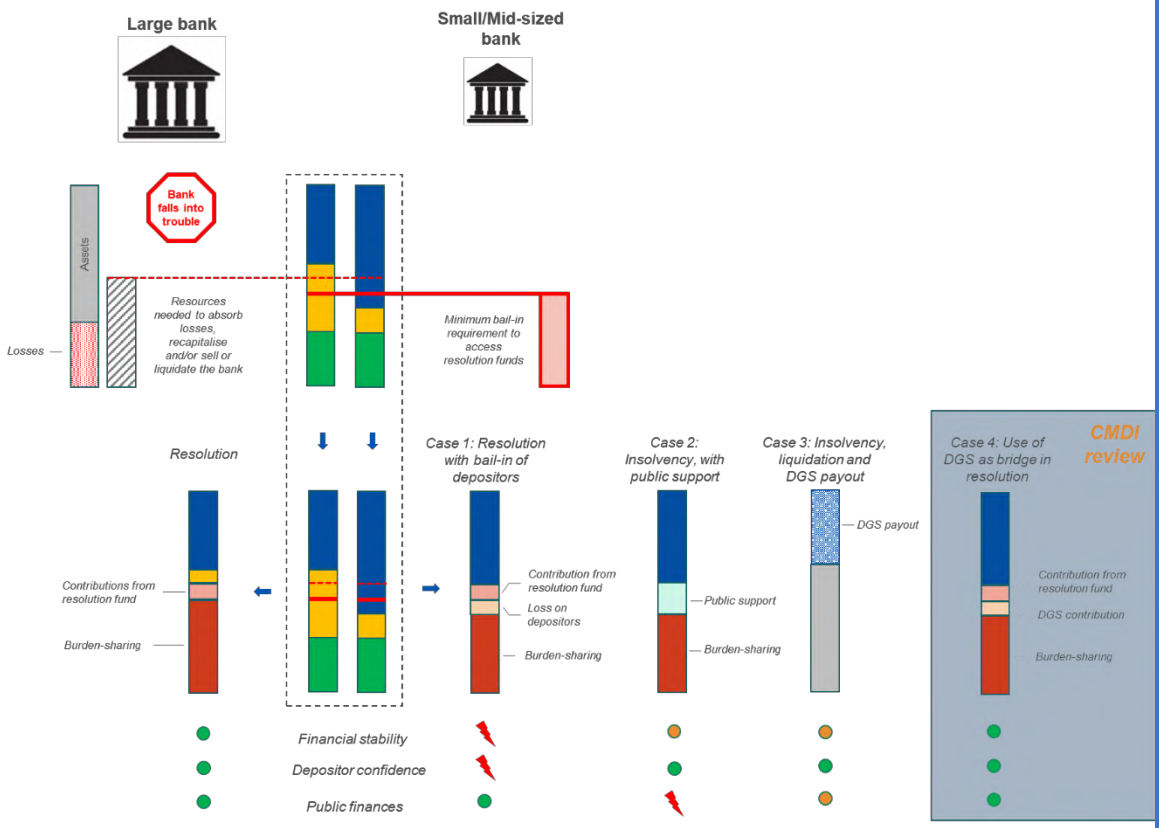
of industry-funded safety nets more frequently may increase the scrutiny by market participants of risks taken by their peers, as banks may become liable to replenish the funds once these are used to handle a bank failure. The DGS facility may therefore increase market discipline in the framework.

Moreover, alternative approaches lowering the 8% TLOF threshold (for example by allowing the use of the resolution funds even if 8% TLOF is not met) have been explicitly discarded on the ground of increasing the risk of moral hazard (Chapter 6, or Annex 14).

On this basis, allowing DGSs to bridge the gap to access the resolution funds would introduce more proportionality for smaller/medium-sized banks under transfer strategies and make the framework functional for these types of banks as well, without weakening the minimum bail-in condition to access the resolution funds or increasing the risk of moral hazard.

Figure 9: Stylised example DGS bridge mechanism versus status quo

This stylised example (further building on Box 1 in Chapter 2) shows the benefits of using the DGS bridge mechanism compared to possible alternative avenues under the status quo (resolution with bail-in of depositors, use of public funds, insolvency with DGS payout of covered deposits). The example also highlights the potential impacts of each approach on financial stability, depositor confidence and the use of taxpayer money. It also shows that the involvement of DGS via such bridge mechanism would put a significantly lower pressure on DGS financial means than a payout in insolvency.



Source: Commission services

6.1.1.3. Use of DGS funds

As under all options, the DGS would continue to contribute to the payout of covered deposits, as well as to the use of preventive, resolution and alternative measures in insolvency. In order to facilitate an effective DGS intervention, the following adjustments and clarifications to the access conditions to the DGS funds would be required:

- DGS contribution and access condition to preventive measures: the conditions for the intervention of a DGS for preventive measures (Article 11(3) DGSD) would be improved by including relevant safeguards, i.e. ensuring that preventive measures would be subject to an adequate least cost test and that a solid rationale exists to justify the DGS intervention[82]. To ensure consistent, credible and predictable outcomes when applying crisis management tools, the least cost test would be harmonised to govern the use of DGS funds outside payout of covered deposits in insolvency[83] but would take into account the specificities and timing of preventive measures.
- DGS contribution and access condition in resolution and insolvency: the provision on the DGS use in resolution (Article 109 BRRD) would clarify[84] that the DGS could also finance the transfer of deposits beyond the covered ones, if needed to execute a sale of business transaction in resolution. The least cost test conditioning the DGS intervention in resolution would be fully aligned with the least cost test for alternative measures in insolvency.
- Least cost test: the least cost test conditioning the DGS interventions would provide elements for its quantification and the types of costs (direct and/or indirect) that it could include[85].

These adjustments to the conditions for accessing DGS funds would significantly increase the legal clarity and applicability of rules and simplifying the framework by harmonising some of the conditions, addressing problem 2 described in Chapter 2. These amendments which are closely inter-related would contribute to a more coherent and incentive-compatible framework.

6.1.1.4. Harmonisation of depositor preference in the hierarchy of claims: two-tier preference

As explained in section 2 of Annex 8 and sections 4.1.1 to 4.1.3 of Annex 7, the super-preference of the DGS, in line with the current framework (baseline scenario) and its impact on the least cost test, is the main reason why the DGS cannot be used outside a payout event under the least cost test[86] (see also Box 3). Withdrawing this super-

[82] See Annex 6.

[83] As foreseen by the *Eurogroup statement of 16 June 2022*.

[84] The legal interpretation under the current rules is that the DGS can be used to finance the transfer of the whole deposit book in resolution. However, the legal text would benefit from clarification on this point.

[85] See Annex 6.

[86] The DGS can only provide an amount up to the losses it would bear in case of a hypothetical payout of covered deposits in insolvency. These losses are given by the difference between the amount disbursed by the DGS in case of a payout and the amount the DGS would recover from the sale of the bank's assets in

preference and envisaging a more harmonised depositor preference, when compared to the current situation with a three-tier depositor preference, is instrumental in accessing funding in resolution and making resolution effective for smaller and medium-sized banks. Option 2 explores the impacts of achieving a two-tier depositor preference without the super-priority of covered deposits and DGS in the hierarchy of claims.

Box 3: The impact of DGS ranking in the hierarchy of claims

The objective of the least cost test safeguard is to ensure that any DGS intervention other than paying out covered deposits would not expose the DGS to losses greater than the ones it would incur in a payout of covered depositors in an insolvency counterfactual. The amount of losses in the insolvency counterfactual depends, to an extent, on the ranking of the DGS in the hierarchy of claims. Abstracting from other factors influencing the recovery rates in insolvency (i.e. quality of assets, effectiveness of insolvency regimes, overall duration of insolvency processes), the higher the ranking, the higher the recovery for the DGS and therefore the less likely for the DGS to incur losses in insolvency, which, in turn, makes it less likely for the least cost test to allow a DGS contribution to support measures other than payout.

A quantitative analysis carried out by the EBA in the response to the Commission's call for advice (CfA) on funding in resolution[87] looked at the losses that depositors would bear in order to meet the 8% total liabilities and own funds (TLOF) threshold and access the resolution fund. This analysis, also reflected in Annex 7 (section 3.2.1), showed that, under a baseline scenario[88], deposits (non-preferred, preferred and in a few cases also covered) in 91 banks (out of 368 banks in the sample) located in 20 Member States would suffer losses up to an aggregate amount of EUR 18.3 bn (based on balance sheet data as of Q4 2019) in order to reach the 8% TLOF threshold and access the resolution fund.

When only institutions which already had resolution strategies under the 2019 PIA decision were considered, deposits in 44 banks would be affected up to an aggregate amount of EUR 14.2 bn in 18 Member States. Under more severe scenarios of equity depletion in the run up to a crisis, the share of affected banks would increase significantly[89]. This would be mitigated to an extent when changing the tiered depositor preference in the hierarchy of claims to preferring all deposits *versus* other senior ordinary unsecured claims and removing the super-preference of the DGS.

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insolvency. Given the super-preferred ranking of the DGS in the hierarchy of claim, the DGS has, in some Member States, the possibility to recover most or all its expenditure in the hypothetical insolvency. However, this recovery rate is heterogeneous among Member States, depending on the efficiency of judicial systems, quality of assets to be liquidated, time required to conduct the insolvency proceedings and other factors. As a result, the DGS has very limited scope to intervene in resolution because the least cost test on the basis of which the use of resolution tools would have to be assessed, would not allow for it.

[87] EBA (October 2021), *Call for advice regarding funding in resolution and insolvency*.

[88] Baseline scenario refers to status quo assumptions: no equity depletion in the bank at moment of failure and existing depositor preference (including super-preference of DGS) in the hierarchy of claims.

[89] From 96 banks with an aggregate EUR 18.30 bn affected deposits (44 banks with resolution strategy and an aggregate EUR 14.16 bn affected deposits) under the baseline scenario, to 246 banks with an aggregate EUR 83.1 bn affected deposits (117 banks with resolution strategy and an aggregate EUR 71.6 bn affected deposits) under the next more severe CET1 depletion scenario assuming 75% depletion of capital buffers).

Summary of impacts of various depositor preference scenarios on bailing-in deposits when reaching 8% TLOF

	Institutions that would require DGS intervention to reach 8% TLOF to avoid losses on depositors	Of which: Institutions for which DGS can intervene (positive least cost test)	Of which: Institutions for which DGS interventions under the LCT are sufficient to reach 8% TLOF
Baseline	91	3	2
Single-tier preference	48	41	31
Two-tier preference (no super-preference)	48	18	13
Two-tier preference (with super-preference)	48	3	2
Three-tier preference (with super-preference)	48	3	2

Source: EBA Call for advice, summary of evidence from Annex 7, section 4.1.1.

Note: analysis based on a total sample of 368 banks at consolidated level. The figure above assumes no CET1 depletion in the event of failure. If CET1 depletion were factored in, the impact on deposits would increase very significantly.

The EBA analysis also considered the possibility to use the DGS fund as a bridge to reach the 8% TLOF and avoid such losses on depositors. The analysis has shown that, under the current framework, the least cost test would yield a positive result and allow for DGS use in resolution, for only three out of 91 banks (out of a total sample of 368 banks) where deposits would bear losses to access resolution funding (8% TLOF), considering an 85% recovery rate in insolvency[90]. The least cost test would allow a sufficient DGS support to reach 8% TLOF for two out of these three banks.

Preferring all deposits *versus* ordinary unsecured claims would reduce the number of banks where deposits would be impacted when reaching 8% TLOF, from 91 banks in the baseline scenario to 48 (out of 368 banks in total).

It can be concluded based on this evidence that, under the baseline (status quo), the DGS can almost never be used for measures other than the payout of covered deposits in insolvency (see table above and section 4.1.1 of Annex 7) because its ranking and consequently high likelihood to get its claims paid before other creditors make the counterfactual of a payout in insolvency artificially less costly, despite the fact that a DGS contribution to resolution or an alternative measure could be more cost efficient (involve a lower need for cash disbursement from the DGS to support a sale of business strategy, compared to a full payout of all covered deposits), better preserve depositors' confidence and facilitate a more efficient crisis management. On one hand, paying out covered deposits in insolvency is likely to require a very significant upfront cash

[90] An 85% recovery rate is a conservative assumption and for several Member States, recovery rates are actually lower. Therefore, in those cases their DGS funds would recover less after a payout of covered deposits in insolvency (i.e. the burden of the counterfactual of the payout is underestimated) and in reality, the LCT could be even more favourable to other alternatives to payout of covered deposits in insolvency, such as DGS intervention in resolution.

disbursement by the DGS (especially in cases of predominantly deposit-funded mid-sized banks with significant amounts of covered deposits)[91]. On the other hand, an intervention in resolution to support the transfer of a failing bank to a buyer may require only a portion of those DGS financial means. Transfer transactions can unfold in many ways, depending on the quality of assets and the funding/liabilities to match these, as well as the appetite of the buyer and the offered price. Considering the likely need to plug a gap between the value of assets and deposits to be transferred to a buyer, the DGS/resolution fund contribution to support such transfer may be much lower than the total value of covered deposits that would need to be paid out in insolvency. Under the current set-up, the DGS super-priority ends up protecting the financial means of the DGS and of the banking industry from possible replenishment burden by hindering any DGS intervention, without bringing a better protection for covered deposits. The protection of covered deposits does not depend on their ranking in the hierarchy of claims; rather, it is insured through the obligation to be paid out under the DGSD when accounts become unavailable and the mandatory exclusion from bearing any losses in resolution.

The implementation of a two-tier depositor preference without the super-preference of DGS and covered deposits would require two changes in the BRRD rules on the ranking of deposits (Article 108 BRRD). First, the legal preference in the hierarchy of claims would be harmonised at EU level to include all deposits, meaning deposits would rank above ordinary senior unsecured claims in all Member States. Second, the current three-tier approach would be replaced with a two-tier ranking, whereby covered and preferred deposits would rank *pari passu* and above non-preferred non-covered deposits[92]. Annex 7 and 8 further describe the detailed impact of different depositor preference scenarios assessed, varying in scope and relative ranking among deposits.

Introducing a depositor preference in the hierarchy of claims (be it a two-tier or single-tier, as proposed in option 3) would facilitate the bail-in of ordinary unsecured claims and potentially decrease the likelihood of inflicting losses on deposits. It would also mitigate risks related to potential breaches of the NCWO safeguard currently existing in the baseline option, which could arise when some of the deposits that rank *pari passu* with ordinary unsecured creditors are discretionarily excluded from bail-in by the resolution authority, on contagion and financial stability grounds[93]. This, in turn, may give rise to legal challenges and potential compensation claims by the ordinary unsecured creditors if they can prove that they were treated worse-off in resolution than in insolvency, particularly when they represent a significant share of the ordinary senior unsecured class. At the same time, keeping via the two-tier approach a distinction between covered and preferred deposits (i.e. eligible deposits of natural persons and SMEs) on one hand and the remaining non-covered deposits on the other hand, would facilitate the bail-in of the latter deposits, in situations where that would not affect financial stability, thereby preserving some flexibility by resolution authorities on how to allocate losses. However, as explained in Annex 8, considering that smaller and medium-

[91] See a more detailed analysis in Annex 5 (evaluation), sections 7.1.4.4 and 7.2.2.6 and ECB (October 2022), *Protecting depositors and saving money - why DGS in the EU should be able to support transfers of assets and liabilities when a bank fails*.

[92] See also Figure 29 in Annex 8, section 2, for a stylised view of creditor hierarchy in insolvency with a two-tier depositor preference and without the super-preference of DGS/covered deposits.

[93] Pursuant to Article 44(3) of the BRRD.

sized banks primarily serve retail and SME clients and that the volume of "wholesale" deposits may not be material in some banks, this flexibility may not be used in all cases.

The removal of the DGS super-preference would increase to a relative extent, compared to the baseline, the amount of funds the DGS could contribute for measures other than payout under the least cost test. However, because the DGS would still be a preferred creditor in relation to non-covered non-preferred deposits, the increase in DGS funds unlocked under the least cost test for these measures would be significantly lower than under a single-tier depositor preference explored in options 3 and 4, where all deposits would rank *pari passu* in the hierarchy of claims.

According to the quantitative analysis in Annex 7 (section 4.1.3), 48 banks would require additional resources to meet 8% TLOF and access the resolution fund without imposing losses on depositors when preferring deposits *versus* ordinary unsecured claims, as opposed to 91 banks under the current hierarchy of claims, which does not feature a preference of deposits. A two-tier depositor preference without the super-preference for DGS would lead to a least cost test result where the DGS could contribute for 18 banks out of the 48 to bridge financing needs to shield deposits from losses and help meet the 8% TLOF condition to access the RF/SRF. The number of banks where the DGS funds could contribute under a two-tier preference without super-priority for DGS would be improved compared to the baseline, where only three banks could benefit from DGS contributions but it would be lower than under a single-tier depositor preference where 41 banks could benefit from DGS contributions (considered under options 3 and 4). Under the two-tier depositor preference without the super-priority for DGS claims, the DGS intervention to plug the gap towards accessing the resolution fund would be sufficient to meet 8% TLOF in 13 cases (out of the 48) *versus* two under the baseline and 31 banks under a single-tier depositor preference (options 3 and 4). In terms of euro amount, the DGS could be allowed to contribute under the least cost test for an estimated amount of EUR 0.21 bn under a two-tier depositor preference without the super-priority for DGS, compared to EUR 0.05 bn under the baseline and EUR 0.98 bn under a single-tier depositor preference. Table 25 in Annex 7 also shows that maintaining the super-preference of DGS does not unlock more funds compared to the baseline, even if all depositors were preferred compared to ordinary unsecured claims. Therefore, removing the DGS super-preference is an important element of the preferred policy option to reach the objectives envisaged by this initiative.

Annex 8 explains in detail why the removal of the super-preference of covered deposits and the DGS in the hierarchy of claims does not impede in any way on the protection enjoyed by covered deposits, but it allows for the use of DGS funds earlier and in a more effective and efficient manner.

Some stakeholders (including a few Member States and banks) argue that preserving a super-priority for DGS in the hierarchy of claims is instrumental in ensuring the recovery of funds used to payout covered deposits in insolvency, even if the creditor payout in insolvency can take many years (depending on the judicial system in each Member State

and the approach to liquidate assets[94]). Importantly, the amount of cash the DGS must disburse in a payout in insolvency corresponds to the total amount of covered deposits in bank (plus other direct costs) and, as shown in the evaluation (sections 7.1.4.4. and 7.2.2.6), it is likely to be significantly higher than the amount the DGS would need to contribute to fund the gap between assets and liabilities for facilitating a transfer strategy in resolution or as alternative measure. Additionally, by facilitating transfer strategies in resolution, the franchise value of the failing bank's assets is preserved as opposed to insolvency[95] and so is the client relationship, which is transferred to a new bank rather than being interrupted, avoiding thus potential contagion effects and impacts on financial stability. Therefore, the difference in costs for the DGS between pursuing more resolution *versus* insolvency lies in the more efficient usage of funds, facilitated by removing the super-preference of DGS in the hierarchy of claims.

6.1.1.5. Use of industry-funded safety nets and cost synergies for banks

The assessment of costs and potential synergies for the industry looks at two main aspects: (i) impacts on banks' contributions to safety nets and (ii) the impact of the policy measures on the banks' requirements to hold loss absorbing capacity.

Regarding the contributions to safety nets, under option 2, banks will continue to contribute to the safety nets (RF/SRF and DGS) as under the baseline option (status quo), without any changes to the contribution levels. However, facilitating the use of DGS funds to support the financing of various measures outside payout by modifying the hierarchy of claims may lead to a more frequent usage of these funds and potentially drive up the replenishment burden for the industry, despite the mitigation by the least cost test. It should be noted however, that depending on the features of the sale of business transactions and the form of the support measures required, such replenishment obligations/*ex post* contributions may not materialise for banks (e.g. DGS may contribute with guarantees to the buyer rather than cash injection). Moreover, *ex post* industry contributions to replenish a depleted DGS fund may not only be triggered by the uses of DGS in resolution or alternative measures; they may also occur when the recovery of proceeds from the insolvency estate following a payout event takes very long time. The net impact for the industry in terms of DGS replenishment needs cannot be estimated as it would be a case-by-case assessment in function of the nature of the transfer transaction (full or partial), the amount of losses and DGS contribution under the least cost test. In any case, this possible cost increase for the banking industry would not be compensated by any cost reduction in the DGS contributions, contrary to option 4 where the pooling of funds in EDIS opens this possibility.

[94] In some Member States and in specific cases, the approach to liquidate assets in insolvency is to sell those assets to buyers which may take several years to complete. In other cases, depending on the bank's business, a solvent wind-down of assets may be pursued, meaning that proceeds are recovered by respecting the reimbursement schedule of assets, which for certain loan portfolios such as mortgages can take tens of years.

[95] According to the valuation methodology, the haircut imposed on assets in a transfer transaction is lower than the haircut that could be imposed in some situations in insolvency. This may not be the case in a wind-down liquidation which may take a very long time to complete.

Another relevant aspect when assessing costs for the industry is the usage of the SRF *versus* DGS funds in the Banking Union. Since the SRF is a central fund consisting of pooled contributions by all banks in the Banking Union, its use would trigger replenishment needs spread out over the Banking Union population of banks. DGS funds, in the absence of EDIS, remain national under this policy option meaning that replenishment needs bear on the national banking system in the Member State where the DGS funds were used. From a cost synergy perspective at system level, it is therefore more interesting, in the absence of EDIS, to use SRF funds and, in order to do so more credibly, the DGS could provide a financing bridge to meeting the SRF access condition, as explained in section 6.1.1.2 above.

Regarding the banks' loss absorbing capacity, smaller and medium-sized banks previously earmarked for liquidation and which would enter the resolution scope due to the PIA changes under this option, would need to comply with a MREL requirement. The MREL target would be calibrated proportionately and in line with the preferred resolution strategy, which for transfer strategies could be lower than for open bank bail-in strategies. This is because the loss absorbing capacity would support a transfer of (a set of) assets, rights and liabilities of a bank to a buyer with a simultaneous market exit of the former and not a full restructuring and recapitalisation to allow the bank to continue to operate in the market on a standalone basis.

Looking at the funding equation as a whole and in order to substitute potential public funds injections (frequently observed in the past), the private sources of financing for a bank failure would be a combination of banks' loss absorption capacity, contributions by RF/SRF and contributions by DGS, where option 2 would have the potential to marginally improve the balance among the elements (resolution scope and funding) and enhance economic efficiency of the funding equation though not at a zero net cost for the industry (compared to the baseline).

6.1.1.6. Assessment of Option 2

Benefits

The main benefit of option 2 would be a relative expansion of the scope of resolution to include smaller/medium-sized banks by slightly increasing the availability of funding solutions for some specific resolution strategies leading to market exit. This option would ensure a more flexible and harmonised use of DGS funds thanks to changes in the hierarchy of claims and harmonisation of the least cost test and increasing the proportionality when accessing the RF/SRF in resolution, under specific conditions and safeguards. These changes to the funding equation would make transfer strategies[96] easier and more credible to plan and implement than under the baseline, contributing to the orderly handling of failed banks and ensuring their market exit without impacts on financial stability or depositor protection while reducing the recourse to public funds. In terms of access to external funding, this option would indeed lower to some extent the recourse to public funds, as banks' loss absorbing capacity complemented, where needed,

[96] Whether transfer strategies in resolution or under insolvency proceedings, where available.

by industry-funded safety nets would be used instead to fund more resolution actions for more banks under the harmonised framework.

These changes are also likely to increase the convergence in resolution practices, legal certainty, level playing field and simplify and standardise the access conditions to DGS funds (through a harmonised least cost test and clearer conditions for a contribution to preventive measures). The review of certain DGSD aspects (see section 6.3) and the legislative changes concerning the PIA leading to an increased application of resolution tools would also improve depositor confidence and preserve a continuous access of depositors to their accounts, which can be particularly important in EU's increasingly digitalised economies.

Moreover, enabling the application of resolution tools such as transfer tools on a broader scale and the related funding could be conducive to further financial stability and cross-border market integration.

Costs

The main drawback of this option is the untapped potential expansion of the resolution scope because of an insufficiently effective improvement in the funding equation. This may impact the efficiency and effectiveness of the framework and may not provide an optimal solution to address some of the issues identified in Chapter 2. Implementing option 2 requires indeed similar legal amendments as foreseen under option 3, but with more modest effects in terms of outcomes, implying therefore comparatively higher adjustment costs for resolution authorities when assessed against results. Option 2 would yield a lower probability of PIA expansion for the same number of banks and a lower amount of DGS funds unlocked under the least cost test for measures other than the payout of covered deposits in insolvency, than options 3 and 4 (i.e. as shown in Annex 7, a two-tier depositor preference would deliver a lower total amount of DGS funds that could contribute for a smaller number of banks to fund resolution or alternative measures than under a single-tier depositor preference analysed in option 3).

A consequence of a broader use of DGS funds for interventions other than payout of covered depositors in insolvency (depending also on the needs to access the RF/SRF and protected by safeguards such as the least cost test and the two-tier depositor preference) is a risk of shortfall in national DGS funds. Without EDIS, the probability of DGS shortfalls ranges from 20.7% to 56% depending on the severity of the simulated crisis[97] and independently of a possible CMDI impact compounding the risk of shortfalls in national DGSs. These shortfalls could be mitigated through extraordinary contributions by the banking industry or lending from other DGSs. DGS shortfalls could also be mitigated through lending from the market, or recourse to public funds; however the latter would reinforce the bank-sovereign nexus. DGS' vulnerability to large shocks may also impair depositor confidence in the banking sector. In addition, the limited potential for cost synergies for banks (e.g. diversification and compensation effects leading potentially to a lower target level or contributions) would not materialise in this option.

[97] The amounts of these DGS shortfalls would range from EUR 0.3 bn to EUR 0.5 bn. However, these amounts are probably significantly underestimated as they are calculated only on a sample of banks. See Annex 7, section 4.4.2.

Option 2 would also require additional coordination and consultation between resolution and DGS authorities. The DGS intervention to bridge the gap to 8% TLOF to access to the RF/SRF would require additional preparation. However, despite more preparation work, such a mechanism would ensure broader access to resolution funding for smaller/medium-sized banks and address to some extent the funding-related problems identified, slightly reducing costs in other areas (taxpayer money, loss of franchise value and loss of depositor confidence).

In addition, placing more banks in resolution than under the baseline option entails a requirement for them to ensure adequate levels of internal loss absorbing capacity (MREL) to allow for the execution of resolution strategies (bail-in or transfer strategies). The MREL requirement is bank-specific, proportionate to the chosen resolution strategy and it may be complied with own funds and eligible liabilities. It is impossible to estimate *ex ante*, whether such a policy change would lead to a need for banks to issue additional MREL capacity, mainly due to two factors: (i) the level of bank-specific MREL targets that resolution authorities would set for banks entering the resolution scope needs case by case calibration and cannot be estimated in advance and (ii) the starting point in terms of outstanding stock of MREL eligible instruments that each bank holds combined with the level of the requirement determines the issuances needs of each bank which cannot be estimated in advance[98]. Nevertheless, it should be recalled that, in line with the fundamental objectives of the CMDI, the first line of defence in case of bank distress, should always be the banks' internal loss absorption capacity. A mitigating factor for failing banks would be avoiding the bail-in of depositors and preserving asset value by using the safety nets in case the MREL capacity were not sufficient to support the resolution action, subject to safeguards.

Moreover, banks entering the scope of resolution for the first time would also be subject to the obligation to enhance recovery plans, provide information to resolution authorities on a more frequent basis for the preparation of more extensive resolution plans and ensure they become resolvable. While this would also involve additional costs for banks, these are estimated to be marginal, because banks earmarked for liquidation already report data to resolution authorities who prepare resolution plans albeit on a less frequent basis (simplified obligations). Banks entering the resolution scope would also need to invest in projects to become more resolvable (i.e. enhancing their management information systems, valuation capabilities, revising contracts to assure resolution stays with counterparts, other projects related to the organisation structure and separability).

The benefits of improving preparedness and resolvability of banks in case of failure would increase the chances of preserving financial stability and taxpayer funds and exceed such costs.

Finally, increasing depositor preference, by rendering all deposits senior to ordinary unsecured debt (be it through a two-tier depositor ranking or a single-tier depositor ranking under options 3 and 4) has the potential to lead to marginally higher issuance costs for ordinary unsecured debt (and by extent to marginally higher funding costs for banks) by reducing their potential recovery prospects in the event of a bank's insolvency.

[98] See Annex 13, section 5.

However, this pricing impact is not supported by empirical evidence[99]. Moreover, any potential marginal cost impact must be weighed against the added benefits that depositor preference brings in terms of enforcing market discipline on financial investors to monitor banks' risks more closely, once their expectation that they will be bailed-in (instead of being bailed-out under a less effective CMDI framework) becomes more credible.

Overall assessment

Effectiveness, efficiency and coherence: Under option 2, the slightly broader use of resolution tools thanks to a slightly improved access to funding for more banks (compared to the baseline option) would enhance financial stability and decrease to some extent the recourse to taxpayer money, however not to the full potential that a more comprehensive CMDI reform could achieve (as described under option 3 or 4). Critical functions for the society (e.g. deposit taking, lending, payments) and the franchise asset value of failing institutions would be better maintained by applying resolution tools more broadly than today and enabling the more extensive use of industry-funded safety nets such as the RF/SRF and DGS funds, subject to the minimum 8% TLOF bail-in access condition and the least cost test safeguard respectively. However, the relatively moderate increase in the scope of resolution (see PIA section 6.1.1.1) correlated with a slight improvement in accessing DGS funds through the implementation of a two-tier depositor preference in the hierarchy of claims and the use of DGS funds to fill the gap in accessing the RF/SRF, would still maintain a higher degree of uncertainty and potential divergences in the application of the PIA than under other options. The absence of EDIS would also render it less effective in ensuring depositor protection and sufficient liquidity in case of DGS funding shortfalls, contributing therefore comparatively less than option 4 to protecting taxpayer funds and breaking the bank-sovereign nexus. Moreover, absent EDIS, the potential for cost synergies through lower contributions to the RF/SRF and DGS funds by the industry would not materialise (unlike in option 4). On the contrary, some banks may face increased costs (potentially raising MREL eligible instruments, *ex post* replenishment needs for the safety nets as well as the obligation to enhance their recovery plans and become more resolvable because of broadening the resolution scope) which may be passed-through, to some extent, to customers.

Stakeholder views and political considerations: The majority of Member States favouring a strong CMDI reform could consider this option as sub-optimal because of the untapped potential for broadening the scope of resolution supported by a more ambitious revision of the funding equation, in particular the harmonisation of the depositor preference. One Member State is reluctant to facilitate the usage of industry-funded safety nets in resolution (RF/SRF) for non-systemic banks and, in this context, favours handling the failure of smaller/medium-sized banks at national level and with national DGS funds rather than under the harmonised framework. Depositors in particular would greatly benefit from solutions that avoid inflicting losses on them and ensure their uninterrupted

[99] See for example, the IMF Working Paper 13/172 (July 2013), *Bank Resolution Costs, Depositor Preference, and Asset Encumbrance*, from a review of previous studies it concludes that introducing a single-tier depositor preference in the US had "little "systemic effect" on overall bank funding costs.

access to their accounts[100]. They may therefore regard this option as sub-optimal because the resolution scope would not be expanded to its full potential, meaning that some deposits may still be on the line to bear losses when applying resolution tools.

Regarding the industry, the majority of stakeholders from both big and small/medium sized banks see merit in targeted amendments of the framework to improve its practical application, in particular views converge on the need to improve the predictability and transparency of the PIA assessment and to avoid paying additional contributions into industry funded safety nets. However, views of some small and large banks diverge on the need to broaden the scope of resolution. On one hand, some smaller/medium-sized banks, in particular cooperatives and savings banks[101] may prefer to stay outside the scope of resolution to avoid costs related to additional requirements (MREL, reporting obligations to resolution authorities for resolution planning and MREL calibration, increased scrutiny by markets) or possible *ex post* contributions to the safety nets (RF/SRF or DGS). Many large banks, on the other hand, are supportive of bringing more smaller/medium sized banks into the resolution scope, regardless of their size and country of origin, and enhancing the credibility, predictability and consistency of the framework as well as level playing field in the single market. Large banks also support minimising risks to taxpayer money and minimising moral hazard by ensuring a use of internal resolution buffers and a consistent and careful approach across the EU for the use of industry funded safety nets subject to a harmonised least cost test, supporting market discipline and avoiding competitive distortions. On the other hand, they are critical of the prospect of paying additional contributions into the safety nets, if these were to be used more frequently to handle the failure of more small/mid-sized banks[102].

Winners and losers: Reduced risks to financial stability through a potentially slightly broader application of resolution tools under this option would benefit taxpayers and depositors. Depositors, including individuals and SMEs, would be better off than under the baseline option due to continued access to their deposits and the continuity of the bank's critical functions through more extensive use of resolution and thanks to a more effective use of DGS resources in general. This impact, however, would be limited to the resources available in the DGS until there is progress on EDIS and would be less certain than under options 3 and 4 where the expansion of resolution is broader given a positive presumption of public interest and hence resolution.

Resolution authorities are also winners in this option. They would benefit from legal clarifications of the PIA and more consistent rules on access to funding in resolution and insolvency. This would reduce their risk of legal challenge. The increased access to funding in resolution for transfer strategies would permit them to confidently take positive PIA decisions and facilitate their implementation, although this would imply additional work in improving the planning of such strategies.

[100] See responses to the public and targeted consultations.
[101] ESBG (The European Savings and Retail Banking Group) (October, 2022), *Short paper on the CMDI framework*.
[102] AFME (Association for Financial Markets in Europe – an association of large banks) (October 2022), *Position paper on the CMDI review*.

The impact on the DGS funds and consequently on banks' contributions is twofold. On the one hand, DGS funds could be used more frequently than under the baseline if cheaper than paying out covered deposits in insolvency (thanks to harmonising the hierarchy of claims by implementing a two-tier depositor preference which facilitates meeting the least cost test, although not as much as under a single-tier preference explored under option 3), potentially increasing the need to replenish depleted DGSs on the basis of industry contributions. On the other hand, such an impact could be mitigated by a broader use of transfer strategies, increasing the cost efficiency of DGS interventions, and better preserving DGS available financial means, compared to a more costly payout in insolvency[103].

As originally intended by the framework but not observed in its application to date (see evaluation), banks' senior creditors[104] would likely be losers under option 2, as they could bear relatively more losses if more banks are put in resolution upon failing. In this context, option 2, when compared to the baseline, may transfer some benefits from banks' creditors back to taxpayers, depositors and the society. Importantly, enabling access to resolution financing by using the DGS fund for transfer strategies would not discriminate against banks with open bank bail-in strategy because the latter would be recapitalised, restructured and continue their operations, while banks under transfer strategies would need to exit the market as a condition for the more proportionate funding access.

6.1.2. Option 3 – Substantially improved resolution funding and commensurate resolution scope

Option 3 envisages reviewing certain elements of the CMDI framework (BRRD/SRMR, DGSD) achieving a robust reform of the funding equation, which would facilitate a more credible and significant expansion of the resolution scope to more smaller and medium-sized banks whose failure may not be handled in insolvency without consequence on financial stability, taxpayer money and depositor protection. This option is designed to deliver a broader use of resolution tools supported by a more substantial access to funding than under option 2, but not as broad as under option 4 where EDIS as a common central fund would act as a backstop to the national DGS funds.

6.1.2.1. Public interest assessment

Legislative amendments to the PIA under this option (in line with option 2) would include regional economic considerations in the assessment of critical functions and financial stability implications, the need to preserve DGS resources and the possible granting of State aid in insolvency as part of the considerations on the resolution objectives[105]. Importantly and differently from option 2, the legislative amendments to the PIA would also clarify that national insolvency proceedings should be selected as the

[103] See Annex 6.
[104] Banks' shareholders and junior creditors would bear losses first, as also the case under State aid rules. However, the BRRD already foresees that the claims held by senior creditors could also be bailed-in, in order to cover losses and recapitalise an institution.
[105] SRB (May 2021), SRB's updated approach to PIA, *System-wide events in the public interest assessment.* The SRB already took steps to clarify the PIA in its internal policy.

preferred strategy only when they achieve the framework's objectives better than resolution (as oppose to achieving them in the same manner, as under the baseline and option 2), leading to an increased prevalence to put banks in resolution, as the resolution authorities would face a slightly increased burden of proof to place banks in insolvency. Nevertheless, the PIA decision will remain at the discretion of the resolution authority on a case-by-case basis. The outcome, in terms of expanding the resolution scope under option 3, would be less ambitious than under option 4, where the inclusion of EDIS in the funding solution would allow an even larger scope to apply resolution and a general presumption of positive PIA. As also mentioned under other options, the number of additional banks channelled through resolution under this option cannot be estimated upfront as the PIA remains a case-by-case assessment by resolution authorities. However, the strengthening of the PIA provisions in the legislation coupled with credible funding in resolution are likely to allow a significant broadening of resolution application.

6.1.2.2. Conditions to access industry-funded safety nets

From the perspective of improving access to funding in resolution, the adjustments to access criteria under this option would be the same as under options 2 and 4, i.e. implementing the possibility to use DGS funds as a bridge to meet 8% TLOF and reach the RF/SRF for transfer strategies with market exit in order to avoid imposing losses on deposits, where that is desired on financial stability grounds. The key distinction in the funding solution between options 2 and 3 is the amount of DGS funds made available for potential interventions outside the payout event, in particular resolution strategies leading to market exit (see section 6.1.2.4 for the corresponding change to the hierarchy of claims envisaged). This more ambitious reform to the funding solution in resolution is matched by a more ambitious expansion of the resolution scope.

6.1.2.3. Use of DGS funds

Under Option 3, DGS funds would contribute to the payout of covered deposits, preventive, resolution and alternative measures under insolvency proceedings. Access conditions would be clarified in the same way as under option 2.

These adjustments would address the problem of unclear and inconsistent rules in accessing DGS funding, contributing to improved level playing field also delivering clearer rules leading to more legal certainty (e.g. the least cost test).

6.1.2.4. Harmonisation of depositor preference in the hierarchy of claims: single-tier depositor preference

Option 3 explores a harmonisation of the ranking of deposits in the hierarchy of claims through a single-tier depositor preference and by removing the super-preference of covered depositors and the DGS in the hierarchy of claims[106]. This entails two changes being introduced in the BRRD. First, as under option 2, the legal preference at EU level

[106] See Figure 29 in Annex 8, section 2, for a stylised view of creditor hierarchy in insolvency with a single-tier depositor preference.

would be extended to include all deposits (general depositor preference), meaning that all deposits, including eligible deposits of large corporates and excluded (uninsured) deposits[107], would rank above ordinary senior unsecured claims. Second, the existing different relative ranking of deposits (i.e. the current three-tier approach) would be replaced by a single ranking, whereby all deposits rank at the same level (i.e. *pari passu*) amongst themselves (single-tier approach). Annex 7 further describes the different depositor preference scenarios assessed, varying in scope and relative ranking among deposits.

Annexes 7 and 8 (section 2) provide evidence that the general depositor preference with a single-tier ranking would best address the objective of the revised framework, because it would: (i) protect deposits in resolution by reducing the amount that would be otherwise bailed-in to reach 8% TLOF and access the RF/SRF; (ii) maintain intact the protection enjoyed by covered deposits which does not depend on their ranking and (iii) unlock the largest amounts of funds that the DGS could contribute to measures other than the payout of covered deposits under the least cost test, which is critical for facilitating more cost-efficient interventions by the DGS, as proposed under this option. It should also be acknowledged that, by placing non-covered non-preferred deposits (e.g. deposits of large corporates) on the same ranking as covered and preferred deposits (deposits of households and SMEs) and facilitating the use of the DGS bridge, banks would need to replenish the DGS funds to protect not only covered and preferred deposits, but also deposits of large corporates in the context of a transfer strategy. While it may expose the DGS industry-funded safety nets to more frequent contributions by the banks, it would reduce the likelihood and extent of recourse to taxpayer money, improve financial stability and depositor protection and safeguard the financial means of the DGS to a greater extent than a payout of covered deposits in insolvency.

As highlighted in Annex 7 (section 4.1.3), a comparative analysis of depositor preference scenarios showed that the single-tier preference would best shield deposits from bearing losses by reducing most significantly the number of banks where deposits would be impacted when reaching 8% TLOF, from 96 banks in the baseline scenario to 48 (out of 368 banks in total), reducing the value of impacted deposits from EUR 18.3 bn in the baseline to EUR 6.4 bn and unlocking on aggregate up to 20 times more funds for DGS contributions under the least cost test (EUR 0.98 bn) than under the baseline or the alternative scenarios retaining the super-preference of DGS (EUR 0.05 bn). Under the single-tier preference, the DGS intervention under the least cost test would be sufficient to bridge the gap towards 8% TLOF in 76% of cases when considering the entire sample and in 88% of cases when considering only banks with resolution strategy[108,109].

[107] The deposits of public authorities would no longer be deemed as excluded deposits (see Annex 6, section 3.2.6).

[108] The resolution or liquidation strategy of banks in the analysed sample reflects the PIA decisions as of Q4 2019. Given the intended expansion of the PIA, the results based on the entire sample as well as the ones considering only banks with resolution strategies as of Q4 2019 are provided for comparison in Annex 7.

[109] These results are based on an assumption for a recovery rate of 85% in the insolvency counterfactual when conducting the least cost test. A lower recovery rate would mean that the DGS would be able to

The analysis shows that some deposits in a number of banks would not be shielded from losses in case the 8% TLOF needs to be met. In view of a greater protection of deposits, alternatives solutions for certain tail scenarios may be explored. For instance, should the DGS support not be sufficient or not be able to intervene due to the least cost test to cover the gap between the assets and the deposits transferred[110], the RF/SRF might provide additional financial support (irrespective of whether the 8% TLOF has been reached or not), when justified based on financial stability grounds or other exceptional circumstances. However, this additional flexibility was discarded as the 8% TLOF access condition to the resolution fund is generally perceived as a critical safeguard against moral hazard.

Regarding the argument of cost-efficiency associated with the use of DGS funds in resolution or alternative measures *versus* the cost of a payout of covered deposits, an ECB report on DGS alternative measures[111] shows that 261 banks, banking groups or hosted subsidiaries in the Banking Union could individually deplete their fully-filled DGSs with a single payout of covered deposits in insolvency. While 129 of these banks are significant institutions likely to involve resolution rather than a depositor payout in insolvency, the 132 remaining are less significant institutions or their hosted subsidiaries, which also have covered deposits exceeding the target level of their DGSs.

6.1.2.5. Use of industry-funded safety nets and cost synergies for banks

The nature of the impacts on banks and industry-funded safety nets, and the potential cost synergies related to these are the same as described under option 2. The main distinction under option 3 is the intensity of these impacts. Since the access to funding from DGS would be facilitated more substantially under this option (as a result of the single-tier depositor preference in the hierarchy of claims), DGS replenishment needs via *ex post* industry contributions could be higher. However, this potential higher cost for the industry would be counter-balanced by the following effects: (i) increased depositor protection including for non-covered deposits, which could facilitate more effective and efficient transfer strategies (restructuring and market exit) thereby fostering competitiveness for the sector; (ii) increased financial stability through credible financing of transfer tools in resolution or alternative measures for more failing banks in a credible manner, preserving asset value, reducing contagion and ensuring the continuation of client relationship, and (iii) reduced recourse to taxpayer funds while synergies between RF/SRF and DGS would be more efficiently combined, in particular in the Banking Union where the SRF and DGSs do not have the same base for the bank contributions. The combined use of the safety nets would enhance the resilience of the industry-funded

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contribute more and shield more depositors in a larger number of banks, as explained in Annex 7, section 4.5, while a higher recovery rate would have the opposite effect.

[110] DGS contributions to reach 8% TLOF may not be sufficient due to the least cost test limit or the cap when using the DGS funds for an individual bank (0.4% of covered deposits, or 50% of the DGS means).

[111] ECB (October 2022) *Protecting depositors and saving money - why DGS in the EU should be able to support transfers of assets and liabilities when a bank fails*.

source of funding available for bank failures and, to some extent, reduce the procyclicality of *ex post* contributions bearing on the sector[112].

However, foregoing the pooling effects that the implementation of EDIS could have brought, this option would not result in savings related to lower safety net contributions by the banking sector (see option 4). Therefore, the combined target level contributions for DGSs would remain as under the baseline option (0.8% of covered deposits).

[112] As replenishment needs are spread across a larger population of banks, not only on the domestic banking sector in case a DGS is used.

6.1.2.6. Assessment of Option 3

Benefits

Option 3 would broaden the application of the EU harmonised framework for resolution to more smaller/medium-sized banks on the back of more ambitious improvements in the funding solution. The legal clarification of the PIA would deliver a broad application of resolution tools. Legal clarity and level playing field would be significantly enhanced and the uncertainty regarding the handling of smaller and medium sized banks through diverging national solutions greatly reduced. The problems identified in the current framework regarding the difficulty to access funding sources and the broad discretion when deciding whether to place a bank in resolution or insolvency, would be addressed to a large extent. A more extensive use of resolution underpinned by a mechanism to improve access to the DGS and resolution funding, while meeting the 8% TLOF minimum bail-in condition, would limit further the recourse to public funds and enhance financial stability. At the same time, allowing DGS funds to bridge the gap to access the RF/SRF would introduce more proportionality for smaller/medium-sized banks under transfer strategies in accessing safety nets without weakening the minimum bail-in condition to access the RF/SRF. Implementing a single-tier depositor preference would shield more depositors from taking losses and enable more DGS funds' contribution to finance transfer tools in resolution or alternative measures under the least cost test. This would *de facto* provide more scope for DGS funding interventions for a larger population of banks than under the baseline and option 2, to either facilitate transfer transactions directly or help bridge the gap to meet the access condition of RF/SRF (provided market exit as a safeguard is observed).

The implementation of option 3 would strengthen the level playing field in the EU, improve legal certainty and predictability, and make the CMDI framework more incentive-compatible across all possible interventions available in the toolbox, whether they are embedded in the harmonised framework (BRRD/DGSD) or available under national insolvency procedure**.** Similarly to the other options, option 3 would facilitate the use of DGS funds in resolution, but also better frame interventions outside resolution such as preventive and alternative measures by clarifying access conditions (least cost test), leading to more standardisation, transparency, predictability of rules and an equitable treatment of depositors, creditors and taxpayers across the EU.

Option 3 would deliver tangible benefits to resolution authorities by increasing the legal certainty of the framework and providing them with stronger financing solutions to credibly handle bank failures. It would also enhance depositor protection and a more efficient use of industry funds, whose main purpose is to finance crisis management measures. Additionally, enabling and significantly strengthening the funding of resolution strategies, such as transfer tools, would be conducive to further cross-border market integration and consolidation.

Costs

The nature of the costs assessed under option 2 would largely remain valid under option 3, with the distinction that some costs under option 3 may be somewhat higher or

applicable to more banks, while at the same time comparatively delivering greater benefits (see above). These costs, as already explained under option 2, include: (i) potential additional replenishment needs by the industry without benefiting from lower contributions (in the absence of EDIS), (ii) risks of shortfalls in national DGS funds, which may require borrowing (from other DGSs or the market) or for a backstop by the sovereign, reinforcing the bank-sovereign nexus, (iii) additional coordination efforts between resolution and DGSs authorities, (iv) the need for banks earmarked for resolution due to the changes to the PIA to raise the required levels of MREL and (v) costs related to marginal reporting needs by banks entering the resolution scope for the first time.

A more substantial improvement in accessing industry-funded safety nets (RF/SRF and DGS funds), both in terms of higher amounts unlocked and for a larger population of banks (thanks to the single-tier depositor preference), may increase the risk of shortfalls in national DGS funds. Without EDIS, these shortfalls could be mitigated through extraordinary contributions by the banking industry, which may lead to pass-through costs effects from banks to their customers. DGS shortfalls could also be mitigated by lending from other DGSs, lending from the market or recourse to public funds. However, the latter would reinforce the bank-sovereign nexus. As under option 2, in the absence of EDIS, cost synergies for the industry in the form of reduced contributions to safety nets would not materialise and DGS' vulnerability to large shocks may continue to impair depositor confidence in the banking sector.

The implementation of this option would also require additional coordination among resolution and DGS authorities when using the DGS fund to reach the resolution fund. It would also imply additional tasks for resolution authorities to prepare additional resolution plans and set bank-specific MREL requirements due to the extension of the PIA. However, these costs would be mitigated by the benefits of using the framework as intended and ensure the market exit of failing banks without consequences on financial stability.

This option would also impact banks through the requirement to ensure adequate levels of internal loss absorbing capacity to allow for the execution of resolution strategies (bail-in or transfer strategies) and investing in projects to become more resolvable (i.e. enhancing their management information systems, valuation capabilities, revising contracts to assure resolution stays with counterparts, other projects related to the organisation structure and separability). However, whether new MREL requirements would translate into higher costs is a case-by-case assessment that cannot be estimated upfront, depending on the required MREL targets, the outstanding stock of eligible instruments that banks already hold as well as on bank individual features and market conditions. A mitigating factor for banks would be avoiding the loss of franchise value and the continuation of critical functions via a transfer to a buyer, avoiding the bail-in of depositors by using DGS to fill the gap towards accessing resolution funding, in case MREL capacity were not sufficient to support the resolution action, subject to safeguards.

While option 3 would address to a larger extent than option 2 the problems identified in chapter 2, it should be acknowledged, however, that the resolution scope and necessary

funding may not be secured in all cases under this option due to remaining discretion and the inherent limitations in the conditions to access funding (least cost test)[113]. As a consequence, the problem of insufficient legal certainty and predictability may not always be fully addressed and there may be some residual uncertainty in the treatment of certain bank liability holders in the event of a bank failure.

Overall assessment

Effectiveness, efficiency and coherence: Under option 3, the broadening of the resolution scope would be achieved with increased legal certainty and mirror the increased availability in funding. It would materially tackle the problem of level playing field, convergence in practices and use of public funds to manage failing banks, unlike the baseline or option 2 which would deliver a weaker reform in the same direction. Providing the funding and the PIA legal clarity to place more smaller/medium-sized banks in resolution would contribute to improving financial stability, depositor protection, limiting contagion and preserving critical functions in banking compared to the baseline and option 2, however to a lesser extent than under Option 4 where EDIS would significantly reinforce the funding equation. In this context, the issues related to the existing room for arbitrage and lack of clarity and predictability in the application of crisis management tools, as identified in Chapter 2, would be largely resolved, despite some residual risks that may remain due to certain inherent limitations in the access to funds (least cost test) and the remaining discretion. The possibility to use the DGS funds as a bridge to access the RF/SRF if conditions are met would require enhanced coordination between the SRB and national DGS authorities. However, this does not imply any change in governance. As explained above, the reforms envisaged in option 3 would entail certain costs, which would be outweighed by the benefits brought by the improvements to the framework in terms of financial stability, depositor protection, level playing field and taxpayer money.

The policy option package 3 (as well as 2) is assessed against the background of the 2015 EDIS proposal under the assumption that political negotiations remain on hold. However, option 3 is neutral but open to the introduction of EDIS at a later stage. Within the Banking Union, the establishment of EDIS (whatever the design), would enhance the effectiveness and efficiency of the framework under this option, as the firepower of deposit guarantee schemes to contribute to transfer strategies would increase, and with EDIS in place, there would be a better alignment between the level of the decision taking (EU or national) and the responsibility related to financing.

Stakeholder views and political considerations: The reform proposed under option 3 is fully aligned with the vision put forward by the Eurogroup in its statement of 16 June 2022[114]. The Eurogroup in inclusive format agreed on a clarified and harmonised public interest assessment, broader application of resolution tools in crisis management at European and national level, including for smaller and medium-sized banks where the

[113] Even under a single-tier depositor preference, the least cost test would not allow DGS fund intervention in all cases. Therefore, funding in resolution may remain beyond reach for a number of banks, provided the resolution authority wanted to include them in the scope. See Annex 7 section 4.
[114] Eurogroup (16 June 2022), *Eurogroup statement on the future of the Banking Union*.

funding needed for effective use of resolution tools is available, notably through MREL and industry-funded safety nets. The Eurogroup also agreed to further harmonise the use of national DGS funds in crisis management, while ensuring appropriate flexibility for facilitating market exit of failing banks in a manner that preserves the value of the bank's assets. It called for a harmonised least cost test to govern the use of DGS funds outside payout of covered deposits to ensure consistent, credible and predictable outcomes. Given diverging views among Member States on the merits and risks of implementing a single-tier depositor preference, the Eurogroup statement deferred the impact analysis and policy making to the Commission.

While many Member States find the idea of expanding resolution and a more extensive use of the RF/SRF appealing, some remain reluctant to facilitating the access to resolution funding due to concerns related to moral hazard and redistribution effects in case of replenishment needs following a depletion of the SRF in the Banking Union. At the same time, many Member States support the idea of expanding the resolution scope and framing the discretion regarding the PIA, while at the same time integrating more proportionality in the rules to access funding. One Member State is reluctant to facilitate the usage of industry-funded safety nets in resolution (RF/SRF) for non-systemic banks and, in this context, favours handling the failure of smaller/medium-sized banks at national level and with national DGS funds rather than under the harmonised framework.

The European Parliament supports adjustments to the CMDI framework with the goal of ensuring more coherent, credible and effective approaches across all Member States, including facilitating market exit of failing banks to the benefit of financial stability, taxpayers' protection and depositors' confidence[115]. In particular, the European Parliament supports a clarification of the PIA criteria, so that the framework is applied in a more consistent and predictable manner. It is also supportive of using DGS funds: (i) to fill the gap towards reaching the minimum bail-in rule (8% TLOF) to access resolution funding for smaller/medium sized banks with a transfer strategy or (ii) to support alternative measures in national insolvency for those banks, subject to a stringent, harmonised least cost test. The European Parliament therefore calls for more clarity on the least-cost principle and to the conditions for the use of DGS funds. It has finally stressed the need to explore a possible alignment of specific aspects of insolvency law for the purpose of aligning incentives and ensuring a level playing field.

The views of the industry, as for all options, are confirming the need to bring forward targeted amendments for improving the practical application of the CMDI framework, in particular with regard to improving the predictability of the PIA assessment. As under all options, on one hand, some smaller/medium-sized banks, in particular cooperatives and savings banks[116] may prefer to stay outside the scope of resolution to avoid costs related to additional requirements (MREL, reporting obligations to resolution authorities for resolution planning and MREL calibration, increased scrutiny by markets) or possible *ex post* contributions to the safety nets (RF/SRF or DGS). Many large banks, on the other

[115] European Parliament (June 2022), *European Parliament 2021 annual report on Banking Union*.
[116] ESBG (European Savings and Retail Banking Group) (October, 2022), *Short paper on the CMDI framework*.

hand, are supportive of bringing more smaller/medium sized banks into the resolution scope, regardless of their size and country of origin, and enhancing the credibility, predictability and consistency of the framework. Large banks also support minimising risks to taxpayer money and minimising moral hazard by ensuring a consistent and careful approach across the EU for the use of industry funded safety nets subject to a harmonised least cost test, supporting market discipline and avoiding competitive distortions. On the other hand, they are critical of the prospect of paying additional contributions into the safety nets, if these were to be used more frequently to handle the failure of more small/mid-sized banks[117]. However, the principle of industry funding (internal absorption capacity and safety nets) absorbing losses in case of distress/failure as opposed to public bail-out would inevitably come as a cost. Overall, the majority of stakeholders agree that resolution and insolvency tools should be applied more consistently, thereby ensuring a better level playing field in the treatment of similar banks across the EU.

In addition, some international institutions[118] acknowledge the more efficient use of funds in resolution rather than through payout in insolvency and the economic inefficiency, at a system level, of having significant funds sitting idle and untapped, while public funds are being employed to handle failures. Also, some industry players acknowledge the need for additional market consolidation in the EU and ensuring that smaller/medium-sized institutions actually exit the market when failing. Depositors, including SMEs, and consumer organisations support the reform proposed under option 3 because it would reduce the need for recourse to taxpayer funds and because they would be shielded to a greater extent from bearing losses in a failure, while industry-funded safety nets would take the second line of defence (after banks' internal loss absorbing capacity) to cover losses and sustain the financing of the crisis management measures.

Winners and losers: Depositors, including households and SMEs, are likely winners under option 3 by retaining uninterrupted access to their accounts under the assumption of a broader use of resolution tools delivered by legal clarifications in the PIA and enhancement of funding options. Taxpayers would also be better off under this option since banks' failures would be financed by industry-funded safety nets created for this purpose.

Smaller and medium-sized banks relying on equity and deposits and their clients would essentially be in a better situation if they were to fail, thanks to alternatives to access RF/SRF without bailing-in deposits and a more credible possibility of being transferred to a buyer while preserving their franchise asset value. Alternatively, under national

[117] AFME (Association for Financial Markets in Europe – an association of large banks) (October 2022), *Position paper on the CMDI review*.

[118] For instance, the Financial Stability Institute (FSI) insights on policy implementation no.45 (July 2022) "*Counting the cost of payout: constraints for deposit insurers in funding bank failure management*" argues that (p.4): *"Financial stability may benefit from broader use of deposit insurance funds in the management of a failing bank….(DGS) support for non-payout measures such as transfer transactions, bridge banks or capital and liquidity support under bank insolvency and resolution frameworks can achieve the same objective by minimising interruptions to depositors' access to their funds and, in addition, potentially offer wider benefits for financial stability. Those benefits stem from a broader range of failure management options for authorities which avoid the uncertainties and frictions of lengthy liquidation proceedings and achieve closure at a much earlier stage".*

insolvency regimes, they would have to rely on the national DGS funds to transfer the business or payout covered deposits under a liquidation process. However, the banking sector in general may face costs due to potential replenishment needs for DGS and RF/SRF, which would be used more broadly to substitute public funds. Absent any reduction of contributions to the safety nets, option 3 may be more expensive for the banking industry compared to option 4, while providing less benefits in terms of depositor protection and not addressing the bank-sovereign nexus in the absence of EDIS. Option 3 may also be potentially more expensive for the industry than option 2, however it would deliver superior benefits, as explained above. Banks newly subjected to resolution strategy would also need to invest in projects to become more resolvable (negative aspects from a banks' cost perspective, while a very positive one for financial stability). As under the other options, facilitating the access to resolution financing by using the DGS for banks with transfer strategies aims at ensuring an orderly market exit for such banks and it would not create an undue advantage compared to banks with open bank bail-in strategies, which are meant to be recapitalised and continue their operations post-resolution.

Resolution authorities would be winners under this option, benefiting from additional legal clarity stemming from the PIA legal amendments, a strong toolkit underpinned by more accessible safety nets and more consistent rules on access to funding in resolution and insolvency. Achieving standardisation and transparency thanks to the harmonisation of the least cost test, the reform under option 3 would solve the problem of misaligned incentives when deciding on the type of measures and tools to apply, leading to more convergence, legal certainty and improved level playing field. It would also reduce the authorities' legal risk (litigations).

Banks' creditors, and specifically senior ordinary unsecured creditors[119], would be more exposed to the risk of bearing losses under this option, since the banks in which they hold claims are more likely to be placed in resolution in case of failure than under the baseline and option 2, but to a lesser extent than under option 4. The degree of this impact depends on whether the bank would have a possibility to be restructured under national insolvency law under the current legislation.

6.1.3. Option 4 – Ambitious reform of the CMDI framework including EDIS

Option 4 envisages a review of the CMDI framework coupled with the implementation of EDIS as the third pillar of the Banking Union architecture. However, EDIS as envisaged under option 4 does not correspond to the fully fledged mechanism put forward in the 2015 Commission proposal, which did not make progress in co-legislative negotiations. Instead, it is consistent with a hybrid, intermediate mechanism more recently discussed in inter-governmental format since 2018 (see Annex 10, section 2). While this option was explicitly not endorsed by the Eurogroup, the Commission and

[119] The depositor preference (valid across all options) means that senior ordinary unsecured creditors become junior to deposits in the hierarchy of claims, while they previously ranked *pari passu* with non-covered non-preferred deposits. This would facilitate bailing in these creditors without creating a no creditor worse off risk, as under the baseline, in case non-covered non-preferred deposits would be shielded from losses.

many stakeholders continue to underline its importance, pointing that EDIS would make the CMDI framework more robust. The interplay between the CMDI framework and a possible EDIS in the future is important to bear in mind for the conceptual logic and policy design of the review. Therefore, it has been included in this impact assessment for technical completeness and consistency and in sign of acknowledgement of all the political and technical discussions which took place on EDIS in the past years.

6.1.3.1. Public interest assessment

Option 4 would deliver an expansion in the scope of resolution that would exceed in intensity the one under option 3, primarily thanks to a more ambitious funding solution including EDIS as a complementary central industry-funded safety net alongside the SRF in the Banking Union. The more extensive application of resolution, compared to other options, would be achieved through the same legislative amendments as proposed under options 2 and 3 plus loosening, more than under option 3, the burden of proof for resolution authorities to place banks in resolution thanks to a "general positive presumption of public interest". As also mentioned under other options, the number of additional banks that would go in resolution under this option cannot be estimated upfront, as the PIA remains a case-by-case assessment by resolution authorities. However, the strengthening of the PIA provisions and the presumption of public interest in the legislation are likely to result in a significant broadening of resolution application.

6.1.3.2. Conditions to access industry-funded safety nets

For a credible application of resolution tools on a broad scale, the access to resolution financing is key, especially for smaller/medium-sized banks with a large deposit base, likely to be resolved under transfer strategies. Importantly, as under options 2 and 3, the minimum bail-in requirement of 8% TLOF remains unchanged, to safeguard against moral hazard when using the RF/SRF. However, when deemed important for financial stability, deposits would not be required to cover losses to meet such requirement, if certain conditions are met. More specifically, the DGS/EDIS can intervene to support transfer strategies[120] leading to a market exit and cover losses *in lieu* of deposits up to the amount determined under the least cost test. This approach as in options 2 and 3 is justified by the need to ensure consistency with the broader approach to the PIA and the expectation that more adequate access to funding in resolution needs to be available for certain strategies.

Extending the scope for resolution combined with the possibility to access funding more broadly and credibly (RF/SRF, DGS/EDIS) would improve legal certainty in applying the PIA, achieve more convergence and level playing field in applying resolution across jurisdictions and, importantly, address the funding issues identified in Chapter 2. Implementing an EDIS central fund as a backstop to the DGS funds would tackle the problem of potential shortfalls in available resources of national DGSs that may be caused by significant shocks, which no other option can credibly tackle without engaging taxpayer funds. As under the other options, the targeted DGS/EDIS contribution to

[120] Concerning other enhancements made in the proposed reform to promote the use of DGS for transfer strategies, see Chapter 6, section 1.1.2.

reaching the condition to access RF/SRF for transfer strategies would introduce more proportionality, while at the same time safeguarding against moral hazard by maintaining the minimum condition of 8% TLOF.

6.1.3.3. Use of DGS funds/ EDIS role and governance

Option 4, which is the most ambitious in terms of resolution scope combined with a central fund in EDIS, also aims to address the problem pertaining to unclear rules and access conditions to DGS/EDIS funds per type of intervention, eliminating legal uncertainties. In terms of scope of intervention, support from EDIS would be called for all DGSs functions: payout of covered deposits, preventive measures, contribution in resolution and alternative measures in insolvency. The following clarifications would be made:

- Clarify and harmonise the conditions for financing of preventive measures by DGS/ EDIS contribution;
- Clarify the scope of intervention and least cost tests of DGS/ EDIS in resolution;
- Clarify and harmonise the least cost test for DGS contributions and access conditions to EDIS alternative measures in insolvency;
- EDIS to contribute, as a backstop to the DGS, to the payout of covered deposits in insolvency.

These adjustments would contribute to clearer rules leading to more legal certainty, simplification of the least cost test and eliminating difficulties in its application, enhanced level playing field and address the issue of inconsistent solutions to funding.

Under option 4, with the establishment of EDIS, the governance in the Banking Union would be revised and strengthened. In order to reflect the substantial concentration of resources at central level, a key role for the SRB in the decision-making process concerning the funding measures (including use of DGS/EDIS) would be required under this option. The SRB would therefore be empowered to take decisions in all scenarios where EDIS would need to be tapped. For certain elements of the decision-making process, and particularly the least cost test calculation, the SRB may however still decide to rely on input from national authorities when more specific national considerations are concerned (e.g. the ranking of liabilities at national level or an estimate of the recovery rates for assets).

6.1.3.4. Harmonisation of depositor preference in the hierarchy of claims

Option 4 envisages the implementation of a single-tier depositor preference in the hierarchy of claims and removing the super-priority of DGS/EDIS/covered deposits, as also explained under option 3. The only distinction is that the benefit of implementing a single-tier preference for depositors would also entail facilitating the use of EDIS under the least cost test where necessary as backstop to national DGS funds.

6.1.3.5. Use of industry-funded safety nets and cost synergies for banks with EDIS in place

Option 4 would generate significant synergies between the SRF and EDIS, both in terms of funding structure, liquidity depth and scope of intervention in resolution and insolvency. By design, pooling resources and increasing risk diversification would allow to increase the level of depositor protection, while creating room for lowering the target level and, consequently, reducing the contributions burden for the banking sector. The quantitative analysis[121] demonstrates the possibility to maintain or even increase the current level of depositor protection with a lower target level, even under systemic crisis simulations. The more resources are pooled the higher the potential reduction of contributions would be. For instance, assuming an ambitious pooling, EDIS would significantly lower the probability and the amounts of liquidity shortfall compared to the status quo with a 0.6% target level[122]. The cost savings for the banks in the Banking Union could represent on aggregate EUR 14 bn or 25.5% of total DGS contributions, as estimated based on Q4 2020 data. However, given the risk-based nature of contributions, the cost reduction would not affect all banks to the same extent[123].

However, if Member States wish to retain and cover the residual national options and discretions (other than preventive and alternative measures) under the DGSD (not fully harmonised), they would be required to finance them with funds above the target level. The current target level of 0.8% of covered deposits would continue to apply in the Member States outside the Banking Union.

6.1.3.6. Assessment of Option 4

Benefits

Option 4 would deliver a decisive step forward towards completing the Banking Union with its third pillar, EDIS. It would be broadening the application of the EU harmonised framework for resolution. In the Banking Union, it would create a central EDIS fund with pooled resources available to handle multiple bank failures, which would enhance the financial stability of participating Member States, strengthen the single market in banking and underpin the Economic and Monetary Union.

The legal clarification of the PIA would deliver a broad application of resolution tools. Legal clarity and level playing field would be significantly enhanced and the uncertainty regarding the handling of smaller and medium sized banks through diverging national solutions greatly reduced. The problems identified in the current framework regarding the robustness of funding sources, the difficulty to access them and the broad discretion when deciding whether to place a bank in resolution or insolvency, would be addressed to a large extent. An extensive use of resolution underpinned by central industry-funded

[121] In terms of calibration, a lot of work has been carried out in various fora (Council working parties, HLWG on EDIS, EGBPI, JRC reports) assessing various possibilities to pool funds into a central fund in a gradual manner. See Annex 10.

[122] There is a 95% probability that the hybrid EDIS with such a reduced target level provides a better protection than the status quo. See Annexes 10 and 12.

[123] The riskier the bank, the smaller the cost reduction and vice-versa.

safety nets and a mechanism to improve access the resolution fund while meeting the 8% TLOF would limit further the recourse to public funds and enhance financial stability, weakening the bank-sovereign nexus in the Banking Union.

Improvements to conditions for DGS/EDIS contribution to various interventions other than payout would render the use of DGS/EDIS more efficient when compared to a payout scenario[124] and boost depositor confidence, including due to continued access to their accounts also ensuring level playing field with an equitable treatment of depositors, creditors, taxpayers across the EU.

At the same time, allowing DGS/EDIS to bridge the gap to access the RF/SRF would introduce more proportionality for smaller/medium-sized banks under transfer strategies without weakening the minimum bail-in condition to access the RF/SRF.

This option would deliver cost synergies for the banking sector through a lower combined target level and related contributions, while providing extensive benefits via the available pooled resources.

Moreover, enabling and significantly strengthening the funding of resolution strategies such as transfer tools would be conducive to further cross-border market integration. It could also contribute to the efficiency of the EU resolution regime by promoting a functional framework able to cater for the failure of smaller/medium-sized banks, as it is the case in other jurisdictions (e.g. US with the Federal Deposit Insurance Corporation). In line with this more centralised use of funding, including when it comes to EDIS, this option proposes a governance structure with a prominent role for the SRB to manage funding for banks under its remit.

Costs

The creation of EDIS would involve set-up costs to pool funds in a central EDIS fund. However, these costs would be likely marginal, when compared to the set-up of the SRM/SRB/SRF in 2015, as the functioning of EDIS would build on already existing and functioning funds (DGS funds and SRF) and established processes, workflows and authorities (national DGS authorities and the SRB). While the set-up costs of this option would be higher than zero, the benefits of available liquidity in case of DGS shortfalls would render the cost-effectiveness of this option comparatively higher than that of other options.

The implementation of this option would also require additional coordination among authorities when using the DGS/EDIS to reach the resolution fund. It would also imply additional tasks for resolution authorities to prepare additional resolution plans and set bank-specific MREL requirements due to the extension of the PIA. However, these costs would be mitigated by the benefits of using the framework as intended and ensure the market exit of failing banks without consequences on financial stability.

This option would also impact banks which would need to comply with the requirement to ensure adequate levels of internal loss absorbing capacity to allow for the execution of resolution strategies (bail-in or transfer strategies) and investing in projects to become

[124] See also Annex 10.

more resolvable. However, whether new MREL requirements would translate into higher costs is a case-by-case assessment, depending on the required MREL targets, the outstanding stock of eligible instruments that banks already hold as well as on bank individual features and market conditions. A mitigating factor for banks would be avoiding the bail-in of depositors by using DGS/EDIS to fill the gap towards reaching the minimum bail-in rule (8% TLOF) to access resolution funding for banks with transfer strategy, in case MREL capacity were not sufficient to support the resolution action, subject to safeguards. However, using the DGS/EDIS fund and the RF/SRF would also entail re-couping those funds through *ex post* contributions from the industry.

Overall assessment

Effectiveness, efficiency and coherence: Option 4 would be a step forward towards completing the Banking Union with its third pillar. It would contribute by design to a greater application of resolution tools than any other option (through legal amendment including a general presumption of positive PIA), also strengthening financial stability, limiting significantly the recourse to taxpayer money, thanks to stronger, more accessible industry-funded central safety nets. This option is the one that would best preserve critical functions and the franchise value of assets in failing banks given the extensive use of resolution. This option would also contribute to better legal clarity and aligned incentives in the choice of applicable procedure (resolution or insolvency) as well as enhancing the EU level playing field. It would boost depositor protection and ensure they are treated equitably, irrespective of their location.

Stakeholder views and political considerations: Given the outcome of the June 2022 Eurogroup and the lack of agreement on a comprehensive roadmap to complete the Banking Union including EDIS, this option is considered politically unfeasible, at least in the current institutional cycle.

In its recent report on Banking Union[125], the European Parliament has stressed the importance of completing the Banking Union with the establishment of an EDIS, as its third pillar. In particularly, the European Parliament stresses the importance of EDIS, for improving the protection for depositors in the EU and their trust in the banking sector and for reducing the link between banks and sovereigns. However, the Parliament has not yet concluded its first reading of the Commission's 2015 EDIS proposal.

The potential to place more banks in resolution, benefiting from strong central safety nets and reducing financing costs (i.e. for EDIS in the Banking Union), is appreciated by the banking industry (banks of all sizes and business models), which considers that national DGSs are limited in size and firepower and a fully-fledged EDIS would be an essential piece of the Banking Union architecture. This view is not shared by IPS members, which consider their solidarity model as sufficient to avert failures. Some respondents to the targeted and public consultations[126] underlined that a fully-fledged EDIS would reduce the burden on banks while minimising the probability of a call for *ex post* contributions, also avoiding pro-cyclical impacts on banks' balance sheets. However, certain

[125] European Parliament (June 2022), *European Parliament 2021 annual report on Banking Union*.
[126] See Annex 2.

smaller/medium-sized banks which would come into the scope of resolution may need to bear additional obligations to enhance recovery plans, provide more extensive information to resolution authorities for the preparation of resolution plans, ensure compliance with MREL requirements and become more resolvable[127].

Consumer organisations are supportive of a centralised deposit insurance scheme[128] to ensure a uniform level of depositor protection and reinforce consumer confidence. Consumers support any solution that limits the use of public money to rescue failing banks. They would however prefer solutions where capital requirements for banks would be increased, and State aid in liquidation proceedings and of precautionary support would be subject to a stricter test[129].

Winners and losers: Taxpayers, depositors and Member States would benefit greatly from an improved and more proportionate CMDI framework with a strong EDIS in the Banking Union. Such a framework, given the expected application of resolution and the improved functioning of measures outside of resolution, would significantly reduce risks for financial stability, and would preserve banking critical functions for the society. The reduced recourse to public funds and the corresponding increased use of industry-funded safety nets (RF/SRF, DGS/EDIS) would have a positive impact on weakening the bank-sovereign nexus. More depositors would be likely better off than under other options, due to continued access to their deposits and depositor protection thanks to a robust EDIS in the Banking Union. Such a construction may also increase the appeal of the Banking Union with non-participating Member States, paving the way towards a more integrated and centralised single market in banking.

Smaller and medium-sized banks relying on equity and deposits, which are generally candidates for transfer strategies, and their shareholders, creditors and employees would also benefit from more proportionality by being able to access the RF/SRF more easily, without the need to systematically inflict losses on depositors. Such banks would be able to access the RF/SRF through DGS contributions under the least cost test, while being subject to safeguards (e.g. market exit if they fail). However, the smaller and medium-sized banks subject to an extended PIA would also need to comply with MREL requirements in line with the resolution strategy and invest in projects to become more resolvable (negative aspects from a banks' cost perspective, while a very positive one for financial stability). As under the other options, facilitating the access to resolution financing by using the DGS for banks with transfer strategies aims at ensuring an orderly market exit for such banks and it would not create an undue advantage compared to banks with open bank bail-in strategies, which are meant to be recapitalised and continue their operations post-resolution.

Resolution authorities would be winners under this option (even more so than under other options), benefiting from a strong toolkit underpinned by robust safety nets in the Banking Union and more consistent rules on access to funding in resolution and

[127] Yet, as a mitigating factor for these additional obligations, the BRRD provides for a proportionate treatment of smaller institutions by allowing for simplified obligations in terms of planning preparation and reporting of information to relevant authorities.
[128] Respondents to the consultation did not specify whether a centralised deposit insurance should take the form of the 2015 proposal or a hybrid model as under this option.
[129] See responses to the public and targeted consultations.

insolvency. This option would achieve more convergence and legal certainty in the application of rules, leading to improved level playing field. It would also reduce the authorities' legal risk (litigations).

Banks' creditors, and specifically senior bond holders, would be more exposed to the risk of bearing losses since the banks in which they hold claims are more likely to be placed in resolution in case of failure than under the baseline and other options. The degree of this impact depends on whether the bank would have a possibility to be restructured under national insolvency law under the current legislation.

6.2. Comparison and choice of preferred options

Table 1 provides a high-level summary of how the previously-described options compare (for the sake of readability of the tables, the labels of the options have been shortened).

Table 1: Summary of how the options compare

	EFFECTIVENESS				***EFFICIENCY (cost-effectiveness)***	***COHERENCE***	***OVERALL SCORE***
	Financial stability	***Minimise recourse to taxpayer money***	***Level playing field, single market***	***Depositor protection***			
Option 1 *Do nothing*	0	0	0	0	0	0	**0**
Option 2 *Slightly improved resolution funding and commensurate resolution scope*	+	+	+	+	+	++	+
Option 3 *Substantially improved resolution funding and commensurate resolution scope*	++	++	++	++	++	++	++
Option 4 *Ambitious CMDI reform including EDIS*	+++	+++	+++	+++	+++	+++	+++

Magnitude of impact as compared with the baseline scenario (the baseline is indicated as 0): +++ very positive; ++ positive; + slightly positive; +/- mixed effect; 0 no effect; – slightly negative; -- negative; --- very negative.

Leaving aside option 4 which, although technically the most robust option, is not politically feasible at this stage, option 3 would, on balance, deliver solutions to most problems identified in chapter 2. It is therefore considered to be the preferred option.

In particular, in terms of effectiveness, option 3 would deliver a crisis management reform contributing comparatively more than other options to strengthening financial stability, while facilitating market exit of failing banks. It would likely reduce the recourse to public funds by creating the funding conditions to handle more failures of smaller/medium-sized banks in the CMDI framework, using industry-funded safety nets. Increased access to funding in resolution or for alternative measures would open the possibility of shielding depositors from bearing losses, maintaining the client relationship and the franchise value of assets by creating room for a successful transfer of failing banks. Option 3 would also improve the legal clarity and predictability of the framework by standardising and harmonising the access condition to DGS funds for all contributions other than payout of covered deposit, ensuring incentive compatibility among the various

measures (preventive, resolution, alternative measures in insolvency) that could be used to handle bank failures.

In terms of cost-efficiency, option 3 would deliver benefits exceeding its costs by ensuring that already established industry-funded safety nets could be used more broadly and in a more efficient manner[130]. Additional obligations on banks generated through this reform would be mitigated by increased societal benefits, through protecting financial stability and taxpayer money, more market consolidation and transferring the benefits from banks' creditors to depositors and taxpayers. In comparison, option 4 would deliver more cost synergies to the industry through reductions of contributions to EDIS, thanks to the pooling effects that a central fund would create. However, in option 3 (as in option 2), the potential increase in costs for banks due to calls to replenish depleted safety nets, requirements to build-up loss absorbing capacity and other additional requirements, which come with having a resolution strategy (e.g. reporting, becoming more resolvable), would not be balanced by any cost reduction in contributions to the safety nets under this option.

In terms of coherence, all option packages, including option 3 have been designed with internal coherence among the various elements in mind (e.g. ambition on the PIA expansion matched by funding solutions).

The changes envisaged under option 2 go into the same direction as the ones described for option 3, however they would deliver a less extensive reform and, as a result, achieve a less effective outcome in terms of the objectives of the framework. This is mainly due to a less effective outcome in terms of potentially unlocking DGS funds as a result of implementing a two-tier depositor preference as opposed to a single-tier depositor preference as envisaged under option 3, which may limit the potential to place more banks in resolution. The overall costs of option 2 may be somewhat lower than in option 3, but so are the benefits delivered, i.e. a narrower scope to broaden resolution matched by a narrower increase in funding, as explained in the respective sections in Chapter 6.

When ranking the effectiveness of the various reform options envisaged and measured in terms of PIA scope, access to industry funding and depositor protection, the benefits delivered under option 2 would improve the current framework (baseline) less significantly. Option 3 would make a more substantial impact than option 2. Based on the sample analysed in Annex 7, section 4.1.3, the funding unlocked under option 3 would be 20 times higher than under the baseline, while it would be five times higher than under option 2. In this regard, option 3 would lead to an increased protection of taxpayer money and depositors, although it would also come at a potentially higher cost for the banking sector.

[130] Using the DGS fund for measures other than payout may result in lower disbursement needs than when paying out covered deposits in insolvency. See sections 7.1.4.4 and 7.2.2.6 in the evaluation (Annex 5) and ECB (October 2022), *Protecting depositors and saving money - why DGS in the EU should be able to support transfers of assets and liabilities when a bank fails*.

6.3. Common elements across the packages of options

This section provides an assessment of additional policy changes envisaged to enhance depositor protection and which are common across all packages of options. The remaining common elements across all packages of options (early intervention measures, timing of FOLF trigger, interaction between FOLF and insolvency triggers) listed in section 5.5 are of a more technical nature and presented in Annex 8.

Depositor protection

As observed in the four EBA opinions, the consistency of depositor protection in the EU needs to be improved across all options[131]. In addition to the current standard protection of EUR 100 000 per depositor per bank applicable across the EU, more convergence focusing on specific depositors (i.e. public authorities) or types of deposits (i.e. client funds of financial institutions, so-called temporary high balances) would contribute to a more equal treatment of depositors across the EU. The organisation of depositor payouts, addressing various situations involving money-laundering concerns in a cross-border context, or specific elements of information disclosure would also benefit from improvements. Having regard to the increasing volume of cross-border and Fintech services[132], these improvements would also help depositors navigate the different legal regimes to claim the repayment of their deposits in other Member States.

Key areas for further improvements are:

- Eligibility for depositor protection (e.g. public authorities);
- DGS payout processes (prescription timelines, determination of repayable amount, set off);
- Specific improvements to information disclosure for depositors;
- Cooperation between DGSs (reimbursements in host Member States, passported services and transfers of contributions in the event of changes to DGS affiliation);
- DGS funding (definition of available financial means, use of funding sources);
- More convergence in the application of national options and discretions, e.g. temporary high balances, third country branches;
- The treatment of client funds held by non-bank financial institutions.

Box 4: Implementing the EBA advice

The analysed policy options closely follow the opinions provided by the EBA for the CMDI review through two main channels.

First, the options retain 16 out of 19 recommendations from a set of four opinions dedicated to the review of the DGSD functioning (Table 10, Annex 6, section 2). The only exceptions are related to definitions of certain concepts discarded based on technical and legal considerations, or to recommendations which received no support

[131] See Chapter 2, section 2.3.1 and Annex 6.

[132] Fintech services refer to technology and innovation that aims to compete with traditional financial methods in the delivery of financial services (e.g. payments, investment).

from Member States. This is the case for the following elements:

- the recommendation to clarify the concept of "normal banking transaction" in the definition of deposit in light of recent case law[133] that clarifies whether certain funds held on an account fall within the definition of a deposit will be subject to a case-by-case assessment;
- the recommendation to assess whether there was a need to revise the definition of low-risk assets related to investments of the DGS available financial means led to the conclusion that there was no need to change this definition based on the feedback received from Member States where a majority did not see merit in changing the current definition;
- the recommendation on the possibility to use failed institutions' assets for a DGS payout was discarded based on the low likelihood that a failed institution would have a significant amount of liquid assets to pay depositors in the DGS' stead.

Second, the EBA report responding to the Commission's call for advice regarding funding in resolution and insolvency was fully taken into account. The policy options of the impact assessment mirror the different scenarios of changes in the creditor hierarchy analysed by the EBA, from the unharmonised three-tier depositor preference (status quo) to the harmonised single-tier depositor preference (preferred option). The EBA provides evidence that equally preferring all deposits to other ordinary unsecured claims could significantly increase the number of institutions that could be more efficiently managed in case of failure, by (i) reducing the overall cost (as the value of the bank is better preserved when it can be sold in resolution, as opposed to its assets sold in pieces in insolvency), (ii) accessing resolution financing arrangements (funded by the industry as opposed to taxpayers) and (iii) avoiding a bail-in of deposits (and deriving financial stability concerns and possible contagion generated by the unavailability of deposits in a liquidation). The impact assessment leverages on this pivotal conclusion to justify its policy choices in Annex 7 and reproduces the EBA's quantitative material in the numerical tables reported in this Annex.

7. PREFERRED OPTION

The packages of policy options outlined above would all provide an improvement to the status quo. All of them address, to some extent, some of the core issues identified in the problem definition and follow a similar direction. In particular, they would allow (to various degrees) a more extensive application of resolution, more proportionate and consistent access to funding sources in resolution and outside, and incentivise a more extensive use of the sources of financing which are funded by the industry (resolution fund, DGS) as a possible complement to the internal loss absorption capacity of the bank concerned. This would foster financial stability, depositor protection and limit recourse to taxpayers' funds. As an important distinguishing element, option 4 would also implement EDIS as a central fund[134], which would backstop the national DGS funds and reduce the link between banks and sovereigns, which cannot be achieved under the other

[133] The EU CJEU has clarified the meaning of the concept 'normal banking transactions' in the judgment of 22 March 2018 (Joined cases C 688/15 and C 109/16 Anisimovienė and Others v. Snoras).

[134] However, a different mechanism (hybrid) than the fully fledged EDIS put forward in the 2015 Commission proposal.

options. Although option 4 would be an important step towards completing the Banking Union, it cannot be implemented politically at this point in time.

All the options provide improvements with respect to the legal certainty and predictability in the management of bank failures. In particular, the clarifications to important provisions such as the harmonisation of the least cost test contribute to clarifying and resolving certain interpretive issues which have led to uncertainty in the application of the framework.

In the same vein, the proposed clarifications to some elements of the toolbox (detailed in section 6.3 of Chapter 6 and in Annex 8) which are important to ensure early action before the bank's failure (early intervention measures, preventive DGSD measures, BRRD precautionary measures) are effective in ensuring a better framed and more consistent use of these tools. Additionally, clarifications regarding advancing the timeliness of resolution action (by ensuring an adequately early FOLF triggering) would bring significant net societal benefits in terms of cost minimisation. While there may be limitations to the degree of ambition for advancing the determination in time of a bank as FOLF[135], the earlier this determination is made, the more resources (capital, liquidity) are available in the failing bank to facilitate the execution of a successful resolution action with potentially less need to impose losses on deposits. Finally, clarifications to the FOLF triggers and their coordination with triggers for insolvency (see Annex 8) would improve clarity with respect to the need for a swift exit of a failing bank from the market when there is no public interest in resolution. This in turn reduces the burden for authorities and banks in ensuring compliance with the legislative provisions. Since many of these amendments and clarifications are common to all options, it can be concluded that they all equally achieve the mentioned objective.

However, with respect to the objective of improving the effectiveness of the funding options and address the divergent access conditions in resolution and outside resolution, not all options are able to achieve the policy objectives to the same extent. From this perspective, the design features on access conditions to, and availability of funding are intrinsically linked with the scope of resolution that would be achieved as predicated by the PIA under the various options. In this respect, option 3 is the preferred option retained, as it achieves a strong funding from industry-funded safety nets aimed at supporting transfer strategies for failing banks in resolution or under alternative measures, if available, setting the stage for a credible broadening of the resolution scope.

Option 3 would make more DGS funds available for measures other than the payout of covered deposits in insolvency by harmonising the ranking of deposits through a single-tier preference in the hierarchy of claims and removing the super-priority of the DGS. Option 2 would enable a more modest use of DGS funds through a two-tier depositor preference without the super-priority of DGS, and thus lead to a less ambitious CMDI reform, which would require the same types of legislative changes as option 3 only with a lower impact in terms of achieving the overall objectives of the framework. It should, however, be acknowledged that option 3 would reduce the flexibility for resolution

[135] FOLF may not be triggered if private solutions are available to avert the bank's failure.

authorities to allocate losses to non-covered non-preferred deposits without breaching the "no creditor worse off" principle, as they would rank *pari passu* with other deposits excluded from bail-in. The preferred option 3 provides for a reinforced role of DGSs in the context of the CMDI framework. In particular, it promotes a more efficient use of more DGS resources for transfer strategies and introduces the possibility for DGSs to contribute to bridge the gap between deposits and 8% TLOF, under the least cost test.

All these changes are likely to translate into a more intensive use of DGS funds for measures other than the payout of covered deposits, which in turn may lead to higher costs for the industry in case of replenishment needs and potentially, higher risks of shortfalls. The magnitude of these costs for the industry may be higher under option 3 than under option 2, but they would also be balanced by addressing the identified problems to a greater extent and in a more credible manner and achieving greater societal benefits through a considerably higher likelihood to preserve financial stability, protect public funds and deposits. Also, as shown in the evaluation (sections 7.1.4.4. and 7.2.2.6) using DGS funds to facilitate transfer transactions in resolution or alternative measures is likely more efficient than paying out covered deposits in insolvency (baseline).

In the absence of EDIS, the only available avenues to remedy a DGS shortfall would be recourse to industry *ex post* contributions, alternative funding arrangements[136] and, in insolvency, to supplement the DGS intervention with liquidation aid financed by the State. In all cases, the solutions are less efficient than receiving financing from a centralised EDIS, which would provide an opportunity for lowering banks' contributions and a much more easily accessible source of financing compared to borrowing from other DGSs or the market. Moreover, an EDIS backstop to national DGS funds would weaken the bank-sovereign link. The political reality, however, has removed the implementation of EDIS as part of this CMDI reform package. But even without EDIS, the CMDI reform would improve the framework substantially by ensuring more banks could be handled via the harmonised framework by using the banks' loss absorbing capacity and industry-funded safety nets rather than taxpayers' funds.

Finally, also when it comes to the objective of addressing the uneven and inconsistent depositor protection, all options provide clarifications aimed at reducing the divergences in the protection of depositors across Member States (see further Annex 6). However, the lack of robustness in DGS funding identified as an issue in Chapter 2 cannot be fixed via this reform in the absence of EDIS.

The proposed policy options would not have a significant impact on administrative costs (i.e. information provision obligations by banks and resolution authorities), which would remain low under all options. This is because, the very marginal increase in reporting burden for banks entering the scope of resolution for the first time[137] would be offset by

[136] Article 10(9) DGSD Recourse to alternative funding sources would entail borrowing from the market, from other DGSs or from the State's public budget.

[137] Banks entering the scope of resolution for the first time would also be subject to the obligation to enhance recovery plans, provide information to resolution authorities on a more frequent basis for the preparation of more extensive resolution plans and ensure they become resolvable. While this would also involve additional costs for banks, these are estimated to be marginal, because banks earmarked for

the relief resulting from removing the MREL decision for liquidation entities where the MREL requirement is equal to own funds, as also shown in Annex 3.

Box 5: What this reform could mean for depositor protection and DGSs

Proposed changes under this reform

- Facilitated use of DGS funds in resolution to support the transfer of deposits, including non-covered deposits, from smaller/medium-sized banks funded by deposits that would have a positive PIA in case of failure, to other viable acquirers;
- Possibility to shield more depositors from losses, if conditions are met, at a lower cost for the DGS compared to a payout of covered deposits under insolvency;
- Harmonising the depositor preference in the hierarchy of claims by achieving a single-tier depositor preference, reducing unlevel playing field and NCWO issues in cross-border cases;
- Allowing a more cost-efficient use of DGS funds:
  - Changing the creditor hierarchy would enable unlocking DGS funds for resolution and alternative measures, under the least cost test, with increased cost efficiency compared to the cost of payout events. However, this would also potentially increase the use of DGS funds for transfer strategies with a call on the industry to replenish them;
  - Facilitating transfer strategies and better preserving the DGS financial means and protecting also non-covered deposits, as they would generally be more cost-effective than the payout of covered deposits. Transfer strategies in resolution could be more cash efficient and preserve the DGS funding capacity (e.g. by providing guarantees), or strongly limit the potential final loss but be more cash consuming (e.g. by providing loans) (see Annex 10);
  - The use of DGS funds in measures alternative to payout of covered deposits ensures intact client relationships and continued access of depositors to their accounts without any interruption of services, an important aspect in digitalised economies;
  - A clearer and more consistent approach to preventive measures would also be cost-effective for depositors by avoiding the bank's deterioration, depositor service interruption and costly payout events.
- Least cost test:
  - Removing legal uncertainty and inconsistency regarding the least cost test and the DGS intervention in preventive measures, resolution and alternative measures in insolvency (clarification and harmonisation of applicable conditions under Articles 11(3), 11(6) DGSD and Article 109 BRRD);
  - The inclusion of indirect costs in the least cost test calculation may be envisaged, but this alone would not replace the effect that the changes in the hierarchy of claims have on its outcome.

liquidation already report data to resolution authorities who prepare resolution plans albeit on a less frequent basis (under simplified obligations).

What stays the same

- The DGS coverage level (eligible deposits up to, generally, 100,000 EUR) and the DGS target level (in principle, 0.8% of covered deposits);
- Covered deposits and of the remaining part of eligible deposits of natural persons and SMEs (preferred deposits) would continue to rank senior to ordinary unsecured creditors;
- The protection of covered deposits, which continues to be ensured by:
  - the mandatory exclusion of covered deposits from bail-in as per Article 44(2) BRRD
  - The repayment of the covered amount guaranteed by the DGS, in case of unavailability
  - the possibility for the DGS to contribute to interventions other than the payout of covered deposits, such as contribution to resolution or to preventive measures and alternative measures in insolvency;
- The counterfactual in the least cost test (referring to the losses that covered deposits would have incurred in insolvency).

Rationale for shielding also (non-covered) depositors from losses

- Allowing more credible transfer strategies by facilitating the inclusion in the transfer perimeter of entire deposit contracts and not only the covered part. This avoids compromising the customer relationship and the franchise value, which would otherwise increase the risk of deposit runs and potentially impair the appetite of the acquirer for the transfer;
- Maintaining the integrity of deposits, which are considered by most national authorities instrumental to bank intermediation in the economy (i.e. channelling savings into investments and lending), one of the main pillars of confidence in the banking system and an important element to financial stability and the functioning of the payment system;
- Deposits fulfil a different role in the economy than investor claims. Depositors use banks, primarily, as a secure place for placing their savings, for meeting future needs, while investors take a (remunerated) claim in the bank after having analysed related risks and rewards;
- Alignment with past experiences of handling banks' failures showing a high interest in protecting deposits, where State aid was granted, *inter alia*, with the aim of protecting depositors and where the use of those public funds did not require the burden sharing of any depositor.

It can be concluded that, from a technical point of view, Option 3 is the one that would, on balance, meet most of the objectives in the most effective, efficient and coherent manner. This would entail a legislative proposal addressing the funding and the incentive compatibility problems in the CMDI, namely measures to improve the proportionality of accessing the resolution fund for deposit-based banks, by opening the possibility for the DGS to be used to cover some of the losses that would otherwise be borne by depositors (in order to reach the 8% TLOF and access resolution financing). The improvement in proportionality is necessary in order to make the framework work for smaller/medium-sized banks and it does not go beyond what is strictly necessary for the sake of meeting the policy objectives.

These technical considerations are aligning well with the equally relevant political ones expressed by Member States in the June 2022 Eurogroup statement and by the European Parliament[138]. While the Commission retains full authority and independence in proposing legislation, it is appropriate and efficient to take into account the elements emerging from the related political discussions. Striking a balance between a solution which can satisfactorily address the identified problems while being sufficiently supported politically should form the basis for a successful negotiation between the co-legislators.

REFIT

The proposed reform will bring about benefits with respect to administrative efficiency and cost savings. These are largely the result of the various proposed measures to increase the harmonisation of certain elements of the framework and to clarify points, which have led to considerable discussion to achieve agreed interpretations.

In this respect, the measures proposed on the least cost test and the use of a consistent methodology across different uses of DGSs will bring more simplification. Similar positive impacts should be expected from the proposed clarifications to the use of DGSs in resolution (Article 109 BRRD), and the use of resolution fund resources for liquidity purposes. Other relevant clarifications in this respect are those related to the use of early intervention measures, where simplification and clarity is achieved by removing overlaps with supervisory measures, which have so far impaired the use of early intervention measures. In addition, clarifications of FOLF triggers and the concept of winding down under national measures applying in case of negative PIA will ensure further certainty and consistency of outcomes of the procedures available.

Additionally, the proposed harmonisation of the ranking of depositors will bring about more consistency and harmonisation across Member States on the treatment of deposits, avoid uncertainties and potential unlevel playing field. It will also facilitate the role of the resolution authorities when assessing the existence of breaches of the no creditor worse of principle. In the same manner, the proposed technical improvements in the DGSD[139] are expected to remedy application issues and improve, overall, the consistency of depositor protection in the EU.

Finally, the improvements included in this initiative are "future-proof" and deemed to significantly enhance the preparedness of banks and resolution authorities in dealing with emerging and future crises cases, especially in the context of the deteriorating economic environment due to geopolitical tensions.

[138] See also section 6.1.2.6 on the main considerations of the European Parliament related to the CMDI reform.
[139] See section 6.3 and Annex 8 on the 'Common elements across the packages of options'.

Other impacts

Climate and environmental impacts

Pursuant to Article 6(4) of the European Climate Law[140], no direct climate or environmental impacts and no significant harm, either direct or indirect, are expected to arise from the implementation of the preferred option. The initiative may have some indirect positive impacts on fostering the transition to a more sustainable economy by increasing financial stability and the overall resilience of the banking sector, therefore enabling banks' contribution to green transition goals. This effect would be however indirect and is not possible to quantify. The initiative is considered to be consistent with the objectives of the European Climate Law.

Social impacts

Employees are not directly impacted. A robust and resilient banking sector and enhanced protection of depositors in cases of bank failures, including of SMEs and larger corporate depositors, would increase the likelihood that employees would be able to keep their jobs in companies that hold deposits and are clients in banks. Moreover, a solid banking sector could better contribute to financing the economy and promoting growth which would benefit the non-financial sector and their employees. No further significant social impacts are expected.

SMEs

The CMDI review is not directly addressed to SMEs, however they would benefit from the improvements that the reform is expected to bring, in their quality of depositors and bank customers. The initiative aims to ensure that the crisis management toolbox can be flexibly applied to more smaller/medium-sized banks in a manner that achieves the framework's objectives, including the protection of depositors, which can be SMEs. Additionally, enabling crisis management tools facilitating the transfer of the failing bank's business to a buyer would ensure the continued client relationship for depositors, including SMEs and avoid the interruption of access to the accounts and the risk of losing the non-insured part of their deposit, as in case of an insolvency.

Digitalisation

This initiative has a slightly positive impact on digitalisation, arising notably through the proposed option to broaden the use of DGS funds for supporting the handling of failing banks through measures other than payout in insolvency (i.e. resolution, preventive or alternative measures), which would be disruptive for customers' continued access to their accounts for a significant period of time. Based on our assessment, the preferred option would ensure continued access to customer accounts, an important element encouraging digitalisation in banking services.

[140] Regulation (EU) 2021/1119 of the European Parliament and of the Council of 30 June 2021 establishing the framework for achieving climate neutrality and amending Regulations (EC) No 401/2009 and (EU) 2018/1999 ('European Climate Law')

External impacts

This initiative does not specifically target third countries or their entities, as it is focused on reforming the EU CMDI framework. However, certain benefits arising from further legal clarity, harmonisation and standardisation (i.e. depositor preference in the creditor hierarchy) would also benefit entities of third country banks operating in the EU.

Impact on fundamental rights

The preferred option respects the rights and principles set out in the Charter of Fundamental Rights. The free movement of persons, services and establishment constituting one of the basic rights and freedoms protected by the Treaty on the European Union and the Treaty on the Functioning of the European Union is relevant for this measure.

The preferred option will not have any negative impacts on fundamental rights since most Member States recognise that the need to safeguard the rights of banks' shareholders and creditors must be balanced against the rights of taxpayers, depositors and the general interest of protecting economic value and financial stability. Overall, the impact on fundamental rights will be neutral.

8. HOW WILL ACTUAL IMPACTS BE MONITORED AND EVALUATED?

The Commission shall carry out an evaluation of this package of proposed amendments, five years after its entry into application and present a report on the main findings to the European Parliament, the Council and the European Economic and Social Committee. The evaluation shall be conducted according to the Commission's better regulation Guidelines. Member States shall provide the Commission with the information necessary for the preparation of that report. The evaluation will be based on a list of specific and measurable indicators that are relevant to the objective of the reform, as presented in the following table.

Summary of indicators

Objectives	Indicator	Source of information	Data already collected?	Actor(s) responsible for data collection
Further enhance legal certainty and strengthen an even playing field as regards the application of the tools available in bank resolution and insolvency.	Number of banks undergoing resolution	Information from the NRAs/SRB, Official Journal	Yes	EBA/NRAs/ SRB, Commission
	Number of different resolution tools and powers applied (e.g. transfer tools, bail-in)	Information from the NRAs/SRB	Yes	EBA/NRAs/ SRB
	Number of banks benefitting from precautionary aid measures, which subsequently are determined to be FOLF	Official Journal	Yes	Commission
	Number of banks benefitting from DGS preventive measures, which subsequently are determined to be FOLF	Information from the DGSs, Official Journal	Yes	EBA, Commission
	Number of banks (for which EIM triggers have been met) addressed through an EIM measure	Information from NCAs/SSM	No	EBA

	Number of positive PIA assessments by the NRAs/SRB for banks determined to be FOLF and type of elements included in the PIA assessments	Information from the NRAs/SRB	No	EBA
	Number of winding up procedures	Information from the NCAs/DGSs	Yes	EBA
	Average period between the issuance of a negative PIA assessment and the initiation of the orderly winding up proceedings for failing banks that cannot be resolved	Information from the NCAs/NRAs/DGSs	No	EBA
	Complaints about competitive disadvantages due to different insolvency rankings of ordinary unsecured claims and other deposits	Stakeholder feedback	No	Commission
	Ad-hoc statistical analysis e.g. correlation between CDS banking sector and CDS of sovereign, correlation between bank share price and sovereign spread (*)	Market data	Yes	EBA
Facilitate access to safety nets in case of bank failure and improve the clarity and consistency of funding rules.	Number of banks (of small/medium/large size) which are determined to be FOLF accessing resolution funding and amount of resolution funding provided. Percentage of banks (of small/medium/large size) which are determined to be FOLF accessing resolution funding	Information from the NRAs/SRB; Official Journal	Yes	EBA, Commission
	Number of banks undergoing resolution accessing DGS funding in resolution and amount of the DGS funds provided in resolution in relation to the two possibilities: (a) bridging the gap to the 8% minimum bail in requirement otherwise required, for transfer strategies, or (b) other uses in resolution than bridging the gap to the 8% minimum bail in requirement otherwise required, for transfer strategies.	Information from the DGSs/SRB, Official Journal	Yes	EBA/DGS/ SRB, Commission
	Number of banks accessing DGS funding for alternative measures and amount of DGS funds provided for alternative measures.	Information from the DGSs, Official Journal	Yes	EBA, Commission
	Number of banks accessing DGS funding for preventive measures and amount of DGS funds provided for preventive measures.	Information from the DGSs, Official Journal	Yes	EBA, Commission
Further align the coverage level of depositors and upgrade the capacity of national DGS's to withstand local shocks.	Number of national DGSs without any alternative funding arrangements in place	Stakeholder feedback	No	Commission
	Final amount of losses incurred by DGSs for any type of intervention	Information from the DGSs	No	EBA
	Number of cases where third country branches were granted a derogation from the obligation to participate in the DGS.	Information from the responsible authority	No	EBA

(*) This type of indicators would capture several of the general objectives of the CMDI framework (such as financial stability, breaking the sovereign-bank nexus, etc.) and disentangling the individual effects would not be possible.

Compliance and enforcement will be ensured on an ongoing basis including, where needed, through infringement proceedings for lack of transposition or for incorrect transposition and/or application of the legislative measures. Reporting of breaches of EU law can be channelled through the European System of Financial Supervision, including the national competent authorities, EBA as well as through the ECB. EBA will also continue publishing its regular reports, such as the reports taking stock of the compliance with MREL in the EU. This is run in parallel with the quarterly MREL dashboard

published by the SRB for the Banking Union. EBA will also continue to assess and monitor the resilience and the funding levels of the national DGSs.

ANNEX 1: PROCEDURAL INFORMATION

1. LEAD DG, DECIDE PLANNING/COMMISSION WORK PROGRAMME REFERENCES

This impact assessment report was prepared by Directorate D "Banking, insurance and financial crime" of the Directorate General "Directorate-General for Financial Stability, Financial Services and Capital Markets Union" (DG FISMA).

The D*e*cide Planning references are:

- PLAN/2020/8120: BRRD Review – Proposal for a Directive of the European Parliament and of the Council amending Directive 2014/59/EU (BRRD)
- PLAN/2020/8121: DGSD Review – Proposal for a Directive of the European Parliament and of the Council amending Directive 2014/49/EU (DGSD)
- PLAN/2020/8122: SRMR Review – Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 806/2014 (SRMR)

This initiative was part of the Commission's 2021 Work Programme[141], though its timing was determined by the long-awaited political agreement on a comprehensive work plan to complete the Banking Union, which was not achieved in the June 2022 Eurogroup. Instead, the Eurogroup invited the Commission to table legislative proposals for reforming the CMDI framework[142].

2. ORGANISATION AND TIMING

Eight Inter-Service Steering Group (ISSG) consultations – chaired by SG – were held between 2020 and 2023:

- 19 October 2020
- 25 March 2021
- 11 May 2021
- 4 June 2021
- 18 May 2022
- 12 to 16 September 2022 (under written procedure)
- 25 November 2022
- 17 January 2023.

The ISSG consisted of representatives from various Directorates-General of the Commission: BUDG, COMP, ECFIN, GROW, JUST, REFORM, TRADE, SG and SJ. The contributions of the members of the Steering Group have been taken into account in the content and shape of this impact assessment.

Adoption of the package is expected in April 2023.

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[141] Commission Work Programme 2021: A Union of vitality in a world of fragility, 19 October 2020, COM(2020)690 final.

[142] Eurogroup (16 June 2022), *Eurogroup statement on the future of the Banking Union*

3. CONSULTATION OF THE RSB

An upstream meeting was held with the Regulatory Scrutiny Board (RSB) on 28 April 2021.

The draft report was sent to the RSB on 28 September 2022 and the hearing took place on 26 October 2022. The RSB delivered a negative opinion on 28 October 2022. The report was resubmitted to the RSB on 9 December 2022; the RSB then issued a positive opinion on 17 January 2023.

The principal areas/topics raised by the RSB's opinion of 28 October 2022 are addressed and clarified in this Impact Assessment in the following manner:

Recommendations of the RSB Elements to improve (section (C) of the Opinion)	**How the comments have been addressed**
(1) The report needs to better identify and explain the substantive problem and shortcomings in the current framework it seeks to address and substantiate it with robust evidence. In doing this, it should draw on the conclusions of the evaluation that the EU resolution framework is sparsely used. It should examine exactly why this is a problem and what the drivers behind it are by clearly setting out the disincentives for Member States (and banks) to practical bank resolution using the EU framework. It should explain why the current arrangements and incentives have failed and why Member States have shown a strong preference for resolution outside of the EU framework. It should demonstrate why this poses a risk to the wider financial stability of the EU. It should show why the current arrangements would not be fit for purpose in a large scale financial crisis scenario. Finally, it should better explain the international experience in handling bank failures and the lessons that can be drawn from these.	• Clarifications of the objective, design and scope of the crisis management and deposit insurance framework and the merits of resolution compared to national insolvency proceedings (Chapter 1 and Annex 4 for additional details). • Summary of the problems identified during the implementation of the framework and the reasons why this reform is necessary, in particular why the framework should also be applicable to small and mid-sized banks; additional evidence showing that the failure of smaller banks can also impact financial stability including a stylised example to illustrate these problems (Chapter 2, Annex 4, Box 6) • Details on the nature and magnitude of the risk of maintaining the framework as it stands, considering the problems identified and their impacts on financial stability, depositor protection and public finances (Chapter 5, section 5.3) • Update of relevant figures on the implementation of the framework to take into account a recent resolution case in Poland (Chapter 2 and Annexes 5 and 9) • Details on the how recent cases of failure managed under the CMDI framework relate to the identified problems (Boxes 8, 10 and 11, Annex 5)
(2) While the resolution framework is designed to cover all banks in the EU, in	• Explanations on how the principle of subsidiarity is addressed in the reform

practice its use has been limited. The report should recall and better explain that all banks are covered by the existing framework and demonstrate, with evidence, the need to facilitate the practical use of the EU resolution framework for smaller and mid-sized banks. It should demonstrate how this is consistent with the principle of subsidiarity. This should include evidence to demonstrate the clear cross-border nature of the problem including by providing evidence on the composition of the banking sector in different Member States and the differing scale and geographical spread of the potential recipients. It should provide evidence of the risk of EU-wide contagion in the internal market and for public finances if the current arrangements persist. Finally, it should better set out the division of roles between the EU state aid framework (and its upcoming revision) and the resolution framework and how coherence will be ensured between the two.	and evidence on risk of contagion and systemic nature of small banks (Chapter 3, section 3.2, Annex 4, Box 6) • Details on the interactions between the CMDI and the State aid rules under the current framework and how consistency will be achieved with the revision of the CMDI framework (Chapter 5, section 5.2 and Annex 4) *Some amendments listed to address recommendation (1) are also relevant for recommendation (2).*
(3) The report should better explain the links between the EBA advice and the options set out in the report. It should clarify the envisaged bridging facility, its scope and limitations, and its envisaged impacts. It should explain that EDIS under the most comprehensive option 4 is different from the 2015 EDIS proposal. It should better articulate how the analytical and policy coherence between option 3 (which does not include EDIS and for which a further legislative proposal is envisaged) and the pending 2015 EDIS proposal will be ensured. In view of this specific context and the results of the presented analysis the report should reflect whether analytically it is not more useful to leave the choice of the preferred option open.	• Details on how the advice provided by EBA has been taken into account in the design of the policy options (Chapter 6, section 6.3, Box 4) • Details on the functioning of the DGS bridge financing, including on the scope and safeguards and a stylised example with a visual presentation of the CMDI reform on this point (Chapter 6, section 6.1.1.2, Box 2) • Clarification that EDIS envisaged under option 4 in the packages of policy options is not the same mechanism as envisaged as the Commission 2015 proposal (Chapter 6, section 6.1.3 - Option 4, section 6.1.2.6 – Option 3 and footnote in Chapter 7)
(4) The report should be revised to make it self-standing and accessible to the non specialist reader. While technical language is necessary in certain parts for experts practitioners, and in particular in annexes, it is important that the main narrative remains clear for political decision makers.	• Executive summaries of EBA and JRC reports used in, and annexed to, this impact assessment respectively (Annexes 11 and 12) • A general review of the core impact assessment and the glossary to clarify technical terms and contribute to make the report more self-standing for a non-expert audience. • Additions to, and review of, the

	glossary
(5) The report should better integrate the views of all stakeholders in the main report, by better distinguishing between the views of different groups on all key aspects.	• Additional information on stakeholder views with a distinction between small and large banks (Chapter 6, sections 6.1.1.6 Assessment of Option 2 – Overall assessment and 6.1.2.6 Assessment of Option 3 – Overall assessment)

The limited suggestions raised by the second RSB's opinion of 17 January 2023 are addressed and clarified in this Impact Assessment in the following manner:

Recommendations of the RSB Elements to improve (section (C) of the Opinion)	**How the comments have been addressed**
(1) The report should address the 'One In: One Out' requirements. If quantitative estimates cannot be produced, or if these are negligible, or the proposal is considered to have no 'One In: One Out' implications, this should be explained.	• Additional information on the 'One In One Out' clarifying the neutral effect of the initiative on administrative costs added in Annex 3 and referenced also in Chapter 7 when describing the preferred option.
(2) While the report presents general views of large and small banks on the policy options, Annex 2 still does not provide a general overview of differentiated stakeholder views. Annex 2 should consider responses by type of stakeholder.	• Additional information on stakeholder views with a distinction between small and large banks included in Annex 2, in line with the description of stakeholder views in Chapter 6.

4. EVIDENCE, SOURCES AND QUALITY

The impact assessment evaluation drew on a broad range of information sources such as results of consultations with stakeholders, reports from the EBA, and additional desk research by the Commission services. More specific sources included:

- Eurogroup's Statement of June 2022[143];
- The Commission's 2019 review report of the BRRD and SRMR[144];
- Overview of past cases of bank failures, including those handled under State aid rules[145];
- 11 expert group meetings with Member States as part of the Commission's Expert Group on Banking, Payments and Insurance (EGBPI);
- The European Parliament's 2021 report on the Banking Union[146];

[143] Eurogroup (June 2022), *Eurogroup statement on the future of the Banking Union of 16 June 2022*.
[144] European Commission (April 2019), *Report from the Commission to the European Parliament and the Council on the application and review of Directive 2014/59/EU (BRRD) and Regulation 806/2014 (SRMR)*.
[145] See Annex 9.
[146] European Parliament (June 2022), *European Parliament 2021 annual report on Banking Union*.

- Feedback from the inception impact assessment which took place between 10 November – 8 December 2020 and gathered 15 responses from EU and third countries (see Annex 2);
- Two public consultations on the experience with the application of the CMDI framework and views on its revision (see Annex 2):
    - a public (general) consultation[147] which ran for 12 weeks from 25 February– 20 May 2021 and gathered over 90 responses from a broad range of stakeholders across the EU, and
    - a targeted (technical) consultation[148] which took place between 26 January and 20 April 2021 with over 90 responses received from a broad range of stakeholders across the EU, as well as third countries;
- Feedback from DG FISMA's conference organised on 18 March 2021 discussing the challenges in the current CMDI framework and exploring potential avenues for its review[149] (see Annex 2);
- An administrative arrangement (N FISMA/2020/003/D3/AA) with the Joint Research Centre in 2020/21 on Financial Safety Nets in the European Union (FinSafEU) for analytical assessments in particular on risk-based contributions, temporary high balances, different EDIS designs and the review of the BRRD framework (see Annex 12);
- A Call for advice to the EBA targeted on funding issues in the CMDI framework[150] (see Annex 11);
- Four reports from the EBA on the implementation of the DGSD[151];
- EBA reports, i.e. on the application of early intervention measures in the EU[152];
- ECB's occasional paper on why DGSs in the EU should be able to support transfers of assets when a bank fails[153];
- A study financed under the European Parliament's pilot project "Creating a true Banking Union" on the options and national discretions under the DGSD and their treatment in the context of a European Deposit Insurance Scheme (EDIS)[154];
- A study financed under the European Parliament Pilot Project "Creating a true Banking Union" on the differences between bank insolvency laws and their potential harmonisation[155];

[147] *Public consultation* on the review of the bank crisis management & deposit insurance framework.
[148] *Targeted consultation* on the review of the bank crisis management & deposit insurance framework.
[149] High-level conference – *Strengthening the EU's bank crisis management and deposit insurance framework: for a more resilient and efficient banking union.*
[150] European Commission (19 April 2021) *Call for advice to the EBA regarding funding in resolution and insolvency as part of the review of the crisis management and deposit insurance framework*.
[151] EBA opinions of *8 August 2019*, *30 October 2019, 23 January 2020* and *28 December 2020* issued under Article 19(6) DGSD in the context of the DGSD review. See also Annex 6.
[152] EBA (27 May 2021), *Report on the application of early intervention measures in the European Union in accordance with Articles 27-29 of the BRRD*, EBA/REP/2021/12.
[153] ECB (October 2022), *Protecting depositors and saving money - why DGS in the EU should be able to support transfers of assets and liabilities when a bank fails*.
[154] European Commission (28 November 2019) under the European Parliament's Pilot Project "Creating a true Banking Union" *Study on the Options and national discretions under the DGSD and their treatment in the context of a European Deposit Insurance Scheme*.
[155] European Commission (28 November 2019) under the European Parliament's Pilot Project "Creating a true Banking Union" *Study on the differences between bank insolvency laws and on their potential harmonisation.*

- 50 bilateral meetings with resolution and competent authorities between 2019 and 2022;
- Third party events (e.g. seminars, workshops, conferences) on the topic of the CMDI framework[156];
- 58 bilateral stakeholder meetings with banks, industry associations, think-tanks (between 2019 and 2022);
- The Risk reduction monitoring report prepared jointly by the Commission services, the ECB and the SRB for the Eurogroup meeting of 30 November 2020 in view of the political decision to approve the ESM Treaty reforms and the early introduction of the backstop to the SRF[157] and the Eurogroup meeting of May 2021[158] and subsequent edition of November 2021[159].
- Discussions in the High Level Working Group (HLWG) on EDIS and the Council's Working Party (CWP)[160];
- Eurogroup conclusions of November 2020[161], calling for a review of the CMDI framework and which agreed the early introduction of a common backstop to the SRF in 2022;
- The Fit for the Future (F4F) Platform's opinion on the completion of the Banking Union. [162]
- The Financial Stability Board's (FSB) Too big to fail (TBTF) report[163] evaluating the application of resolution frameworks for global systemically important banks around the world.

The Commission services also took into consideration the report by the European Court of Auditor's on the functioning of the Single resolution mechanism[164] and on the control of State aid to financial institutions[165].

[156] For example, workshop at the Banca d'Italia on *The crisis management framework for banks in the EU - How can we deal with the crisis of small and medium-sized banks*.
[157] European Commission, ECB and SRB (November 2020), *Joint monitoring report on risk reduction indicators*.
[158] European Commission, ECB and SRB (May 2021), *Joint monitoring report on risk reduction indicators*.
[159] European Commission, ECB and SRB (November 2021), *Joint monitoring report on risk reduction indicators*.
[160] The outcome of these discussions is mostly in public domain on the Council webpage.
[161] Eurogroup (30 November 2020), *Eurogroup conclusions.*
[162] F4F Platform Opinion (10 December 2021), *Completing the Banking Union*.
[163] Financial Stability Board (1 April 2021), *Too big to fail report*.
[164] European Court of Auditors (January 2021), *Special report: Resolution planning in the Single Resolution Mechanism*.
[165] European Court of Auditors (October 2020), Special Report 21/2020, *Control of State aid to financial institutions in the EU: in need of a fitness check*.

ANNEX 2: STAKEHOLDER CONSULTATION

1. INTRODUCTION

The European Commission is currently reviewing its CMDI framework and is expected to make legislative proposals in Q1 2023. In order to understand better the performance of the framework as well as the possible scope for improvements, the Commission undertook extensive exchanges through different consultation tools to reach out to all stakeholders involved. Annex 2 provides a summary of the consultation activities that were considered while preparing the impact assessment.

2. CONSULTATION STRATEGY

To ensure that the Commission's proposal on the CMDI framework review adequately takes into account the views of all interested stakeholders, the consultation strategy supporting this initiative builds on the following main consultation activities:

- An **Inception Impact Assessment**
- **A targeted consultation** open for a total period of 12 weeks
- **A public consultation** open for a total period of 12 weeks
- **Targeted consultations** of Member States and bilateral exchanges with stakeholders and resolution/competent authorities
- **A high-level conference**
- **EBA opinions**
- The **F4F Platform's opinion** on the completion of the Banking Union

The results of each component are presented in the synopsis report below.

3. FEEDBACK ON THE COMBINED INCEPTION IMPACT ASSESSMENT/ROADMAP

The combined Inception Impact Assessment and roadmap aim to provide a detailed analysis on the actions to be taken at the EU level and the potential impact of different policy options on the economy, the society and the environment. The feedback period for the Inception Impact Assessment lasted four weeks (10 November – 8 December 2020). The Commission received 15 responses through the *"Have Your Say!"* portal from different stakeholder groups: banking associations (5), public authorities (4), company/business organisations (2), trade union (1), academia (1) and "other" (2).

All respondents acknowledged the need for a targeted review of the CMDI framework to increase its efficiency, proportionality and overall coherence. Some respondents emphasised the need for improving the applicability of existing resolution tools.

Most feedback, including from both large and small/medium-sized banks, supports levelling the playing field in the management of bank failures, in particular, by reducing discretion and ensuring more consistency in the application of the public interest assessment (PIA) and by limiting incentives for resorting to solutions outside resolution. One respondent underlined that any initiatives for further harmonising the creditor hierarchy and increasing the level of protection of (certain) creditors, should be treated

with caution, while a detailed assessment of the associated costs will need to be reflected in the impact assessment.

As regards funding solutions (sources, access conditions) in resolution and insolvency, most feedback supported that the CMDI framework should include proportionate and adequate solutions for the management of failures of any type of bank, but without compromising the principle of burden sharing which is inherent to the Bank Recovery and Resolution Directive (BRRD). According to most respondents, a review of the conditions for granting State aid in- and outside resolution would be necessary. One respondent called for a simpler and more transparent methodology for calculating the contributions to the Single Resolution Fund (SRF), and requested the same for the methodology for contributions to a European deposit insurance scheme (EDIS).

As regards depositor protection, some feedback called for a preservation of national protection systems and of national options such as preventive and alternative measures that have worked well in the past. However, most of the views converged that there is a need for improving the efficiency of these measures, in particularly through clarification of their conditions, limits and purpose. One respondent flagged that risk-reducing specificities of institutional protection schemes (IPS) should be duly considered.

Most respondents underlined that any policy options should consider the potential ramifications with regard to the discussions on EDIS. Three respondents support that the pooling of funds from various sources should be avoided or not form part of the review. Two respondents were of the view that EDIS should not be part of the review.

4. PUBLIC AND TARGETED CONSULTATIONS

The Commission launched two consultations[166] to seek stakeholder feedback on the application of the CMDI framework and views on possible modifications. The *targeted consultation,* covering 39 general and specific technical questions, was available in English only and open from 26 January to 20 April 2021. The *public consultation* consisted of 10 general questions[167], available in all EU languages and the feedback period ran from 25 February to 20 May 2021. Both consultations were open for 12 weeks. In total, the Commission received 188 official responses and three additional replies were submitted informally. All but five respondents were stakeholders from the EU. Responses received were from a variety of stakeholders representing EU citizens (26%), business organisations (24%), business associations (16%), public authorities (19%), consumer organisations (2%) and academia (3%). It is also important to point out that numerous answers provided (in particular to the *public consultation)* were of the same wording and stance, thereby suggesting that certain respondents cooperated when drafting their response prior to submitting their final answers.

The Commission services published a 'summary report' on the feedback to both consultations on 7 July 2021 on the respective consultation pages. Below is a summary of the views expressed with regard to the experience with the framework so far and to future action to make the framework more resilient.

[166] See consultation pages of the *targeted consultation* and the *public consultation*.
[167] The questions of the public consultation were a subset of the questions of the targeted consultation.

I. General objectives and review focus

a. Policy objectives

Respondents overall agreed that the CMDI framework is an improvement compared to the situation pre-2014/15 and that the objectives of the framework have been achieved to a large extent. Nevertheless, improvements are warranted. While respondents were satisfied with the protection of depositors and the reduced risk for financial stability stemming from bank failures, the framework, however, seemed to have failed in protecting taxpayer money and breaking the bank/sovereign loop. Respondents noted that more could be done with respect to minimising the recourse to taxpayer money and improving the level playing field among banks from different Member States, with certain respondents perceiving EDIS as a missing element to reach this objective.

b. Available measures in the CMDI framework

The majority of respondents who provided a view (88%) believed that some of the measures in the CMDI framework succeeded in fulfilling the intended policy objectives and the management of banks' crisis, notably precautionary measures, provided that the latter remain limited in use. Early Intervention Measures (EIMs), however, were widely criticised by stakeholders pointing out the need to eliminate the overlap between EIMs and supervisory powers, with a significant preference for a merger in order to increase efficiency. The resolution tools were overall described as satisfying with certain institutions calling, however, for a more appropriately tailored mechanism for smaller and medium-sized banks and for an instrument for liquidity in resolution. Opinions on deposit guarantee scheme (DGS) preventive measures were split, with several respondents being in favour, while others demanding further harmonisation and clarifications on the relationship between State aid and DGSs. It was also noted that a harmonised European insolvency framework should be provided.

c. Exclusivity of the BRRD tools

Several respondents, including small and medium-sized banks as well as other stakeholders (ministries of finance), expressed caution to mix resolution tools with national insolvency systems, claiming that this would increase complexity and legal uncertainty. They suggested that smaller and medium-sized banks should continue undergoing national insolvency proceedings. Conversely, most respondents in the targeted consultation suggested that the tools and powers in the BRRD should be subject to changes and supported the extension, particularly through a wider use of the PIA to cover smaller and medium-sized banks. In terms of the different funding sources in resolution and insolvency, 55% of respondents were against a potential alignment of the access conditions (i.e. imposing the access condition to the resolution fund everywhere), fearing the creation of additional complexities and the infringement of the proportionality principle. By contrast, those in favour of the introduction of harmonised tools outside resolution strongly highlighted their preference for the creation of a harmonised "orderly liquidation tool", notably for smaller and medium-sized banks, to prevent divergences in handling failing banks under national insolvency systems.

The need for a reform is generally supported by the industry, which sees merit in targeted amendments aimed at improving its practical application. Respondents from large and small/medium-size banks support an improved transparency and predictability of the PIA and agree to avoid paying additional contributions into industry-funded safety nets.

In terms of the possible expansion of the scope of resolution, several respondents representing smaller/medium-sized banks, in particular cooperatives and savings banks, may prefer to stay outside the scope of resolution to avoid costs related to additional requirements or possible *ex post* contributions to the safety nets. By contrast, several respondents representing large banks generally support bringing more smaller/medium sized banks into resolution to ensure a level playing field in the single market and improve the credibility of the framework. In this vein, these respondents also support the need to minimise moral hazard and the risks for public finances through holdings of loss-absorption buffers as a first and main line of defence, calling for caution over an extended use of industry funded safety nets for small/medium-sized banks and the prospect of additional future contributions to address replenishment needs.

d. Measures available before a bank's failure

EIMs: Respondents showed broad support for improving the conditions for EIMs or other features of the framework in order to facilitate their use. However, a few stakeholders (banks) are of the opinion that EIMs should be deleted as supervisory powers are sufficient, while a few stakeholders (IPS, public sector) mentioned that they do not see an overlap between EIMs and supervisory powers.

Precautionary recapitalisation: Most respondents expressed a wish to maintain precautionary recapitalisation within the crisis management toolbox in order to provide flexibility and address exceptional situations. However, respondents consider that its application should remain limited to specific circumstances and be sufficiently strict. Others considered conditions as too strict. A few respondents called for a phase-out of the provision or refer explicitly to the need to avoid using precautionary recapitalisation. Most respondents are in favour of targeted amendments for clarification.

Preventive measures: Broad consensus was visible on the necessity to provide clarifications for the application of DGS preventive measures. Most respondents would welcome a more harmonised approach in the least cost test application. Several stakeholders (public sector, banks) highlighted that the conditions for the application of preventive measures should be aligned with the conditions for precautionary recapitalisation, while many respondents underlined the need to clarify that using the measures does not trigger a declaration of failing or likely to fail (FOLF). Regarding the application of State aid rules, DGS respondents supported that minimum burden sharing requirements should apply irrespective of the governance arrangements in place. Conversely, a sizeable number of respondents (mainly banks) believe that State aid rules should not be applicable for the DGS' use for preventive measures, independently from the DGS private or public legal nature. Respondents from Member States that have IPSs noted the indispensability of preserving the well-proven national discretion for granting preventative measures. Some respondents from these Member States stressed that it is important that the functioning of IPSs recognised under Article 113(7) CRR can

continue unchanged. In view of EDIS, the ring-fencing of losses absorbed by a national DGS within the local Member State to avoid that these losses are borne by other banking sectors is important for stakeholders from the banking industry. Views were split about the need for changing or not the creditor hierarchy (and extending the coverage to all deposits), in order to encourage or mitigate, respectively the use of such measures.

II. Experience with the framework and lessons learned for the future framework

a. Resolution, liquidation and other measures to handle banking crisis

In general, the majority of respondents consider that the resolution toolbox already caters for all types and sizes of banks, provided that the available tools are applied consistently in case of a failure of banks that are of public interest. Insolvency laws are generally seen as providing an appropriate framework for a liquidation of an institution, bearing in mind Member States' specificities, but possibly at the expense of consistency in public interest assessments or scope of interventions of DGS due to the differing counterfactual insolvency scenarios. Regarding the accessing conditions to funding sources in resolution, the majority noted that DGS and EDIS funds should remain separated from the RF/SRF, with a few stakeholders underlining the necessity to improve the liquidity provision to banks post-resolution. A limited amount of respondents demanded an alignment between the source of funding and governance structures, stating that for national funding sources national authorities should have a prominent role. If funding were to rely mostly on European centralised funds, governance should accordingly be more centralised.

PIA: Most respondents acknowledge that the PIA must offer room for interpretation by authorities, but consider that the provision, as regulated now, gives opportunity for many different interpretations, thereby creating level playing field issues and uncertainty. Many respondents argue that the outcome of the PIA in the planning phase should be more predictable.

Small and medium-sized banks: While the extension of the PIA threshold to facilitate small and medium-sized banks' access to resolution funds has been partly supported, numerous respondents defined the funding sources for smaller and medium-sized banks as sufficient. Many state that bail-in of shareholders and creditors should remain the main source of financing in resolution and stressing the existence of other relevant tools to help smaller and medium-sized banks (i.e. winding-up under insolvency proceedings sometimes involving State aid). The importance of the minimum requirement for own funds and eligible liabilities (MREL) was emphasised due to its role in preserving financial stability and ensuring depositor protection. Other respondents stressed that small and medium-sized banks should be liquidated and that therefore their MREL should not exceed the loss absorption amount. A few noted the role that retained earnings and other forms of equity could play in ensuring that small and medium-sized banks comply with their MREL.

FOLF: Regarding the existing legal provisions and their alignment between the conditions required to declare a bank FOLF and the triggers to initiate insolvency proceedings, the majority supports full or maximum possible alignment, bearing in mind

restrictions in national law. Others raised caution when the FOLF assessment is based on likely infringements of prudential requirements. Furthermore, the vast majority of participants support the possibility of granting power to the supervisor to withdraw a licence, but not in all FOLF cases, typically covering resolution scenarios where such withdrawal would not be appropriate to preserve critical functions. The definition of FOLF was perceived as sufficiently flexible to assess scenarios on a case-by-case basis, while others highlighted the challenge to trigger FOLF based on likely infringements that are not related to the bank's financial position.

Potential introduction of an orderly liquidation tool: The introduction of such tool, while welcomed by a few respondents, raised concerns with respect to its implementation. Several respondents insisted on the need to avoid amending/deteriorating existing tools, or considered possible impacts on constitutional features and existing national legal frameworks. In terms of differences between a liquidation tool and the sale of business tool in resolution, some respondents pointed at the fact that the orderly liquidation tool and normal insolvency proceedings pursue different goals, with the former aiming at mitigating effects on financial stability while the latter striving to maximise the proceeds for the creditor.

b. Level of harmonisation of creditor hierarchy and impact on no creditor worse off (NCWO) principle

A large majority of respondents indicated that the differences between bank creditor hierarchies across Members States could complicate the application of resolution action as they viewed these divergences as a source of increased fragmentation in the EU and differentiated treatment amongst creditors. The respondents who did not agree with the need to further harmonise the creditor hierarchy noted that insolvency laws are deeply rooted in national tradition/practices and interlinked with other (non-bank related) fields of law. With regard to the ranking of deposits, some respondents were in favour of a general depositor preference and of removing the super-priority of covered deposits, the latter with the purpose of allowing the effective use of DGS funds. However, a larger number of respondents were against this super-priority elimination, on the basis of minimising DGSs' costs and liquidity needs, maintaining depositor confidence and financial stability and avoiding moral hazard.

c. Deposit insurance

Most respondents noted that deposits of public and local authorities should also be protected by the DGS, given that their exclusion creates additional management difficulties (consumer organisations and saving banks). Conversely, several banks and associations opposed adding additional groups, fearing it would increase their costs since both the target levels of national DGS and SRF would increase. The view of the majority of banks and DGSs is that the current regular information disclosure is sufficient and that no changes were necessary. Digital communication was often considered as the most suitable to save costs. Consumer organisations demanded that Article 16 of the Deposit Guarantee Scheme Directive (DGSD) on depositor information as well as the template in Annex I of the DGSD should be updated, clarified and more consumer friendly. Savings banks from one Member State highlighted that

disclosure should take place only at the beginning of the business relationship, in case of relevant changes and only in digital format.

Regarding the EDIS, a majority of respondents supported its introduction. Some of them considered that national DGSs are limited in size and firepower and a fully-fledged EDIS would be an essential piece of the Banking Union. Moreover, others underlined that a fully-fledged EDIS would reduce the burden on banks, while minimising the probability of a call for *ex post* contributions, also avoiding pro-cyclical impacts on banks' balance sheets. In contrast, other respondents underscored that EDIS would make the European financial system riskier because of contagion effects from one national banking sector to the other. As regards the efficiency of EDIS, some respondents considered that the more resources are shared in a common central pool, the more cost-effective the system would be. In contrast, other respondents believed that EDIS would not be cost efficient and that it would entail higher administrative costs, and more payout cases than under the current framework. Numerous respondents raised different concerns in relation to the transfer of funds from the national DGSs to the central fund of EDIS.

Some respondents (especially IPSs) highlighted that IPSs recognised as a DGS must be excluded from EDIS. In the event that they were included, being a member of an IPS should be considered as risk reducing factor when calculating the contributions. Conversely, other respondents insisted that IPSs should be included in EDIS in order not to weaken its firepower, to maintain a level playing field and depositor confidence.

Concerning specific parameters of EDIS, participants raised various views and concerns with the majority of responses underlining the need for caps in order mitigate the first mover advantage while others mentioned the maturity of the loans from EDIS to the national DGS as a crucial parameter. In relation to options and national discretions (ONDs), views were split, with some expressing opposition to the financing of ONDs covered by central financing, others being in favour of expanding the common deposit insurance mechanism to include the coverage of ONDs and some calling for a harmonisation of ONDs. Views were split as regards to whether SRF and EDIS funds should be merged, with those against stressing that the roles of these funds are different.

5. TARGETED CONSULTATIONS OF MEMBER STATES

From 2019-2021, the Commission discussed topics analysed in this impact assessment with Member States, resolution authorities and designated authorities for the DGS during 11 meetings of the Expert Group on Banking, Payments and Insurance (EGBPI). To this effect, 17 non-papers including questionnaires were prepared:

- On 5 December 2019, the two studies commissioned by the Commission to external contractors, with the financial support of the European Parliament, under the Pilot project "Creating a true Banking Union" were presented. The studies covered the national options and discretions under the DGSD and their treatment in the context of EDIS[168] and the differences between bank insolvency laws and their potential

[168] See CEPS study.

harmonisation[169]. There was also a presentation on protection of client funds of payment and e-money institutions.

- On 27 January 2020, members were invited to comment on the advice from the EBA regarding the DGSD review, more specifically on the EBA opinions on eligibility of deposits, coverage level and cooperation between DGS, payouts, funding and uses of DGS funds.
- On 20 February 2020, the Commission presented possible approaches on further harmonisation of insolvency triggers, clarification of certain aspects of precautionary recapitalisation and improvements to the use of EIM.
- On 23 and 24 June 2020, there was an exchange of views with members on the use of DGS funds under DGSD and BRRD and continued the discussion on the EBA opinion regarding the DGSD review.
- On 16 July 2020, the Commission invited members to provide their views on the PIA and continued the discussion on the EBA opinion on the DGSD review.
- On 28 September 2020, the Commission continued the discussions on resolution and insolvency triggers and on the least cost test methodology for the use of the DGS, and consulted members on the harmonisation of the ranking of deposits in the creditor hierarchy in insolvency.
- On 15 October 2020, the Commission presented a preliminary assessment of the funding sources in the EU crisis management framework through stylised examples and gathered views on further elements on the creditor hierarchy harmonisation in insolvency and the protection of client funds of payment and e-money institutions.
- On 12 November 2020, members were asked for their views on the use of DGS in resolution and insolvency through stylised examples and on the legal feasibility of a potential harmonised liquidation tool in insolvency.
- On 14 December 2020, members discussed funding in resolution and enhancement of market integration through the application of existing legal provisions in a home-host balanced manner. One member presented their experience with high recovery rates for subordinated creditors and the impact of NCWO.
- On 25 February 2021, the SRB presented its views on the resolution of smaller to medium-sized banks reliant on deposit funding and members were asked to provide feedback on the EBA opinion on the interplay between the DGSD and the anti-money laundering Directive (AMLD).
  On 26 April 2021, the Commission presented the outcome of surveys distributed in previous meetings.

In addition to the written input provided by the EGBPI members to the questionnaires following each meeting, two detailed surveys were circulated to members: (i) on the harmonisation of insolvency for banks (December 2019) and (ii) on mapping of DGSs in Member States (January 2020).

In parallel to the discussions in the Commission's Expert Group, the issues addressed in this impact assessment were also covered in meetings of the Council's preparatory

[169] See VVA study.

bodies, namely the Council Working Party on financial stability and the Banking Union (CWP) and the High-Level Working Group on EDIS (HLWG).

In what concerns the most recent discussions, in the second semester of 2020 the CWP was chaired by the German Presidency. Of relevance for this impact assessment, Member States exchanged views on the following topics: interaction between supervisory powers under the Capital Requirement Directive (CRD) and EIM in BRRD, the resolution triggers and possible alignment with the national bankruptcy triggers, the creditor hierarchy in insolvency, the crisis management framework for smaller banks (with references to the PIA, a possible "EU bank liquidation regime", the least cost test for the DGS and governance) and furthering market integration. In the CWP, the Commission presented an overview of the data collection exercise carried out to support the development of the methodology for calculating risk-based contributions under EDIS and the results of a survey on the parameters of the hybrid model.[170]

In the first semester of 2021, when the CWP was chaired by the Portuguese Presidency, the discussions focused on the design of the hybrid model for EDIS (with focus on the inclusion of non-CRD/CRR entities, IPS recognised as DGS and third country branches), the treatment of the ONDs in the DGSD (particularly the financing of preventive and alternative measures), the risk-based contributions, the build-up of the central deposit insurance fund, the transition to the steady-state and the articulation between EDIS and the CMDI framework[171].

In what concerns the HLWG, the discussions held at that level were structured around four work streams.[172] Of relevance to this impact assessment were the work streams on crisis management (which discussed topics such as early intervention measures, targeted amendments to the insolvency legislation for banks in the EU, handling of the failure of banks whose resolution is not in the public interest and need for expansion of the liquidation toolbox) and on EDIS (parameters and sequencing for the hybrid model, scope of common deposit insurance, conditionality, risk-based contributions, transitional path towards the steady state, articulation with the CMDI framework).

Further, 50 bilateral meetings with resolution and competent authorities as well as 58 bilateral stakeholder meetings (banks, industry associations, think tanks) took place over the period 2019-2022. In those meetings counterparts explained their country or business model specific situation and/or expressed their views on the CMDI framework orally, as also done through the consultations. More recent meetings in 2021-2022 focused on the possible policy options and their calibration possibilities. Requests for bilateral exchanges were accepted to the extent that the overall balance was maintained. The input provided is reflected in the impact assessment.

The views heard from Member States and industry stakeholders confirmed many of the Commission findings regarding the functioning of the current framework and need for reform. The input provided has been considered throughout the impact assessment.

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[170] European Council (23 November 2020), German Council *Presidency Progress Report* on the Strengthening of the Banking Union.
[171] European Council (2 June 2021), Portuguese Council *Presidency Progress Report on strengthening the Banking Union.*
[172] See *Letter by the HLWG Chair to the President of the Eurogroup* (December 2019).

6. HIGH-LEVEL CONFERENCE

On 18 March 2021, the Commission hosted the High-level conference "*Strengthening the EU's bank crisis management and deposit insurance framework: for a more resilient and efficient Banking Union*".[173] Amongst keynote speakers and panellists: representatives from the banking industry/associations, Ministries, national resolution authorities, DGSs, the SRB, the ECB, Members of the European Parliament, the EBA and academia. Many speakers confirmed the importance of an effective CMDI framework but also highlighted the current weaknesses. Although views were not fully converging, there was consensus regarding room for improvement to make the framework fit for purpose for all banks while protecting financial stability and preserving depositors' trust.

The keynote speakers emphasised as core elements of a robust CMDI framework and Banking Union: (i) setting up EDIS, (ii) a careful calibration of the tools in resolution and insolvency to cater for specificities of smaller banks and (iii) a more effective use of funds in resolution and insolvency, including access to funding for smaller banks.

In the **first panel**, dedicated to issues pertaining to the tools in resolution and insolvency, most panellists agreed that changes to the toolbox are warranted. Panellists shared their experience with the framework and stressed the importance of predictability and called for an alignment of the Commission's Banking Communication with the resolution framework. There was broad agreement on extending resolution to more banks, however on the exact scope views differed. Panellists stressed the importance of a clarification of the PIA. Some also noted the benefits of a harmonisation of insolvency frameworks. One panellist highlighted that the review should not hinder the role of banks to support the real economy and should strengthen financial stability.

In the **second panel**, dedicated to the issues of funding in resolution and insolvency, speakers highlighted that the current rules were too constraining and proposed different solutions to overcome the lack of access of smaller and medium-sized banks to financing sources. Panellists shared their experiences and noted that circumventions to resolution and burden sharing should be prevented. Further, the need to review the constraints to the use of the DGS and EDIS, to tailor MREL to the resolution strategy of each bank and to make the 8% requirement more flexible were highlighted. Some harmonisation of bank insolvency laws would also be welcomed.

The **third panel** voiced their views on how the deposit insurance framework could be further enhanced taking into account experiences from anti money-laundering cases or fintech companies. The increase in fintech players and the COVID-19 response measures led to a strong increase in deposits. Panellists noted that the current framework would benefit from further harmonisation and a better interplay of the DGSD with AMLD rules, the Payment Services Directive and State aid rules. Also, consumer confidence and trust should be reflected in the DGSD review (pointing at the Greensill case) as well as the situation of smaller markets. Further, panellists called for EDIS, to strengthen depositor confidence and reduce costs for the banking sector.

[173] See the European Commission's *conference webpage* for details on the programme, the speakers and the recoding of the event.

The Commission services invited stakeholders to provide their views through the two open consultations, which would be duly considered in the assessment and proposal.

7. EBA OPINIONS

The Commission requested advice from the EBA on possible areas where the DGSD could be strengthened. In 2019 and 2020, the EBA issued four opinions under Article 19(6) DGSD[174]. See EBA opinions and Annex 6 for more information on the recommendations and how these were integrated into the impact assessment.

8. THE F4F PLATFORM OPINION

The Banking Union completion topic and the CMDI review were included in the 2021 Annual Work Programme of the F4F Platform. In its final opinion, which was issued on 10 December 2021, the F4F Platform considers that there is room for improvement to make the CMDI framework fit for purpose for all banks, in a proportionate manner, taking into consideration potential impact on depositors' confidence and on financial stability. The Platform also considers important, given the technical complexity and significance of the objectives pursued with the legislation, to factor in a proper time for allowing the markets and the public authorities to deploy the regulation correctly. To this end, the Platform brings forward five concrete suggestions for improvements:

Suggestion 1: Broadly merging of supervisory powers and EIM

The Platform calls for broadly merging the supervisory powers under the CRD with the early intervention powers under the BRRD and leaving only the most intrusive measures in the BRRD. According to the F4F Platform, this improvement will help ensuring that measures do not overlap but complement each other, thus increasing the consistency of EIM and its overall usage. The Platform also highlights that it should be ensured that the application of the EIM does not pose legal uncertainties with regard to the application of the Market Abuse Regulation which requires public disclosure.

See Annex 5 (evaluation) and section 4 of Annex 8, for more information on how the relevant suggestion of the Platform has been taken into consideration in this impact assessment.

Suggestion 2: Clarification of Article 16 DGSD – Periodic information on deposit protection

The Platform suggests that the provision of periodic information on deposit protection to depositors, as per Article 16(1) DGSD, should only take place at the beginning of the business relationship, or in case of relevant changes, as this could help in reducing the administrative burden.

Suggestion 2 flags an issue that is analysed in this impact assessment. However, as explained in section 3.2.8 of Annex 6, the approach proposed on this issue is to follow the EBA recommendation, which was supported by the vast majority of the experts in the EGBPI, that the annual information disclosure should not be altered because of its positive impact for depositor awareness.

[174] See Annex 1.

Suggestion 5: Improve the consistency between the DGSD, Payment Services and E-Money Directives and increase the protection of client funds of e-money institutions and payment institutions

The Platform expresses the view that an improvement in the interaction between the DGSD, the Payment services and E-money Directives is warranted for increasing depositor protection and public trust in digital payment services offered by non-banks. In particularly, the Platform calls for improvements in the DGSD for clarifying the conditions, under which, client funds deposited with a credit institution by payment institutions or e-money institutions would be eligible for depositor protection under the DGSD. See Annex 5 (evaluation) and section 3.2.4 of Annex 6 for more information in how the relevant suggestion was taken into consideration in this impact assessment.

Finally, the Platform formulated suggestions for improving the legal clarity in the provisions concerning the FOLF triggers **(Suggestion 3)** and the assessment of the public interest for resolution **(Suggestion 4)**. According to the Platform, legal changes in these two areas would be helpful for increasing the legal certainty and consistency in the handling of failed banks.

ANNEX 3: WHO IS AFFECTED AND HOW?

1. PRACTICAL IMPLICATIONS OF THE INITIATIVE

The objectives of this Annex are to summarise how option 3 (assessed as technically superior) addresses the identified problems and to set out the practical implications for the main stakeholders affected by this initiative, mainly the banking sector and their shareholders and creditors, resolution and supervisory authorities, as well as depositors and the taxpayers. The initiative aims to simultaneously address the following problems described in Chapter 2:

- **Problem 1**: Insufficient legal certainty and predictability in the management of bank failures;
- **Problem 2**: Ineffective funding options and divergent access conditions in resolution and insolvency; and
- **Problem 3**: Uneven and inconsistent depositor protection and lack of robustness in deposit guarantee scheme (DGS) funding.

By ensuring a timelier and expanded scope for resolution, which would limit the destruction of banks' value when compared to liquidation proceedings, option 3 would enhance financial stability and generate net overall gains for taxpayers, depositors, including small and medium enterprises (SMEs), resolution authorities, but also the markets and the society at large. Banks' costs may increase due to a broader use of DGS funds which would require replenishment through *ex post* industry contributions, which, in the absence of a European deposit insurance scheme (EDIS) cannot be lowered. Banks' creditors may lose under these options due to bail-in when resolving more smaller/medium-sized banks, however this would contribute to reducing moral hazard and ensuring that losses are internalised to the bank's claim holders rather than externalised to the society.

Option 3 would address the three problems identified by strengthening the legal certainty and clarity of the presumptive path for action in case of failing banks, ensuring more effective funding options and harmonised conditions to access them. Legal certainty and level playing field would be achieved through more standardisation and harmonisation of rules on: the application of the public interest assessment (PIA), use of DGS funds for various interventions, early intervention measures and failing or likely to fail declaration, the requirement to wind-down banks and foster market exit in case of negative PIA (to avoid legal limbo situations) and the harmonisation of depositor preference in the hierarchy of claims[175]. The revision of the least cost test for DGS interventions would improve the effectiveness and efficiency of the use of DGS funds, ensuring coherent and consistent approaches across Member States.

While most of these elements are similar across the option packages presented in Chapters 5 and 6, the changes proposed to the PIA under option 3 deliver a more

[175] As explained in Chapter 2.

significant expansion of the scope for resolution than other options. This goes hand in hand with the ease of accessing funding under the retained option.

Option 3 would improve the access to the resolution funds (RF) or the Single Resolution Fund (SRF)[176] and DGS funds in resolution for an increasing number of smaller and medium-sized banks coming in the scope of resolution through an extended PIA. This implies, in particular, that the restructuring of failing smaller and medium-sized banks, possibly under transfer strategies in resolution or alternative measures in insolvency would be financed more credibly and with more proportionality than under other options. The access to the RF/SRF would be facilitated without compromising the principle of minimum bail-in condition, which safeguards against moral hazard (i.e. making sure the bank's shareholders and creditors are first in line to bear losses before any industry funded safety nets are employed).

The implementation of option 3 would largely benefit depositors (i.e. retail clients, SMEs, municipalities, other public institutions, large corporates, financial institutions) and taxpayers by shielding them from losses, which would be covered by the bank's internal loss absorbing capacity and industry funded safety nets. Depositors would benefit from placing more smaller/medium-sized banks in resolution and having their deposits transferred to a healthy bank with the help of the DGS funds, as they would preserve continued access to their accounts, avoid a run on the bank and benefit from a more efficient use of DGS funds. Taxpayers would benefit as well since handling distressed banks would be more likely financed through industry-funded safety nets rather than public money. The size of available funding to enable transfer transactions is directly proportional with the protection of the respective depositors and taxpayers in the EU.

Banks and their shareholders, investors, employees and depositors would also benefit from the retained option from the perspective of enhanced legal clarity and level playing field in the application of rules and enhanced standardisation. While depositors would be more protected from losses under these options, other investors may see their claims written-down or converted into capital by applying bail-in. However, option 3 would benefit most stakeholders through the preservation of banks' franchise value and the safeguarding of commercial relations through a transfer transaction of parts or all the failing business to a healthy acquirer rather than by applying piece-meal liquidation. This may come at a cost for banks, as the more extensive use of DGS funds would require recouping the funds (possibly) disbursed through *ex post* industry contributions. However, this tendence would be compensated by a more efficient use of funds in resolution/alternative measures as opposed to a full payout in insolvency.

Resolution authorities would also benefit from the retained option, by relying on clearer and more harmonised rules when implementing the provisions of the law, reducing legal risks. Their incentives to decide on the application of certain crisis management tools would be more aligned and focused on the preservation of value, effectiveness and efficiency of outcome.

[176] Through the use of DGS funds to bridge the gap towards the minimum access condition to the RF/SRF, as explained in Chapter 6.

The initiative is neutral in terms of impact on administrative costs[177], meaning, on aggregate, it neither adds nor removes administrative burden on banks, citizens or resolution authorities. Therefore, the initiative does not have a significant impact on the Commission's 'one in, one out' approach[178], seeking to scrutinise and monitor new and/or removed administrative costs (both one-off and recurring) for businesses. This is because, on one hand, banks earmarked for liquidation under the current framework and which would be entering the scope of resolution for the first time under this initiative, would be subject to the obligation to enhance their recovery plans, provide information to resolution authorities on a more frequent basis for the preparation of more extensive resolution plans and ensure they become resolvable. While this would involve some additional costs for banks, these are estimated to be marginal, because banks earmarked for liquidation already report data to resolution authorities who prepare resolution plans *albeit* on a less frequent basis (under simplified obligations). On the other hand, the initiative offsets these effects by providing some relief through waiving the need to adopt MREL decisions for a scope of banks earmarked for liquidation, where MREL is equal to own funds requirements (see Annex 8, section 8). The impact of this change is more meaningful for resolution authorities than for banks (due to the reduction in MREL decisions to be adopted and communicated to banks) and is rather localised in those Member States with less concentrated banking sectors (many small banks which have liquidation as preferred strategy in case of failure) and where the MREL requirement would not exceed own funds.

Additionally, the society would benefit from financial stability and the protection and continuation of critical functions that banks deliver to citizens, more convergence and clarity on the presumptive path in the application of the rules and level playing field, fostering more confidence in the banking sector and the single market in banking.

Tables 2 and 3 summarise the impacts of the preferred option.

[177] According to the Commission's Better Regulation Toolbox (#58), administrative costs are the costs incurred by enterprises, the voluntary sector, public authorities, and citizens in meeting administrative obligations towards public authorities or private parties. Administrative obligations in a broad sense include labelling, reporting registration, monitoring, and assessment needed to provide the information. In some cases, the information must be transferred to public authorities or private parties. In others, it only must be available for inspection or supply on request.

[178] The Commission has committed to the 'one in, one out' (OIOO) approach (see Political Guidelines of President von der Leyen, 'better regulation' Communication of 29 April 2021, COM(2021) 219). This means offsetting new burdens resulting from the Commission's proposals by reducing existing burdens in the same policy area. The 'better regulation' Communication COM(2021) 219, sets out the main principles of the approach (identification through cost estimation methods and reporting for the purpose of OIOO). OIOO only applies to cost implications originating from Commission proposals and covers the impact of new regulatory requirements (not 'business as usual' costs). Costs imposed by other parties – co-legislators or by Member States and local, regional authorities – are not included.

Table 2: Overview table depicting winners and losers

	Summary of winners and losers				
	Taxpayers	Depositors	Banks	Creditors	Resolution authorities
Problem 1: *Insufficient legal certainty and predictability in the management of bank failures*					
Problem 2: *Ineffective funding options and divergent access conditions for the financing of resolution and insolvency*					
Problem 3*: Uneven and inconsistent depositor protection and lack of robustness in DGS funding*					
Baseline: Do nothing	0	0	0	0	0
Option 3: Substantially improved resolution funding and commensurate resolution scope	++	+++	+/-	+/-[179]	+++

Table 3: Overview table depicting to what extent the options achieve the objectives

	Effectiveness					Efficiency	Coherence
	Financial stability	***Minimise recourse to taxpayer money, weaken bank-sovereign loop***	***Level playing field, single market***	***Depositor protection***	***Proportionality***		
Problem 1: *Insufficient legal certainty and predictability in the management of bank failures*							
Problem 2: *Ineffective funding options and divergent access conditions for the financing of resolution and insolvency*							
Problem 3*: Uneven and inconsistent depositor protection and lack of robustness in DGS funding*							
Baseline: Do nothing	0	0	0	0	0	0	0
Option 3: Substantially improved resolution funding and commensurate resolution scope	+++	+++	+++	++	++	+++	++

[179] Bank's creditors would benefit from a higher valuation in resolution than under piecemeal liquidation and preservation of the franchise value of the bank, however, some of them may be bailed-in if the access to the RF/SRF is required to resolve the bank.

2. SUMMARY OF COSTS AND BENEFITS

Table 4: Overview of the benefits

I. Overview of Benefits (total for all provisions) – Retained Options		
Description	***Amount***	***Comments***
Direct benefits		
Enhanced legal certainty, harmonisation and simplification of certain rules leading to convergence and level playing field.	No available amount *ex ante*. Strengthening the single rulebook and harmonising crisis management rules will unify the regulatory environment and increase the level playing field, possibly fostering more integration in the single market, which could be monitored in the future. By harmonising the application of the PIA, the depositor preference in the hierarchy of claims, the least cost test to access DGS funding for various interventions, the retained option would enhance legal clarity and achieve a significant simplification of rules.	Resolution authorities would be the main recipients of these benefits, especially when working on cross-border banking groups, mainly due to increased standardisation, simplification and streamlining of rules. Additional legal clarity would reduce the risk of legal challenge for authorities related to the planning, formulation of requirements to banks and execution of the preferred strategy. Market participants would also benefit from standardisation, as they would be in a better position to assess risks related to banks. Depositors would also be the recipients of these benefits, as the harmonisation of depositor preference in the hierarchy of claims would ensure their fair their treatment across Member States.
Reduced recourse to taxpayer money.	No amount available *ex ante*. Taxpayer money would be more protected when handling failing banks by using resolution or alternative measures more consistently, mainly because shareholders, creditors and, if needed, the resolution fund/ DGS would bear losses and support executing the resolution strategy. Estimating the amount of taxpayer funds savings that would be enabled by these reform would be bank-specific. As an indication based on the past, when considering the examples of failing banks between 2015 and 2022, taxpayer	Taxpayers would be the main recipients of this benefit. A more efficient use of DGS funds would reduce the risk of DGS liquidity shortfall and the need of public intervention as a backstop to the DGS.

	exposures to such contingent liabilities reached EUR 58.2 bn (out of which EUR 28.1 bn were used for liquidity support). However, future uses of taxpayer money cannot be gauged on past cases.	
Strengthened depositor confidence through continued access to accounts, greater protection of eligible deposits (also non-covered) and avoidance of bank runs.	No amount available *ex ante*. Alternative use of DGS for paying out covered deposits under insolvency would limit the disruption caused by blocked deposit accounts. It would be confidence enhancing and less prone to contagion/bank run. Moreover, non-covered deposits (above EUR 100 000) in the EU (amounts not reported to EBA) would also be more protected from bail-in under transfer strategies as per the retained option, while they are not protected under a payout scenario (only covered deposits are protected in that case). This prospect would potentially deter depositors from running on the bank. In a payout event, where depositors must be reimbursed within seven days, interrupted access to accounts, social benefits and credit facilities for even a short period in prevalently cashless societies, using or operating with credit and debit cards and electronic systems, could impact the overall economy. The failure of smaller and medium-sized banks can also create substitutability issues because of challenges for a high number of depositors and banks to simultaneously open new accounts to receive their reimbursement.	Covered and non-covered eligible depositors are the main recipients of these benefits because their deposits would be less likely to be bailed-in. More generally, depositor confidence in the banking sector would be strengthened by limiting DGS payout events and facilitating the use of DGS funds for measures preserving their continued access to their accounts (e.g. resolution or alternative measures in insolvency).
More efficient use of DGS funds in managing banks in crises.	No amount available *ex ante*. The cost of a DGS intervention measure either in resolution or under alternative measures in insolvency would be cheaper than the cost of paying out covered depositors under a piecemeal liquidation. A payout of covered depositors is usually cash consuming as the DGS would be required to reimburse the amount of covered deposits to all eligible covered depositors before recovering (part of) this amount during the insolvency proceedings. Moreover, the least cost test ensures that the DGS contributions under resolution or alternative measures in insolvency are always lower than those in a payout event. Therefore, facilitating other measures than payout would better preserve the financial means of the DGS, reducing the amounts of losses that may arise through the DGS intervention. However, it is very challenging to provide an amount corresponding to the cost reduction for the DGS as this would be bank-specific.	Banks contributing to the DGS funds and DGS authorities are the main recipients of this benefit. By preserving DGS available financial means, banks would be called on to contribute less to replenish the spent funds. Additionally, DGS authorities would benefit from a more efficient usage of DGS available financial means.

More credible and proportionate access to RF/SRF for smaller and medium-sized banks.	No amount available *ex ante*. A more credible and proportionate access to RF/SRF for smaller and medium-sized banks would lead to a wider application of resolution tools (transfer of deposit book), preserving more value, in particular when compared to a piecemeal liquidation or a procedure under non harmonised national insolvency rules. The use of the industry-funded safety net would replace in many cases the bail-in of non-covered depositors. However, estimating the amount of the RF/SRF that would be required is not possible *ex ante* because it would depend on a case by case analysis and the specific circumstances of each bank at the moment of failure (e.g. level of losses at the point of failure, the financial fundamentals of the bank, the composition of its liabilities, all of which feed into the results of the valuation exercise).	Non-covered depositors would be the main recipients of this benefit. They would not see their deposits wiped out in case their bank would be failing and resolved under a transfer strategy. Rather, the DGS and the RF/SRF which are industry-funded safety nets would step in to facilitate the resolution of that respective bank.
Franchise value of a failing bank preserved when facilitating transfer strategies.	No amount available *ex ante*. The transfer of the (whole or partial) business would preserve the franchise value to a greater extent than under a piecemeal liquidation approach. It would avoid the destruction of the business brand, preserving the commercial relationships with the clients and consequently better maintaining the profitability of, and the return on the assets. Transfer strategies could be applied in resolution. Where resolution is discarded (negative PIA), alternative measures in insolvency maintain an incentive to maximise the franchise value, thereby minimising the cost for the DGS. However, an amount reflecting the preservation of value cannot be estimated. Doing so would be fully case-dependant and specific to the circumstances of each bank at the moment of failure.	Stakeholders in a failing bank, the other banks contributing to safety nets, as well as taxpayers are the main recipients of this benefit.

Indirect benefits		
Better aligned incentives to apply resolution tools and benefit from funding solutions to execute the strategy.	No amount available. Improving the incentives to apply an improved and more standardised framework would lead to less circumvention in application and more level playing field at EU level. However, this cannot be quantified, as it would be the sum of the benefits stemming from the protection of taxpayers and depositors, more efficient use of DGS funds and more legal certainty in using tools for the banks, resolution authorities and markets.	Taxpayers, depositors, resolution authorities, banks and markets would all be recipients of this benefit.
Preservation of Europe's diversity in banking business models.	No amount available. Fixing the tools and the funding to deal with smaller/medium-sized banks which are predominantly deposit taking would preserve such traditional business models across the EU, on the condition that they remain viable.	The society at large is the recipient of this benefit.
Administrative cost savings related to the 'one in, one out' approach*		
n/a	n/a	n/a

*(1) Estimates are gross values relative to the baseline for the preferred option as a whole (i.e. the impact of individual actions/obligations of the preferred option are aggregated together); (2) Please indicate which stakeholder group is the main recipient of the benefit in the comment section;(3) For reductions in regulatory costs, please describe details as to how the saving arises (e.g. reductions in adjustment costs, administrative costs, regulatory charges, enforcement costs, etc.); (4) Cost savings related to the 'one in, one out' approach are detailed in Tool #58 and #59 of the 'better regulation' toolbox. * if relevant.*

Table 5: Overview of costs

II. Overview of costs – Retained options							
		Citizens/Consumers /Businesses		Banks		Administrations	
		One-off	Recurrent	One-off	Recurrent	One-off	Recurrent
Expanding the scope of resolution through clarified PIA	Direct adjustment costs	n/a	n/a	More banks coming into the scope of resolution would require investing in projects enhancing their resolvability (e.g. IT systems, timely data reporting, legal structure, review contracts in view of implementing resolution stays, valuation capabilities, liquidity monitoring, etc.). As resolution authorities continue to retain discretion in their decision to place banks in resolution vs insolvency, the number of banks that	Raise MREL eligible instruments in case of shortfalls against the set targets. This cost cannot be estimated upfront because it depends on the features of the bank[180], its potential bank-specific MREL target, the outstanding stock of eligible instruments already held and market conditions.	Applying resolution tools presumably more often, due to the expansion of the resolution scope, depending on the occurrence of failure events. This cost cannot be estimated upfront, as resolution authorities continue to retain discretion in their decision to apply resolution vs insolvency.	Preparing more resolution plans, conducting more resolvability assessments and setting MREL requirements for more banks as part of yearly resolution planning cycles. The number of banks which would enter the resolution scope and therefore this cost cannot be estimated upfront, as resolution authorities continue to retain discretion in their decision to apply resolution vs insolvency.

[180] E.g. rating, creditworthiness, financial fundamentals (such as quality of assets, capitalisation, etc.).

II. Overview of costs – Retained options							
		Citizens/Consumers /Businesses		Banks		Administrations	
		One-off	Recurrent	One-off	Recurrent	One-off	Recurrent
				would enter the scope of resolution cannot be estimated. Moreover, the additional costs that each bank may incur to become more resolvable depends on the specific situation of each bank (efficacy of management information systems, valuation capabilities, etc.)			
	Direct administrative costs	n/a	n/a	n/a	n/a	n/a	n/a
	Direct regulatory fees and charges	n/a	n/a	n/a	n/a	n/a	n/a
	Direct enforcement costs	n/a	n/a	n/a	n/a	n/a	n/a
	Indirect costs		Additional costs for banks may be passed on to clients. However,				

II. Overview of costs – Retained options							
		Citizens/Consumers /Businesses		Banks		Administrations	
		One-off	Recurrent	One-off	Recurrent	One-off	Recurrent
			such costs should be limited.				
Facilitating the use of funds in resolution and alternative insolvency measures	Direct adjustment costs				Facilitating the use of DGS funds may increase the costs for the banking sector due to additional contributions to replenish the DGS upon depletion. No quantification available, as an estimate would strongly depend on the amount of funds the DGS would use which reflects the losses in case of a failure. However, this cost would be compensated through more efficient use of DGS in resolution compared to payout in insolvency.		More complex processes and additional tasks for resolution authorities when DGS can contribute towards the minimum 8% TLOF bail-in condition to access the RF/SRF.

II. Overview of costs – Retained options							
		Citizens/Consumers /Businesses		Banks		Administrations	
		One-off	Recurrent	One-off	Recurrent	One-off	Recurrent
	Direct administrative costs	n/a	n/a	n/a	n/a	n/a	n/a
	Direct regulatory fees and charges	n/a	n/a	n/a	n/a	n/a	n/a
	Direct enforcement costs	n/a	n/a	n/a	n/a	n/a	n/a
	Indirect costs			Costs by small/medium-sized banks which have already raised MREL instruments and can access RF/SRF without DGS contribution.			
Costs related to the 'one in, one out' approach							
	Direct adjustment costs	n/a	n/a	n/a	n/a		
	Indirect adjustment costs	n/a	n/a	n/a	n/a		
	Administrative costs (for offsetting)	n/a	n/a	n/a	n/a		

(1) Estimates (gross values) to be provided with respect to the baseline; (2) costs are provided for each identifiable action/obligation of the preferred option otherwise for all retained options when no preferred option is specified; (3) If relevant and available, please present information on costs according to the standard typology of costs (adjustment costs,

administrative costs, regulatory charges, enforcement costs, indirect costs;); (4) Administrative costs for offsetting as explained in Tool #58 and #59 of the 'better regulation' toolbox. The total adjustment costs should equal the sum of the adjustment costs presented in the upper part of the table (whenever they are quantifiable and/or can be monetised). Measures taken with a view to compensate adjustment costs to the greatest extent possible are presented in the section of the impact assessment report presenting the preferred option.

3. RELEVANT SUSTAINABLE DEVELOPMENT GOALS (SDGS)

III. Overview of relevant Sustainable Development Goals – Retained option		
Relevant SDG	**Expected progress towards the Goal**	**Comments**
SDG no. 8 – decent work and economic growth, nr. 13 – climate action, no. 9 – industry, innovation and infrastructure[181]	Increased financial stability, a more integrated single market and level playing field will lead to increased resilience for the EU banking sector, which in turn, is more likely to finance the economy creating growth and contribute to the sectors' green and digital transition ('twin transition'). These contributions to economic growth and the twin transition cannot be quantified in relation to this initiative.	

[181] United Nations' *Sustainable Development Goals* (2015).

ANNEX 4: 'ZOOM-IN' ON CORE ELEMENTS OF THE CRISIS MANAGEMENT AND DEPOSIT INSURANCE FRAMEWORK

This Annex explains the core elements of the CMDI framework for a deeper understanding of the topic.

Since 2014, the Bank Recovery and Resolution Directive (BRRD) lays down a comprehensive and harmonised regime for the recovery and resolution of failing banks across the EU. The Single Resolution Mechanism Regulation (SRMR) complements that harmonised framework for the Banking Union. The Deposit Guarantee Scheme Directive (DGSD) lays down a set of harmonised rules for depositor protection. Besides reimbursing depositors in case of a failure of the institution up to EUR 100 000, deposit guarantee schemes (DGS) funds can be used to prevent the failure or to finance measures in insolvency (subject to the national transposition of this option) or in the resolution of credit institutions under certain conditions. On the contrary, insolvency is not harmonised and national bank insolvency proceedings differ substantially across the EU.

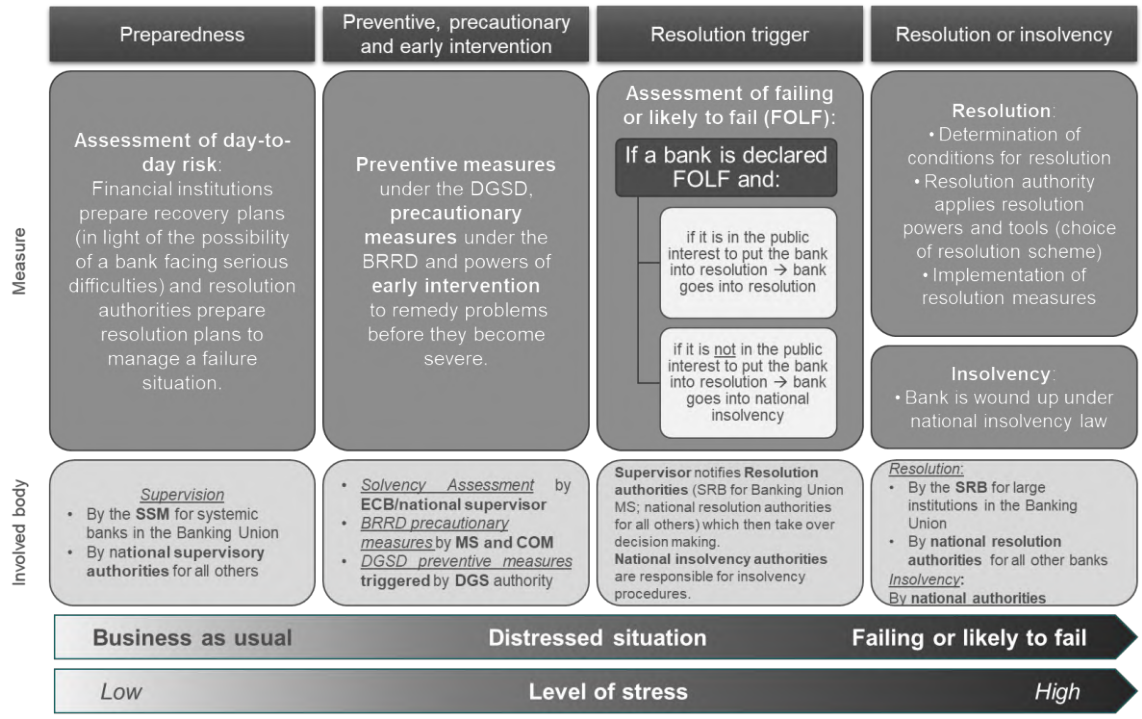
The CMDI framework was designed to avert and manage the failure of credit institutions of any size while protecting depositors and taxpayers. The framework provides for a set of instruments that can be applied in the different stages of the lifecycle of banks in distress. Before a bank is declared failing or likely to fail (FOLF), these instruments allow a timely intervention to address a financial deterioration (early intervention measures), to prevent the failure of a bank (preventive measures with funding from the DGS[182]) or precautionary recapitalisation measures financed by the public budget under strict conditions. When a bank is considered FOLF and there is a public interest in resolving it[183], the resolution authorities will intervene in the bank by using the tools and powers granted by the BRRD[184] in absence of a private solution. These include the power to sell the bank or parts of it to one or more buyers, to transfer critical functions to a bridge institution and to transfer non-performing assets to an asset management vehicle. Moreover, it includes the power to bail-in the bank's shareholders and creditors by reducing their claims or converting them into capital, to provide the bank with loss-absorbing or recapitalisation resources. In the Banking Union, the resolution of systemic banks and cross-border groups is carried out by the Single Resolution Board (SRB). In the absence of a public interest for resolution, the bank failure should be handled through national orderly winding up proceedings, sometimes with financing from the DGS or other sources, carried out by national authorities.

[182] Article 11(3) DGSD.

[183] Resolution is considered in the public interest when resolution is necessary for the achievement of and proportionate to one or more resolution objectives and normal insolvency proceedings would not achieve the resolution objectives to the same extent (Article 32 BRRD).

[184] In the following, reference to the BRRD should be understood as including also corresponding provisions in the SRMR.

Figure 10: Measures and bodies of the CMDI framework



Source: European Commission

The framework is intended to provide a combination of funding sources to manage failures in an economically efficient manner, while preserving the bank's franchise value and reducing recourse to the public budget and ultimately the cost to the taxpayers. The costs of resolving the bank (i.e. the losses) are first allocated to the shareholders and creditors of the bank itself (bank's internal loss absorbing capacity), which also reduces moral hazard. If needed, resources can be complemented by resolution financing arrangements funded by the industry (through the national resolution funds (RF) or the Single Resolution Fund (SRF) in the Banking Union and the DGSs) to cover the remaining losses. In the Banking Union, these rules were further integrated by entrusting the SRB with the management and oversight of the SRF, which is funded by contributions from credit institutions and certain investment firms in the participating Member States of the Banking Union. Depending on the tool applied to a bank in distress (e.g. preventive, precautionary, resolution or alternative measures) and the specificities of the case, compliance with the State aid rules may be necessary for interventions by a RF, a DGS or public funding from the State budget.

The State aid rules for banks[185] are intrinsically interconnected with, and complementary to the CMDI framework. The two frameworks are applied consistently by the Commission (e.g. the Commission checks if a a public or private support qualified as a State aid measure violates intrinsically linked provisions of the CMDI framework and cannot authorise it, if it does so). Despite their natural interlinkages, the two frameworks

[185] The Commission has direct enforcement powers in relation to EU State aid rules, which derive from the Treaty (Article 107 TFEU). In the context of the global financial crisis, the Commission clarified its assessment of compatibility of State aid measures to banks under Article 107(3)(b) TFEU in several Commission Communications, including the 2013 Banking Communication.

are meant to tackle different issues: State aid rules' main purpose is to limit competition distortions from such support to banks, while the CMDI framework's primary objective is to limit risks to financial stability from the disorderly management of bank failures while avoiding or minimising the use of public funds and ensuring depositors' protection.

In order to ensure consistency between the two frameworks, in November 2020, the Eurogroup invited the Commission to carry out and finalise its review of the State aid rules for banks, in parallel to the review of the CMDI framework, ensuring its entry into force at the same time as the revised CMDI framework. Such timeline aims at ensuring consistency between the two frameworks, adequate burden sharing of shareholders and creditors to protect taxpayers and depositors, and preserve financial stability[186]. In June 2022, the Eurogroup took note of the intention of the European Commission to finalise the review of the State aid framework for banks, to ensure consistency between the State aid framework and the renewed CMDI framework.

Having the objective of coherence in mind, it is important to underline that the CMDI framework is subject to co-legislation, which will require time, and its outcome as compared to the Commission proposal is uncertain, while an update of the State aid rules requires a Commission Communication, which, when decided by the Commission, could take effect immediately.

Notwithstanding the interactions between the various components of the current legislative framework, the reform of the State aid rules is not part of the present impact assessment nor of the subsequent legislative proposal. A separate process to assess the need for a review of the State aid rules is ongoing, in parallel to the review of the CMDI framework, also in light of different procedures to amend the relevant acts[187].

In terms of deposit protection, deposits are protected up to EUR 100 000 per depositor and per bank, under the DGSD, regardless of whether the bank is put into resolution or insolvency. In insolvency[188], the primary function of a DGS is to pay out depositors within seven days of a determination of unavailability of their deposits. Under the DGSD, DGSs may also have other functions (all aimed at preserving depositor confidence) such as financing preventive measures or, financing measures in insolvency other than payout, i.e. a transfer of assets and liabilities to a buyer, to preserve the access to covered deposits (DGS alternative measures). The DGSD provides a limit as regards the costs of such preventive and alternative measures. They can never be more costly than a payout of the covered amount. Moreover, DGSs can contribute financially to a bank's resolution, under certain conditions.

[186] Eurogroup (November 2020), *Statement of the Eurogroup in inclusive format on the ESM reform and the early introduction of the backstop to the Single Resolution Fund*. The intention of the Eurogroup is to ensure that the outcome of the State aid rules review is aligned with the outcome of the negotiations of the CMDI review by co-legislators.

[187] In March 2022, the Commission has launched a *Call for Evidence* together with a *public* and *targeted* consultation to seek stakeholder feedback on the evaluation of State aid rules for banks in difficulty. The input collected and a study will feed into the evaluation that the Commission aims to publish.

[188] Insolvency proceedings across the EU are unharmonised; some allow for certain transfer tools similar to resolution financed by DGSs, others only allow for piece-meal liquidation proceedings.

The functioning of the DGSs and the use of their funds cannot be seen in isolation from the broader debate on the European deposit insurance scheme (EDIS).

Notwithstanding the progress achieved, areas for further strengthening and adjustment were identified with regard to both the resolution and depositor insurance framework. The evaluation of the current rules (see Annex 5) has identified issues with the framework's design, implementation and application. The review of the CMDI framework should provide solutions to address these issues and enable the framework to fully achieve its objectives[189] and be fit for its purpose.

The revision of the CMDI framework as well as a possible further harmonisation of insolvency laws are foreseen in the respective review clauses of the legislative texts. The review is part of the agenda for the completion of the Banking Union, as emphasised in President von der Leyen's Political Guidelines. Although the political guidelines included the creation of EDIS, it will not be part of the current initiative because political discussions on EDIS and other workstreams of the Banking Union completion plan have yet to be finalised.

Insolvency

National insolvency proceedings are not part of the CMDI framework, but they are alternative to it. The resolution authority may conclude that the bank does not need to be put in resolution because its failure would not have a significant impact on financial stability or would not endanger any critical function and that the tools available in the insolvency law of the relevant Member State are adequate to manage the bank's failure (i.e. the public interest assessment is negative). In this case, the bank is put in insolvency according to national law. Very small banks are likely candidates for being credibly handled when they fail through insolvency proceedings, without creating ripple effects in the financial system or the real economy.

The procedure and tools available in this case depend on the national legislation. These may vary widely from Member State to Member State. Some foresee a judicial "atomistic" insolvency procedure, leading to the sale of the assets in a piecemeal fashion to repay the creditors in order of their ranking in the hierarchy of claims, similar to the insolvency available for regular corporations (in some countries the insolvency procedure is actually the same for banks and other companies).

Certain Member States' legislations provide for administrative insolvency proceedings for banks. These are generally managed by an administrative authority in cooperation with the relevant court. Concretely, these procedures provide for measures similar to the resolution tools, such as selling the whole business (i.e. also the liabilities) to a buyer without the consent of the failing bank's creditors.

Normally, funding from sources outside of the bank's assets should not be required in insolvency, as creditors are expected to bear losses and share any value realised through the liquidation (sale) of assets, in order of their ranking in the hierarchy of claims.

[189] See Chapter **Error! Reference source not found.** on the objectives.

However, for the insolvency of banks, the DGS has the possibility to use an alternative measure to payout, aiming at preserving the depositors' access to covered deposits, such as a transfer of the assets and liabilities and deposit book to an acquiring bank. This tends to be a more efficient and effective solution than payout, however it is only available in 11 Member States (who transposed this national option). Actions under national insolvency law can also be financed with support from the public budget (State aid).

Merits of resolution versus insolvency, including for smaller and mid-sized banks in the CMDI framework

The fundamental principle of the EU harmonised resolution framework is to provide a common toolbox to deal effectively with any bank failure (irrespective of its geographical location, its size or business model i.e. domestic or operating across the border) in an orderly way, preserving financial stability and protecting depositors without relying on public funds. For many banks, such objectives cannot be met to the same extent under national insolvency frameworks, which, in some cases, are not adapted to the specificities of bank failures.

The CMDI framework implements in the EU regulatory framework the international consensus emerging after the global financial crisis (G20, Financial Stability Board decisions) that banks should never again be bailed out with public money. The set-up of the resolution frameworks around the world constituted a major paradigm shift from bail-out to bail-in (i.e. banks should pay for their own resolution/liquidation with their own resources as well as with industry-funded resources as opposed to public bail out).

This principle of not using taxpayer money for the financial industry is already well rooted in the EU. As an illustration, the Recovery and Resilience Facility[190], an instrument part of NextGenerationEU adopted in the context of the COVID-19 pandemic and aimed at helping the EU emerge stronger and more resilient from that crisis explicitly excluded funding to banks and the financial sector. Similarly, the EU state Aid Temporary Framework[191] adopted in 2020 to enable Member States to use the full flexibility foreseen under State aid rules to support the economy in the context of the coronavirus outbreak also explicitly excluded State Aid to banks.

This principle of protecting taxpayer money was also at the heart of the CMDI framework when adopted in 2014. In addition to this objective, a common resolution framework and toolbox has a number of very important benefits compared to national insolvency proceedings:

- provides predictability and level playing field when handling (any) failing banks, which means that taxpayers, deposits and bank creditors are treated in the same manner across the EU,
- enhances preparedness, through recovery and resolution planning for crisis times, including by imposing requirements on banks to become resolvable and absorb possible losses internally or via the safety nets (thereby shifting away losses from taxpayers and internalising losses with the industry),

[190] European Commission (February 2021), *The Recovery and Resilience Facility*.
[191] European Commission (2020), *The State Aid Temporary Framework*.

- increases efficiency in handling bank failures as it facilitates a restructuring/ sale of business to a buyer, preserving the bank's franchise value without cutting access to client accounts and client relationships,
- fosters consumer confidence in the banking sector, significantly reducing the risk of spiralling contagion to other banks and mitigating the risks that bank clients may start questioning the solidity of the system and its safety nets as it could happen under normal insolvency proceedings,
- ensures losses can be internalised by in the industry, by requiring banks to build resolution buffers and setting up industry-funded safety nets complementing internal bank buffers to absorb losses and avoid recourse to public funds for all banks and not only cross-border ones,
- fosters confidence between Member States that banks failures will be addressed in an effective way, thus preserving financial stability in the single market and the Banking Union, and
- protects Member States' fiscal capacity which may be limited in crisis times.

However, despite the widely shared intention of protecting taxpayer money embedded in the CMDI framework since 2014, some Member States have continued to make recourse to taxpayer money when handling failing banks, since the establishment of the framework, as evidenced in Chapter 2 and Annex 5. This is not because they find it acceptable politically or economically to do so, but because they had to choose between protecting financial stability and deposits on one hand and protecting taxpayer money on the other hand. The current framework poses entry barriers for certain small and mid-sized banks through the onerous access condition to resolution funding, which some banks can only attain if deposits bear losses. However, bailing-in depositors would pose a significant risk to financial stability, as depositors would lose confidence in the banking sector and likely provoke bank runs and spiralling contagion, which can reverberate also into the real economy, as seen during the global financial crisis. There is therefore, a political consensus among Member States that the CMDI framework needs to be fixed in a way that resolution can be used for any bank where needed.

Background on the principle of subsidiarity in the CMDI framework (why should small/mid-sized banks be dealt with under the harmonised resolution framework vs national insolvency proceedings)

The resolution framework as it was created in 2014 was meant to be applicable to any bank when it fulfils the objectives of protecting financial stability, taxpayer money and depositors better than national insolvency proceedings[192]. The merits of resolution vs insolvency are assessed through the PIA, which is a case by case judgement, based on criteria on whether to place a bank in resolution or national insolvency proceedings. The PIA is, *de facto*, the subsidiarity test in the CMDI framework, as also indicated by recital 13 and Article 32(5) of BRRD I[193].

[192] Recital 29 BRRD I: "*Due to the potentially systemic nature of all institutions, it is crucial, in order to maintain financial stability, that authorities have the possibility to resolve any institution*",
[193] Recital 13 BRRD I*: "The use of resolution tools and powers provided for in this Directive may disrupt the rights of shareholders and creditors. In particular, the power of the authorities to transfer the shares or*

In the Banking Union, the PIA decisions are made by the SRB for banks under its remit (systemic banks and less systemic cross border banks) and by the national resolution authorities for smaller banks, for which they are responsible (less significant institutions). Outside the Banking Union, national resolution authorities have the role to determine the path for managing a failing bank in all cases (PIA). This governance structure embedded in the CMDI illustrates the flexibility of resolution authorities to decide what is the pathway that best attains the sought objectives. The EU level rules do not impose or prescribe a treatment for any bank of any size, it provides the necessary discretion to resolution authorities to take the best decision. At the same time, to enable such decisions, the continuum of tools, including the harmonised resolution tools and national tools (preventive measures, administrative insolvency measures, piece-meal judicial insolvency measures) to handle failing banks are preserved in the framework.

In terms of scope of application, the framework applies to all banks. CMDI rules are appropriate for systemic banks, which are "too big to fail" and which will likely go into resolution (in general open-bank bail-in strategy) and be bailed-in if they failed. The framework is also deemed appropriate for very small banks, which are more likely to be placed in insolvency and be liquidated if they failed. However, there is a middle category of banks, which are not "too big to fail" but "too big to liquidate" for which the framework cannot be credibly used in all cases where it would be needed and for which other avenues involving taxpayer money were used in the past (see Chapter 2, the evaluation in Annex 5 and Annex 9 showing past cases of bank failures).

The CMDI review aims to improve the rules in a way that the harmonised resolution framework can also be used for this category of small to mid-sized banks, when resolution best achieves the objectives. To do so, the initiative will revisit: the PIA to include additional criteria to help authorities decide on the best avenue, the access to funding in resolution by using the DGS funds in certain framed circumstances, the least cost test for using DGS funds in and outside resolution to make sure it is harmonised among the various DGS funds uses. This would align incentives between choosing resolution and other avenues and ensure the choice is based on merits/objectives and not on cheaper access to funding.

Box 6: Evidence depicting the systemic impact of failing small/mid-sized banks on financial stability

Small and medium-sized banks, whether purely domestic or cross-border, have an impact on financial stability; albeit a commensurately smaller one than that of large global systemic banks. In line with their size, risk footprint, their interconnectedness and their business strategy, the prudential and liquidity requirements that small and mid-sized banks are asked to comply with, are proportionately lower than those of large systemic banks. They may be also granted access to liquidity assistance by central banks (under

all or part of the assets of an institution to a private purchaser without the consent of shareholders affects the property rights of shareholders. […] Accordingly, resolution action should be taken only where necessary in the public interest and any interference with rights of shareholders and creditors which results from resolution action should be compatible with the Charter of Fundamental Rights of the European Union (the Charter)…"

eligibility conditions) if needed. They should be also able to fail in an orderly manner under the harmonised resolution framework if it best achieves the objectives.

This box aims to provide additional references and examples depicting the impact of small and mid-sized banks on financial stability.

The ***Financial Stability Institute (FSI)***, part of the Bank for International Settlements argues in its paper ***"How to manage failures of non-systemic banks"*** from 2018[194] that "*the social and economic significance of banks' activities mean that even the failure of small, non-systemic banks may entail public interest concerns*". The paper notes that insolvency regimes may provide a viable alternative to resolution, while respecting the principle of no bailout agreed internationally after the global financial crisis of 2008-2009. The paper also states that "*the unique susceptibility of banks to runs and the role of even non-systemic banks in the functioning of the real economy through activities such as deposit-taking and provision of credit and transmission of payments mean that bank failure is significantly more likely to give rise to public policy concerns than ordinary corporate failures*". It analyses the appropriateness of insolvency regimes for dealing with failing banks and finds that these should fulfil four features in order to be considered adequate to deal with bank failures: (i) include depositor protection in the objectives of the insolvency in addition to that of maximising proceeds from asset sales to satisfy creditor claims, (ii) include wider range of grounds for opening insolvency regimes (forward looking criteria and likelihood of failure); (iii) role of administrative authorities and courts; and (iv) more reduced role of creditors in bank versus corporate insolvency regimes. Otherwise, ordinary corporate insolvency regimes are not best suited to the specific characteristics of banking business and particular risks that arise when a bank fails, which motivated the development of resolution regimes.

In a subsequent occasional paper called ***"Bank failure management in the European banking union: What's wrong and how to fix it" from 2020, the FSI***[195] notes that the EU CMDI framework cannot guarantee the handling of bank failures without taxpayer money, which is deemed unacceptable as per the international consensus which emerged following the global financial crisis of 2008-2009. It suggests focusing the reform on options for dealing with the failures of small and medium-sized banks, by facilitating greater use of resources from deposit guarantee schemes to fund transfer transactions (sale of business) in resolution and insolvency. The paper clarifies that there are no adequate strategies in the Banking Union for dealing with the failure of mid-sized banks that are too large to be liquidated, but too small and too traditional to be resolved using bail-in. It recommends that transfer strategies could be the most suitable strategy for facilitating an orderly exit for failed small and mid-sized banks, but this is hindered by restrictions to access funding to support such transfer tools (industry funded safety nets).

[194] Financial Stability Institute (FSI), (October 2018), *How to manage failures of non-systemic banks*.
[195] Financial Stability Institute (FSI), (July 2020), *Bank failure management in the European banking union: What's wrong and how to fix it*

A ***working paper by the European Systemic Risk Board (ESRB)*** from 2021[196] analyses the impacts of bank failures on the real economy by focusing on the credit channel (i.e. interruptions to lending causing a temporary credit shortfall due to a sudden closure of a bank when placed in insolvency proceedings). The paper found that, the application of the harmonized CMDI framework is especially useful for medium-sized banks, which can be considered "grey area" or "middle class" institutions, as defined by Restoy et al. (2020), as it provides insights to reduce the uncertainty on whether their resolution is in the public interest. At the same time, simulations suggest that the failure of similar banks could have effects of heterogeneous severity across jurisdictions.

The ***US savings and loan crisis from the 1980s***[197] refers to very wide-spread contagion among very small financial institutions dealing with mortgage financing (i.e. exposed to similar sector of activity), on the backdrop of high inflation and rising interest rates. There were more than 4,000 such savings and loans institutions in the US in 1980, with assets totalling USD 600 bn. Given the very high costs to taxpayers of paying insured deposits in these institutions (roughly USD 25 bn), regulatory forbearance led to having a large number of insolvent (zombie) institutions still operating on the market, which worsened the situation. In 1989, the Resolution Trust Corporation closed 747 savings and loans institutions with assets over USD 407 bn, with an ultimate cost to taxpayers of USD 124 bn. The use of public money was needed to shield the clients of these institutions from losing their life savings, as it would have happened were they simply put in bankruptcy proceedings.

A ***study by the Dutch National Bank*** conducted in 2018[198] looked at the implications of banking sector size on financial stability. Their analysis suggests that the relationship between banking sector size and financial stability is not clear-cut. For example, several countries with a large banking sector relative to GDP, such as Iceland and Ireland, were hit very hard during the crisis, as they bailed-out large banks with significant impact on sovereign debt. At the same time, however, countries with small, domestically oriented banking sectors, such as Greece, Italy and Portugal, also turned out to be very vulnerable. The study finds that, the size of the banking sector relative to GDP is significantly correlated with most systemic risk measures (as defined by the European Systemic Risk Board (ESRB) in 2013). However, indicators like domestic orientation and sovereign exposures are negatively correlated with size, meaning that small banking sectors are less diversified and tend to be more focused on their home country and government, creating high concentration risks. Among the conclusions of the paper is that the large discretionary power of authorities in deciding how to resolve bank failures may also be an issue.

A ***study entitled 'Too many to fail'*** tabled for a seminar on systemic risk and financial regulation seminar[199] in 2010 found that it is not only the size that can cause an

[196] ESRB (European Systemic Risk Board) (June, 2021), *Measuring the impact of a bank failure on the real economy: an EU wide analytical framework*.
[197] Federal Reserve, *Federal Reserve History – Savings and Loans crisis 1980 – 1989*.
[198] Dutch National Bank (2018), *Size of the banking sector: implications of financial stability*.
[199] Johannes Gutenberg University Mainz (2010), *Too many to fail*, thesis in the course of the seminar 'systemic risk and financial regulation'.

individual bank to be of systemic importance. It is the nature of the bank's strategy and its interconnectedness to other banks that can also make it systemic. Many small banks that are exposed to the same risk factors can be systemic together because they could all fail at the same time, which would in aggregation have a large effect on the financial system ("too many to fail"). Archaya et al (2009) also defines systemic risk as the "*joint failure risk arising from the correlation of returns on asset side of bank balance sheets*." The paper also recalls the significant social cost of liquidating insolvent banks, which can increase drastically with the number of such banks.

The ***examples of bank failures shown in Annex 9*** clearly illustrate that, in many cases of small/mid-sized banks failing, public money or other forms of financial aid (DGS) were used in the national insolvency proceedings. The reason for using these resources was to protect financial stability and avoid imposing losses on depositors, which proves that even small or mid-sized banks cannot be left to simple liquidation, which would not require additional financial resources**.**

Other main features of the CMDI framework

Preparedness and prevention

In order to prevent banking crises, all banks in the EU are required to prepare recovery plans under the supervision of competent authorities. Those plans set up a monitoring system integrated in the banks' risk management, leading to the implementation of recovery options by the banks to restore their financial position at an early stage of distress (before failure). Additionally, resolution authorities draw up resolution plans outlining the preferred strategy and course of action in case of failure and setting a minimum requirement for own funds and eligible liabilities (MREL) with the aim of ensuring that the shareholders and creditors of the bank can absorb its losses and contribute to its recapitalisation[200]. If, during the planning process, the authorities identify obstacles to recovery or resolvability, such obstacles will be removed by taking appropriate measures[201]. For significant institutions within the Banking Union, the ECB/SSM is the relevant authority assessing the recovery plans, taking into account the recommendations of the SRB[202]. The SRB is responsible for the resolution of significant and cross-border institutions, after consulting with the ECB or the national competent authorities. For all other banks, inside and outside the Banking Union, the relevant resolution authorities remain national[203].

[200] For and cross-border banking groups, the BRRD requires that resolution colleges of home and host authorities are set up to coordinate group-wide resolution strategies and implementation of resolution action.

[201] Such measures can be of a structural, organisational, financial or information-related nature.

[202] Article 6(4) BRRD.

[203] Nevertheless, within the Banking Union, national competent and resolution authorities carry out their functions within the framework laid down by Single Supervisory Mechanism Regulation (SSMR) and SRMR and under the general guidance of the ECB and the SRB. Moreover, if the implementation of resolution action to a less significant institution requires the use of the SRF, the resolution scheme must be adopted by the SRB.

Before failure – early intervention, preventive and precautionary measures

In case of a deteriorating financial position, the BRRD, SRMR and DGSD foresee specific intervention measures at an early stage to prevent a bank from failing. In particular, the supervisors have an expanded set of powers to intervene via so-called early intervention measures[204]. These powers include, for example, the ability to dismiss the board or management of a bank and appoint a temporary administrator, or to require the bank to draw up a debt restructuring plan with its creditors. Similarly, DGS funds can be used to prevent the failure of a bank under certain conditions (so called preventive measures[205]). Finally, under certain conditions, the BRRD and SRMR exceptionally allow for the use of State aid without triggering resolution – the so-called precautionary recapitalisation and precautionary liquidity[206]. Such a public support to solvent banks is allowed to cover capital shortfalls identified during a supervisory stress test.

Failing or likely to fail

If a bank's failure is deemed inevitable, the BRRD and SRMR require the competent[207] (or the resolution) authority to determine that it is "failing or likely to fail" (FOLF). The resolution authorities assess whether resolution is in the public interest, via a public interest assessment (PIA) on the basis of the need to pursue the resolution objectives, having also in mind the applicable national insolvency proceedings. In case of a positive PIA, the resolution authority will apply resolution tools. These may include selling the business to a private purchaser, setting up a temporary bridge bank to operate critical functions, separating bad assets through the transfer to an asset management vehicle and writing down debt or converting it to equity (bail-in). When the PIA is negative, the failing institution must be orderly wound up under national proceedings. The applicable creditor hierarchy[208] plays an important role in this context because it provides the order in which claims bear losses both in resolution and insolvency.

Financial safety nets

The framework sets up industry-funded safety nets that contribute to reducing the risk of bail-out by taxpayers. Resolution and deposit guarantee funds, financed by the industry, can provide financial support to failing banks in resolution if needed to complement the internal loss-absorbing capacity.

With the BRRD and SRMR, national resolution funds and the SRF for banks in the Banking Union[209] were set-up in 2015 and 2016 respectively. National resolution funds are established in each Member State and managed by the national resolution authorities.

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[204] These powers are laid down both in the BRRD as well as in the CRD and SSMR.
[205] Article 11(3) DGSD.
[206] Article 32(4) BRRD.
[207] ECB/SSM as the competent authority for all significant banks in the Banking Union and the national competent authority for all other banks.
[208] Each Member State has a specific insolvency hierarchy of claims. Hence, when a bank goes into normal insolvency proceedings, creditors are allocated to different classes, according to the national ranking of creditors. See VVA, Grimaldi & Bruegel (2019) *Study on the differences between bank insolvency laws and on their potential harmonisation*
[209] Further, the *Eurogroup agreed in November 2020* to introduce a common backstop to the SRF. It will be provided by the ESM and its size will be aligned to the size of the SRF, up to a nominal cap of EUR 68 bn. The backstop will be introduced by 2022.

The SRF is established in the Banking Union and it is managed by the SRB. The resolution funds are expected to reach their target levels by 2024, which correspond to at least 1% of the covered deposits of all credit institutions operating in their remit.[210] Banks' (including certain investment firms) annual contributions to the national resolution funds and the SRF are based on their liabilities and risks. The resolution funds may be used only to the extent necessary to ensure the effective application of the resolution tools and as a last resort. Resolution measures financed by a resolution fund can take the form of contributions in lieu of the bail-in of certain creditors and loans or asset guarantees.

In order to access the RF/SRF for solvency (loss coverage) support, a minimum bail-in of 8% of total liabilities and own funds of shareholders and creditors (which may include depositors) must be carried out beforehand. A series of liabilities in the banks' balance sheets are mandatorily excluded from bail-in, including covered deposits[211]. Although not explicitly stated in BRRD and SRMR, a systematic interpretation of the relevant legal provision indicated that the minimum bail-in condition does not apply when accessing the RF/SRF for liquidity support. If the RF/SRF does not have sufficient financial means to fund resolution, *ex post* contributions are raised to cover the additional amounts[212]. On an annual basis, the RF/SRF is replenished by *ex ante* industry contributions to ensure that the level of available funds is not below the target level[213].

In line with the DGSD, national DGSs were established in each Member State and managed by the national DGS authorities. DGS funds are expected to reach a target level equivalent to at least 0.8%[214] of covered deposits in the respective Member State by July 2024. The primary objective of DGS funds is to ensure a harmonised protection of EUR 100 000 (or equivalent amount in the local currency) across the EU by paying out covered depositors up to that level in case their deposits become unavailable. Beyond the so-called "pay box function", DGSs can also support, under specific conditions, proceedings in resolution[215] and insolvency[216], as well as preventive measures to avoid the failure of a credit institution[217].

The conditions to access DGS funds for resolution, preventive measures and alternative measures diverge[218]. In resolution, the DGS may be liable for the losses that covered depositors would have borne were they not excluded from loss absorption, up to the limit of the losses the DGS would have suffered in insolvency.

In insolvency, the DGS has the possibility to use an alternative measure to payout[219] aiming at preserving the depositors' access to covered deposits, such as a transfer of the

[210] As of July 2021, the SRF holds approximately EUR 52 bn, see SRB (2021) *Compartments*.
[211] Article 44(2) BRRD listing mandatory exclusions from bail-in. Article 44(3) lists discretionary exclusions from bail-in.
[212] Articles 71 SRMR and 104 BRRD.
[213] Articles 70 SRMR and 103 BRRD.
[214] In certain cases, this level is lowered to 0.5%.
[215] As laid down in Article 109 BRRD.
[216] As alternative measures laid down in Article 11(6) DGSD.
[217] As laid down in Article 11(3) DGSD.
[218] As laid down in Article 109 BRRD, Article 11(3) DGSD and Article 11(6) DGSD respectively.
[219] Article 11(6) DGSD.

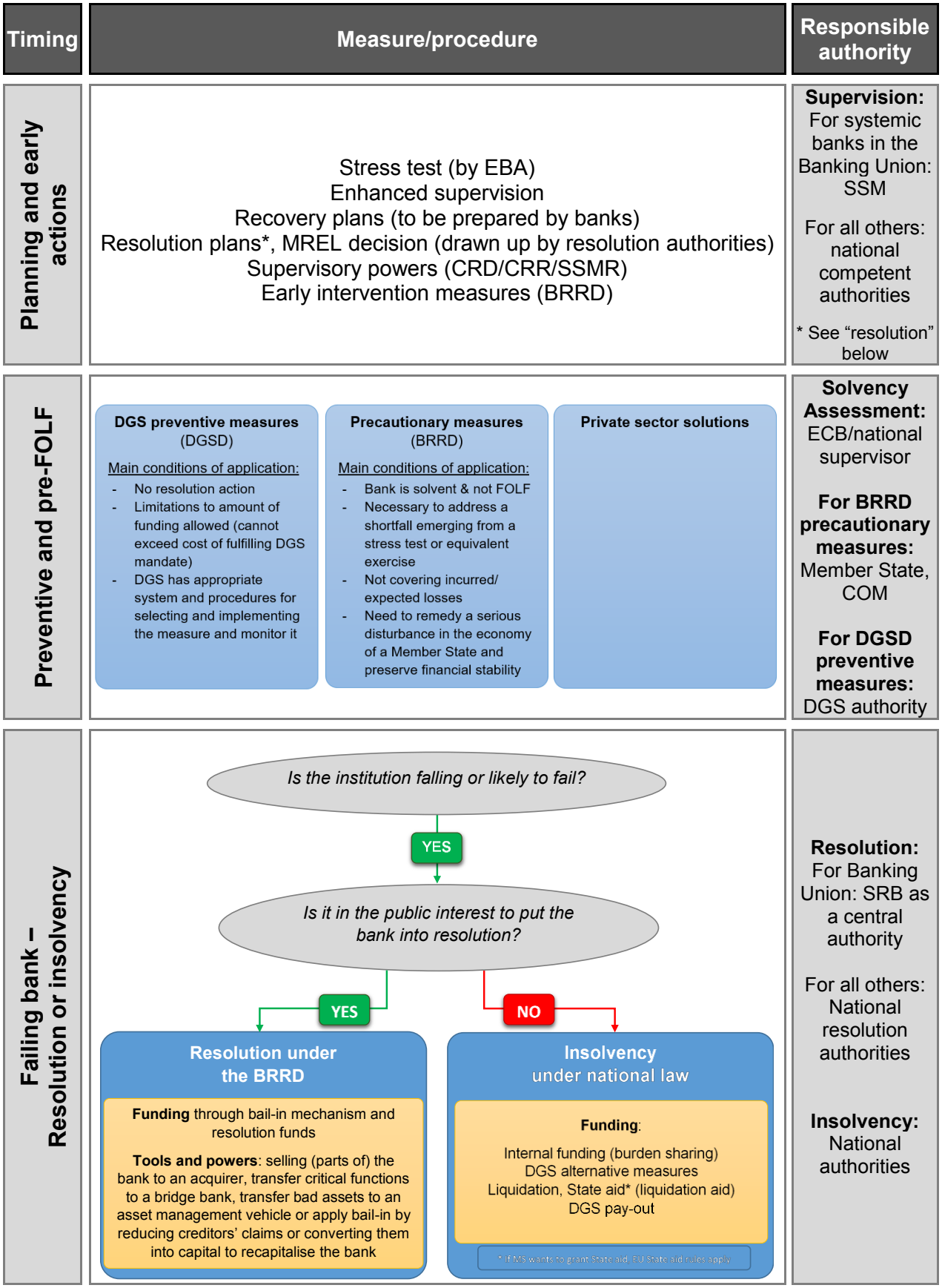
assets and liabilities and deposit book to an acquiring bank. Under Article 11(6) DGSD, the DGS can finance an alternative measure if its cost is limited to the "net amount of compensating covered depositors". In this context, the DGS has to compare the cost of the payout and the cost of the alternative measure (i.e. the least cost test), and applies the least costly option.

For non-failing banks, preventive measures aim to prevent the failure of a bank so that it continues as a going concern. Such intervention is subject to conditions. Under Article 11(3)(c) DGSD, the cost of the measures cannot exceed "the costs of fulfilling the statutory or contractual mandate of the DGS". The interpretation of this condition varies among Member States. Some apply a least cost test similar for preventive and alternative measures, while others do not apply any least cost assessment for preventive measures.

When the financial means of the DGS are not sufficient to fund the necessary measures, the DGS may seek to obtain the missing funds through *ex post* contributions raised with the industry, through borrowing with other DGSs and/or through a loan from the State budget (which is the backstop of the DGS). Once the DGS funds have been depleted, the fund is replenished through *ex ante* industry contributions[220].

[220] Two requirements have to be met: (i) the target level must be reached by 2024, and (ii) after 2024, if the fund is depleted, it has to be replenished within 6 years (Article 10(2) DGSD).

Figure 11: EU resolution and insolvency framework



Source: Commission services

ANNEX 5: EVALUATION OF THE CMDI FRAMEWORK

1. EXECUTIVE SUMMARY

The EU bank crisis management and deposit insurance framework lays out the rules for handling bank failures and ensuring the protection of depositors. It was built around the objectives of maintaining financial stability, protecting depositors, minimising taxpayer losses, limiting moral hazard and improving the internal market for financial services. The EU CMDI framework implements the commitments by the G20 leaders in September 2009 that bank failures should be managed in an orderly manner through cross-border resolutions and that the moral hazard stemming from banks being considered "too big to fail" should end[221]. The EU went beyond the recommendations addressed to the global systemically important banks, implementing a crisis management framework for all banks.

While the CMDI framework applies to all EU Member States, in the Banking Union, further integration is achieved with the Single Supervisory Mechanism (first pillar of the Banking Union), the Single Resolution Mechanism (second pillar of the Banking Union) and the European deposit insurance scheme (EDIS – the still missing third pillar of the Banking Union)[222].

The framework covers three EU legislative texts which, together with the related implementing and delegated acts and relevant national legislation form the rulebook for handling bank failures: the Bank Recovery and Resolution Directive (BRRD), the Single Resolution Mechanism Regulation (SRMR) and the Deposit Guarantee Schemes Directive (DGSD)[223]. All three legislative texts have been applicable for over five years at the time of the review and the evaluation will cover the period since their introduction until the present. The three legislative texts contain review clauses anticipating a possible revision of the resolution framework, further harmonisation of insolvency law as well as a report on the progress concerning the implementation of depositor protection rules[224]. This evaluation also provides a state of play regarding the third pillar of the Banking

[221] G20 Pittsburgh Summit (September 2009), *Leaders Statement*, paragraph 13, last bullet point.

[222] In its Communication of 12 September 2012, "*A Roadmap towards a Banking Union*", COM (2012)0510 final, the Commission called for a Banking Union that would place the banking sector on a more sound footing and restore confidence in the euro as part of a longer term vision for economic and fiscal integration. The report by the Presidents of the European Council, the Commission, the Eurogroup and the European Central Bank of 26 June 2012 *"Towards a genuine Economic and Monetary Union"* endorsed this vision.

[223] Provisions complementing the crisis management framework are also present in the Capital Requirements Regulation (CRR – Regulation (EU) 575/2013) and the Capital Requirements Directive (CRD – Directive 2013/36/EU). The winding up Directive (2001/24/EC) is also relevant to the framework.

[224] Under Article 19(6) DGSD, the Commission, supported by EBA, shall submit to the European Parliament and the Council a report on the progress towards its implementation by 3 July 2019. This report has been postponed due to EBA's work on the technical advice that was completed in January 2020. In this context, four opinions were submitted by EBA: on eligibility, coverage level and cooperation agreements, on DGS payouts, on DGS funding and use of DGS funds and on the AMLD and DGSD interplay. The evaluation covers the assessment of the progress of the implementation of depositor protection rules based on this work conducted by EBA. Consequently, there will be no other progress report issued.

Union. The Commission put forward a proposal for EDIS in 2015[225] which, to date, is still not agreed by the co-legislators, leaving the Banking Union incomplete.

This evaluation complements the impact assessment of the CMDI review and its conclusions feed into the problem definition. It is based primarily on the results of consultations with stakeholders, regular exchanges with experts from the Member States (Ministries of Finance, resolution authorities, deposit guarantee schemes authorities), reports from the EBA, studies commissioned by the European Parliament and exchanges with Members of the European Parliament, discussions with the European Central Bank ECB and the SRB – the central supervisory and resolution authorities in the Banking Union and additional desk research of the Commission services. A detailed description of the methods used to conduct this evaluation and inform the impact assessment for the review of the framework are provided in Section 5.

On the basis of the evidence and in line with better regulation principles, the framework was evaluated against five criteria: efficiency, effectiveness, relevance, coherence and added-value of EU action.

This evaluation concludes that the application of the framework brought important benefits in terms of maintaining financial stability, mainly through more robust crisis preparedness and contingency planning, enhanced banks' resolvability, including through the build-up of resolution buffers and pre-funded deposit guarantee and resolution funds, improved market discipline and curbed moral hazard. The implementation of the framework significantly improved depositor protection and contributed to boosting, overall, consumer confidence in the EU banking sector.

Yet, the practical application failed to achieve some important objectives or achieved them only partially. Experience with the application of the CMDI framework from 2015 until now reveals that, while it can be a very effective tool in addressing problems of bank failures, in some areas, there is scope to improve its functioning. The Commission is therefore reviewing it as part of the work on completing the Banking Union. This review represents an opportunity to improve the functioning of the second pillar of the Banking Union (the Single Resolution Mechanism) to revisit areas of risks related to its application and ensure it is fit for purpose. It also aims to evaluate the need for and make progress on EDIS, the third and still missing pillar of the Banking Union.

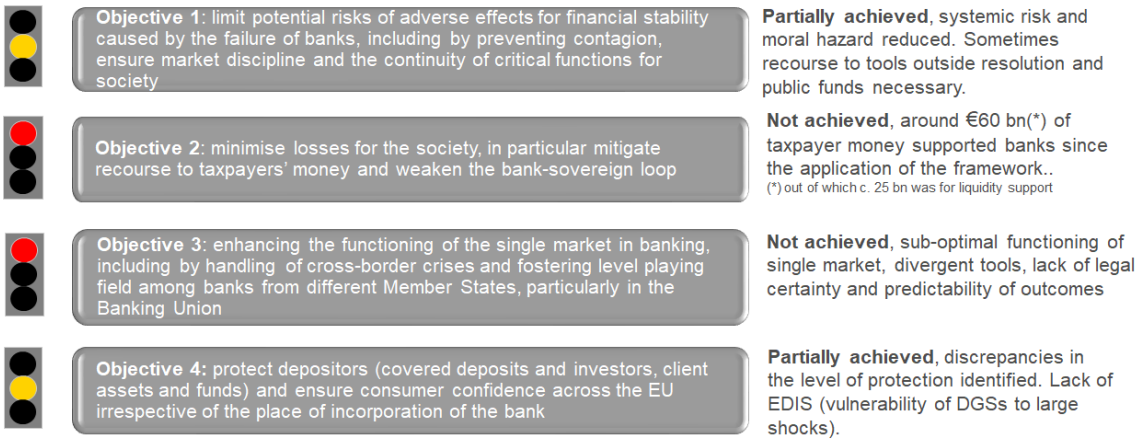
The four opinions and reports[226] from the EBA on the implementation of the depositor protection rules also substantiate the need for clarifying a number of DGSD provisions and improving depositor protection and payout processes in the context of this review.

Considering the effectiveness criterion, two out of the four objectives of the framework have been evaluated as being partially achieved, while the others have not been achieved in a satisfactory manner, except in a limited number of cases. More specifically, the framework partially achieved its objective of containing risks to financial stability and protecting depositors, but it failed to achieve other key overarching objectives, notably

[225] European Commission (November 2015) *Commission proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 806/2014 in order to establish a European Deposit Insurance Scheme* ("the 2015 EDIS proposal").
[226] See Annex 1.

enhancing the functioning of the single market and minimising recourse to taxpayer money. In a significant number of cases, the fulfilment of objectives cannot be directly attributed to the European framework, but to the application of tools at national level, outside of resolution and with recourse to public budgets and taxpayers' funds. The management of bank failures differed across Member States, depending on the existing national regime, which raises questions about the coherence of the framework, resulting in sub-optimal outcomes for level playing field and the single market in banking.

Figure 12: Overview of effectiveness – traffic light analysis



Source: Commission services assessment.

Under the efficiency criterion, the evaluation found that the CMDI framework is not sufficiently cost-effective. On one hand, the main benefits of the framework include enhanced crisis preparedness, contingency planning, increased loss-absorption capacity in banks and the disciplining influence that the existence of the framework exerts on banks and markets. On the other hand, the operationalisation of the CMDI framework came with costs for the banking industry, Member States and resolution authorities. Yet, despite the costs, the framework and its tools and powers have been scarcely used in practice, especially in the Banking Union under the SRMR. The Single Resolution Fund (SRF) has remained idle so far and beyond the losses absorbed by the banks, deposit guarantee scheme (DGS) have been used often backed by public funds. In addition, the use of public funding in recent cases of bank failures indicates a redistribution of costs from banks' senior unsecured creditors to the taxpayers, despite scrutiny on such usage of public funds through the EU State aid rules. Furthermore, available evidence suggests that these costs are uneven between Member States, as national requirements and practices diverge widely.

From a coherence perspective, further improvements are necessary to ensure a better internal interaction and consistency between the various pieces of legislation forming the CMDI framework, in particular the coherence between the CMDI framework and the State aid rules[227] most prominently in respect of access to funding requirements to

[227] State aid rules are intrinsically interconnected with and are complementary to the CMDI framework. These rules are not subject to this review and this impact assessment. In order to ensure consistency between the two frameworks, the Eurogroup invited the Commission in November 2020 to conduct a

support tools outside resolution, the Capital Requirements Directive (CRD) and the Single Supervisory Mechanism Regulation (SSMR) in what concerns the early intervention measures, the Anti-Money Laundering Directive (AMLD), the Payment Services and the E-money Directives in what concerns interactions with the DGSD.

The framework remains very relevant and adds EU value because cross-border crisis management cannot be left to the national level without consequence on public finances, the bank-sovereign nexus, the single market in banking and level playing field for banks, creditors, depositors and taxpayers. The addition of a common safety net such as EDIS would further boost the framework's relevance and EU-value added.

Identified problems are grouped as follows:

- uneven playing field and uncertainty in the management of bank crisis situations – mainly driven by the lack of legal clarity and framing of the application of DGSD preventive measures and BRRD precautionary measures, broad legal discretion in the PIA when placing banks in resolution (under EU framework) *versus* insolvency[228] (under national rules), divergence in the triggers for national insolvency proceedings, divergence in the hierarchy of claims in national insolvency laws[229], an inadequate early intervention framework and timeliness of the FOLF determination;
- ineffective funding options and divergent access conditions for the financing of resolution and insolvency – mainly driven by structural challenges for some banks in fulfilling the conditions to gain access to resolution funds/SRF, divergent requirements to access funding from the resolution fund and other sources of funding outside resolution and unclear rules to access DGS funding in resolution and insolvency;
- uneven and inconsistent depositor protection and lack of robustness in DGS funding – mainly driven by different national provisions as well as vulnerability to large shocks in national depositor protection in the Banking Union due to the lack of centralised safety nets (e.g. EDIS).

2. INTRODUCTION

Purpose of the evaluation

The focus of the evaluation is to assess whether appropriate tools and means exist to manage in an orderly manner the failure of all banks irrespective of their location, size or business model. In addition, it evaluates whether adequate mechanisms are in place to ensure depositor protection, in particular in the Banking Union considering the third missing pillar.

review of the State aid framework for banks and to complete it, in parallel with, the CMDI review, ensuring its entry into force at the same time with the updated CMDI framework.

[228] Insolvency proceedings across the EU are unharmonised; some allow for certain transfer tools similar to resolution financed by DGSs, others only allow for piece-meal liquidation proceedings.

[229] Throughout this document the terms 'hierarchy of claims in insolvency', 'hierarchy of claims', 'creditor hierarchy', 'ranking of claims' are used as synonyms and describe the same concept.

In line with better regulation principles, the evaluation of the EU CMDI framework seeks to assess the extent to which the requirements and the application of the framework have fulfilled the principal objectives in an efficient and effective way, while at the same time being coherent, relevant and providing EU added-value. In particular, with regard to effectiveness, the evaluation assesses whether the implementation of the framework has met its objectives and identifies the areas where there is room for improvement.

This retrospective evaluation was conducted back-to-back with the impact assessment and it feeds into the problem definition chapter. Where the framework fails to fulfil the policy objectives across these criteria, the review initiative aims to propose solutions to address identified issues that would enable the framework to achieve fully its objectives.

Scope of the evaluation

The scope of the evaluation covers all institutions and entities within the scope of the BRRD, SRMR and DGSD. It covers the measures preparing for and preventing bank failures, those applicable once a bank has been declared failing or likely to fail and those concerning depositor protection. In the area of prevention, the evaluation focuses on preventive measures under Article 32 of the BRRD (the so called "precautionary measures"), as well as on measures by the competent authorities (early intervention measures) to address financial deterioration at an early stage or to prevent a bank's failure using funding from the DGS (preventive measures under Article 11(3) DGSD) subject to the safeguards set out in the DGSD. In the area of execution of resolution, the evaluation looks at the overall incentive set-up in bank crisis management, the determination to place banks in resolution or insolvency, the coherence of various triggers, the application of resolution tools, funding issues, including the use of DGS funding prior to resolution, in resolution and insolvency, the level of depositor protection and its vulnerability to financial shocks from the perspective of financial stability.

The updates to BRRD/SRMR adopted in 2019[230] are out of the scope of this evaluation, as they have only been applicable for a short period of time and the effects of their implementation are still to be observed.

3. BACKGROUND TO THE INITIATIVE

The global financial crisis revealed structural issues accumulated in our inter-connected global financial system, some of which had wrongly been considered part and parcel of an inter-connected global financial system delivering deep markets and liquidity. Banks were generally undercapitalised and became highly leveraged in search for ever higher yields and return on equity, which the customer deposit funding model could not deliver. The maturity transformation function that banks had historically provided to the real economy became a point of weakness and fragility once short-term funding could not be extended to support long-term assets. Moral hazard and other agency issues were widely spread. When coupled with accelerated financial innovation and securitisation as well as regulatory forbearance, this generated substantial financial misconduct and poor management of risks.

[230] See section 3 of the Evaluation, for further details on the 2019 updates of the BRRD/SRMR.

The supervisory tools available at the time of the crisis did not capture this complexity nor addressed the underlying issues. They did not provide for well-structured action plans to deal with bank failures based on *ex ante* prepared scenarios. This forced regulators and supervisors into unchartered territory such as: massive bail-outs including through asset relief programs, capital injections, guarantees and provision of liquidity directly into the financial system, unprecedented "lender of last resort" operations, nationalisations as a temporary measure to stabilise systemic banks, or capital controls to reduce the effects of liquidity flight and buy time for devising restructuring and restoration plans.

Once the situation was stabilised, albeit with considerable burden for public finances (aid granted by the Member States between 2007 and 2014 amounted to EUR 671 bn in capital and repayable loans and EUR 1 288 bn in guarantees[231]), significant reforms meant to address the root causes of the crisis were enacted, including to address poor capital adequacy ratios and loopholes in risk management practices, agency issues, the lack of resolution regimes and the insufficient depositor protection in some countries. This wave of measures set the foundation of the Banking Union and its pillars. The first pillar set up a Single Supervisory Mechanism (SSM) and implemented Basel III in Europe through the revised Capital Requirements Regulation and Directive (CRR/CRDIV) finalised in 2013. The second pillar set up a Single Resolution Mechanism (SRM), adopted the first recovery and resolution regime for banks (BRRD/SRMR) and revised the DGSD in 2014. The BRRD established an orderly resolution mechanism for all banks (including those with cross-border operations), requiring banks to build up internal loss-absorbing capacity and providing resolution authorities with comprehensive powers and tools (including a bail-in tool) to intervene when a bank meets the conditions for resolution. A legislative proposal by the Commission in 2015 for an EDIS, and which would constitute the Banking Union's third pillar, is not yet adopted.

The BRRD was published in the Official Journal on 12 June 2014 and became applicable starting 1 January 2015. The provisions related to the bail-in tool became applicable from 1 January 2016. The SRMR was published in the Official Journal on 30 July 2014 and became applicable starting 1 January 2016 with the exception of some provisions which became applicable earlier. Technical aspects and the phase-in schedule of certain core requirements were further specified via implementing and delegated acts, including rules on: preparation of recovery and resolution plans[232], determination of critical functions (contributing to the public interest assessment)[233], conduct of the resolvability

[231] European Commission (February 2015) *Competition State aid brief*- State aid to European banks: returning to viability.
[232] European Commission (March 2016), *Commission delegated regulation (EU) 2016/1075* specifying the content of recovery plans, resolution plans and group resolution plans, […], the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, […] and the operational functioning of the resolution colleges.
[233] European Commission (February 2016), *Commission delegated regulation (EU) 2016/778* with regard to the circumstances and conditions under which the payment of extraordinary *ex post* contributions may be […] deferred, and on the criteria for the determination of […] critical functions.

assessment, calibration of the MREL requirement[234], valuation rules and calculation of contributions to national resolution funds and the SRF[235].

The DGSD was published in the Official Journal on 16 April 2014 and most articles became applicable on 3 July 2015, following transposition, while other parts (depositors' access to funds to cover the cost of living) became applicable on 31 May 2016.

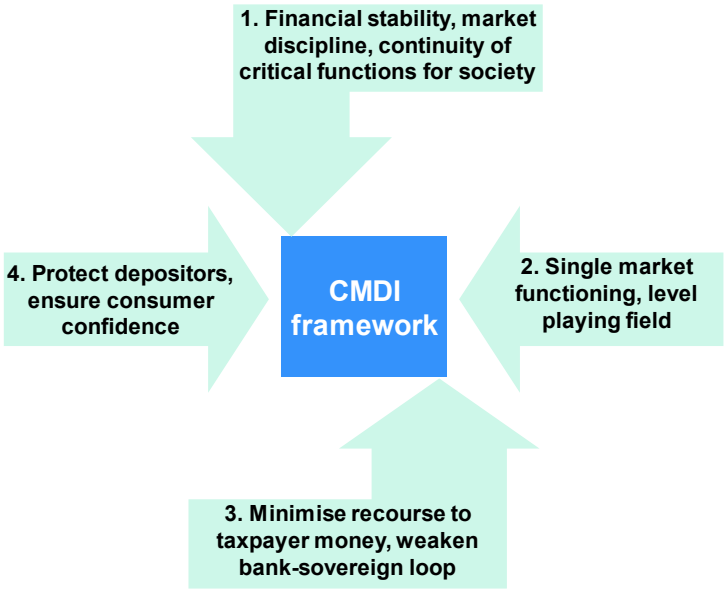
Yet for all the post-crisis progress achieved, areas for further strengthening and adjustment were identified both with regards to the prudential and resolution frameworks. As a result, the Banking package (also known as the "risk reduction package") proposed by the Commission in 2016 was adopted in 2019[236]. The Directive (EU) 2017/2399 (the so-called Bank creditor hierarchy Directive) amending the BRRD was adopted and published earlier in 2017[237]. Building on the previous prudential and resolution legislation, the 2019 Banking package included measures delivering on Europe's commitments made in international fora[238] and acted on the EU commitment to take further steps towards the completion of the Banking Union by providing credible risk reduction measures to mitigate threats to financial stability, as published in the European Commission's 2015 Communication[239]. This targeted update of the CMDI framework through the 2019 Banking package is out of scope of this evaluation due its recent entry into force. The effects of its implementation are still to be observed, in particular where transitional arrangements extend until 2024.

The general policy objectives of the CMDI framework are to: (i) limit potential risks of adverse effects for financial stability caused by the failure of banks, including by preventing contagion and ensuring market discipline and the continuity of critical functions for society[240], (ii) minimise losses for society, in particular mitigate recourse to taxpayers' money[241] and weaken the bank-sovereign nexus, (iii) enhance the functioning of the single market in banking, including by handling of cross-border crises and fostering a level playing field among banks from different Member States, particularly in

[234] European Commission (May 2016), *Commission delegated regulation (EU) 2016/1450* specifying the criteria relating to the methodology for setting the MREL.
[235] European Commission (October 2014), *Commission delegated regulation (EU) 2015/63* with regard to *ex ante* contributions to resolution financing arrangements.
[236] As part of the *Banking package* (also referred to as the "risk reduction package") published in the Official Journal of the EU (OJEU) in June 2019, Regulation (EU) 2019/876 (CRR II), Regulation (EU) 2019/877 (SRMR II) and Directive (EU) 2019/879 (BRRD II) implement a minimum TLAC requirement for EU G-SIIs applicable as of 27 June 2019 and a revision of the MREL requirement for all banks with strengthened eligibility and subordination criteria (applicable upon transposition, from 28 December 2020).
[237] European Commission (December 2017) *Directive (EU) 2017/2399 (Bank Creditor Hierarchy Directive)*, amending the BRRD as regards the ranking of unsecured debt instruments in insolvency hierarchy.
[238] International fora refer to the Basel Committee on Banking Supervision and the Financial Stability Board (FSB). EU commitments in these fora refer to incorporating elements of the prudential framework and extending the resolution framework to tackle the "too big to fail" problem by implementing the Total Loss Absorbing Capacity (TLAC) Standard into EU law.
[239] European Commission Communication (November 2015), *Towards the completion of the Banking Union*.
[240] The continuation of critical functions is a resolution objective as provided by Article 31 BRRD.
[241] Overarching objective of the resolution framework as per Article 31 BRRD.

the Banking Union[242] and (iv) protect depositors and ensure consumer confidence across the EU irrespective of the place of incorporation of the bank[243].

Figure 13: General objectives of the CMDI framework



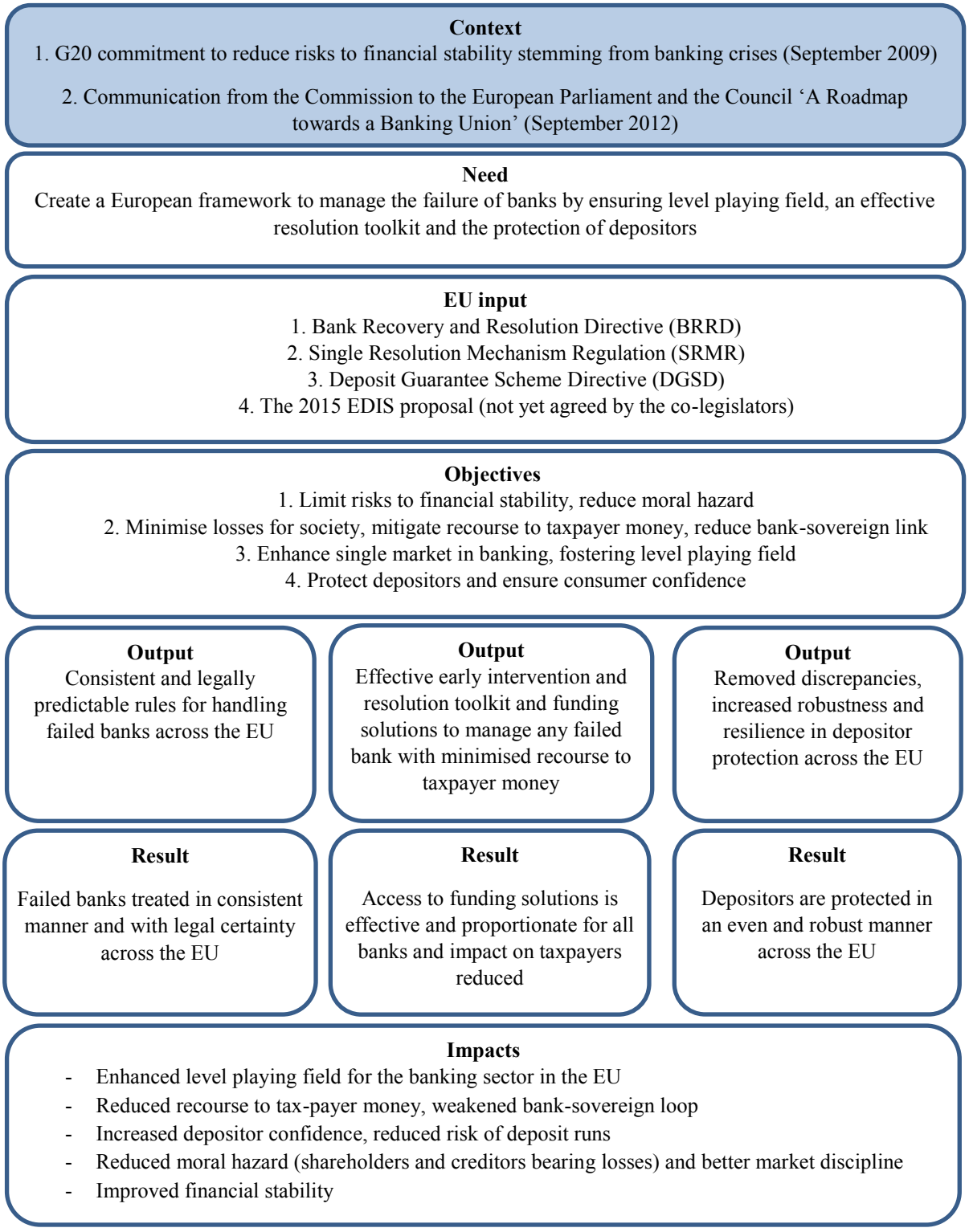
Source: Commission services.

The evaluation assesses the effectiveness of the framework with regard to these overarching general objectives of the BRRD/SRMR/DGSD as provided in the 2014 legislative texts.

The intervention logic (Figure 14) provides a description – in a summarised diagram format – on how the CMDI framework (BRRD/SRMR/DGSD and EDIS (as a third and still missing pillar in the Banking Union) was expected to work. It is also used to carry out the evaluation and answer specific questions.

[242] General objective in both BRRD/SRMR and DGSD. Level playing field and the even treatment of creditors and of banks across Member States is an overarching principle in BRRD/SRMR. In DGSD it is mentioned as an objective in Recitals 3 and 54 as well as in the 2012 impact assessment.
[243] General objective in both BRRD/SRMR and DGSD.

Figure 14: Intervention logic



Source: Commission services

Description of the situation before the adoption of the CMDI framework

The baseline scenario, assuming the CMDI framework had not been adopted, is one in which the EU would continue to rely on the limited (or non-existing) EU legislation[244] and diverging national legislations and arrangements in situations of bank crises.

In terms of preparation and prevention, supervisors would continue to rely on previous practices for detecting risks at credit institutions. In the absence of contingency plans, they would lack key information about the possible de-risking strategies of credit institutions or about their recovery or resolution possibilities (including their financing). Authorities would not have any power to ask overly complex, large or interrelated institutions to reorganise or simplify their operations, which could be a major hurdle in a possible resolution. This would entrench moral hazard risk in banks that are too big, complex or interconnected to fail.

In the case of early intervention by supervisors, the absence of the initiative would mean that supervisors in different Member States would have different powers and intervention tools for different members of the same cross-border banking group. They would be required to intervene at different times, under different conditions and implement different measures, leading to uneven playing field, ring fencing of resources and highly inconsistent outcomes, likely triggering contagion to other members of the group located in different Member States.

If no special bank resolution tools and powers were granted to authorities, the resolution of banks (i.e. allocating losses and preserving the critical functions in the bank under an administrative procedure) would be impossible to execute and bail-out would remain the only alternative. If authorities could intervene in certain countries only when banks are formally insolvent, those countries would bear much higher social cost stemming from banks' failure.

The lack of an EU framework would also represent a source of distortion in the internal market. Faced with a cross-border bank insolvency, different national authorities would continue to focus only on the respective legal entity located in their territory. Conflicting interests would likely impede a more optimal reorganisation solution for the group as a whole, taking into consideration the interest of all Member States. National solutions with divergent and inadequate resolution tools would likely be costlier for citizens and taxpayers than if the failure of banking groups was governed by comprehensive rules and arrangements and, in the case of the Banking Union a central authority (SRB). There would be no private resources (resolution funds) raised from the industry to finance resolution. This accordingly means continuing to rely on prudential capital buffers at the

[244] Before the BRRD/SRMR, there were no comprehensive arrangements, at EU level, governing the orderly resolution of failing banks at national level or for tackling cross-border banking failures. Beyond a minimum set of arrangements for the winding-up and reorganisation of credit institutions with cross border branches (*Directive 2001/24/EC on the reorganisation and winding up of credit institutions*), no EU framework existed which set out how and under which conditions authorities should act in the event of a crisis arising in a bank. Before DGSD, *Directive 94/19/EC on Deposit Guarantee Schemes* set out a minimum harmonisation of national guarantee systems in the EU Member States for the protection of depositors, which however, had to be comprehensively revised to restore and maintain depositors' confidence in the aftermath of the global financial crisis.

level of individual institutions and DGS to the extent that these are able to finance resolution measures. If losses would not be covered by those means and in view of possible DGS shortfalls, recourse to public funds may continue to be the only option for governments to safeguard financial stability and protect depositors.

From a DGSD perspective, in the baseline scenario, the objectives of protecting depositors, preventing bank runs and contributing to financial stability would not be fully met. While the coverage level was already fixed at EUR 100 000, the risk of bank runs and its economic consequences would not be avoided or reduced, because of the long payout delays[245] by national DGS and the lack of financial capacity of some schemes. Further, the potential of the internal market would be hampered by fragmentation and a lack of coordination. A varying scope of covered products and different eligibility criteria for protected depositors in the EU, combined with the lack of information on whether deposits are covered, would lead to depositors searching for the 'best DGS' when depositing their money instead of looking for the 'best product' or 'best service'. This and the lack of mutual cooperation between schemes in cross-border situations and the perspective of having to deal with a DGS in another language[246] would lead to choosing between domestic banks only.

Banks, in particular those operating cross-border, would still suffer from an unlevel playing field due to divergent *ex post* and *ex ante* contribution systems implying they would have to pay high contributions in one Member State, but none in another one so long as there is no bank failure. In the latter case, they would have to provide funding to the DGS in times of general stress on banks' liquidity. Banks would also suffer from adverse selection, if a sound and prudent bank had to pay the same contributions as a bank of the same size operating under an aggressive business model at the margin of prudential regulation and incurring higher risks.

4. EVALUATION QUESTIONS

This section summarises the review questions addressed in this evaluation.

Question 1 - How effective has the EU intervention been? What have been the effects of the EU intervention?

- To what extent have the general objectives of the CMDI framework (BRRD/SRMR/DGSD) been achieved and what factors were relevant in that regard?

Question 2: How efficient has the EU intervention been?

- To what extent have the rules regarding the recovery and orderly resolution of banks under the BRRD/SRMR and the ones regarding depositor protection under the DGSD been cost-effective? Are there significant differences in costs or benefits between Member States and what is causing them?

[245] The payout delays of DGS were set at 4 to 6 weeks from the moment a bank is declared insolvent.
[246] As it has been the case after the failure of the Icelandic banks.

Question 3: How relevant is the EU intervention?

- To what extent are the rules still relevant and how well do the original objectives of these legislative initiatives (BRRD/SRMR/DGSD) correspond to the current needs within the EU?
- To what extent do the risks to financial stability stemming from bank crises continue to require action at EU level?
- Have new challenges arisen which were not existent at the time of introduction of the CMDI framework and which need to be tackled by the framework?
- How is the absence of a common depositor guarantee scheme for depositors, in the Banking Union, such as EDIS affect the relevance of the framework?

Question 4: How coherent is the EU intervention?

- To what extent are rules on the recovery and resolution of banks and depositor protection in the BRRD/SRMR/DGSD coherent as a framework, is the framework coherent with provisions in other pieces of relevant legislation or communications, in particular State aid rules, national insolvency regimes, the CRD, AML/e-money, payment services and E-money Directives?

Question 5: What is the EU-added value of the intervention?

- Compared to the previous national approaches, to what extent have the provisions of CMDI framework (BRRD/SRMR/DGSD) helped improve the functioning of the single market in banking, contributed to financial stability and increasing the level playing field among banks, and consumer confidence taking into account the inherent cross-border nature of banking in the EU?
- How does the gap of the third missing pillar of the Banking Union (common depositor protection) affect the EU-added value of the framework?

5. METHOD

This evaluation draws on a broad range of information sources such as results of consultations with stakeholders (e.g. two public consultations, high-level conference, bilateral meetings), exchanges with Member States (e.g. expert group meetings, ad-hoc working party meetings, bilateral meetings), pilot studies of the EP, exchanges with relevant authorities (ECB, SRB and EBA), reports from the EBA (e.g. opinions, a call for advice, reports, discussion papers), reports from the JRC and additional desk research of the Commission services. A detailed list of all specific sources can be found in Annex 1 of the impact assessment.

Limitations

First, the current evaluation of the effectiveness and efficiency of the CMDI framework is conducted while certain aspects of the framework are still in a transitional period. For instance, banks are still building their resolution buffers (MREL compliance with BRRD II requirements is expected by 2024 for most banks) and the resolution funds/SRF/DGS

will have reached their target level by 2024[247]. Banks are also making progress in improving their resolvability. Resolution authorities continuously improve resolution planning and monitoring resolvability, updating internal policies, in particular on the rules regarding the MREL, setting requirements for resolution entities and subsidiaries in banking groups, enhancing their preparedness for the application of resolution action, collecting contributions to the resolution funds/SRF and relevant data to conduct their work. In addition, some of the crisis cases that occurred since the entry into force of the framework were legacy situations, with their own particularities. However, these aspects are taken into account, when forming conclusions on the evaluation of the framework.

Second, it is not always possible to attribute observed outcomes to the CMDI reforms. The evaluation has sought to establish a causal link between the reforms and observed outcomes. However, some CMDI reforms were only recently implemented, other reforms have been implemented in parallel, and the evolution of monetary policy may have affected the evolution of key considerations regarding for instance the preservation of financial stability and depositor confidence.

Third, certain aspects of this evaluation pertaining to the funding issues of the framework were analysed based on data as of Q4 2019 (banks' liability structure). A dynamic analysis showing the implementation progress over several reporting periods was not feasible, due to lack of data and a lack of comparability owing to the significant evolution in MREL methodology and sample coverage, over the past years[248]. The database also did not capture the impact of the COVID-19 pandemic on the banking sector. This was because existing data collection schedules set by resolution authorities and the EBA did not allow for more recent data. However, certain additional information pertaining to the MREL targets, issuances and shortfalls available as of Q3 2022 and more generally, certain qualitative considerations regarding the impact of the COVID-19 crisis have been integrated in the analysis in order to partially mitigate this caveat. Similarly, new supervisory reporting requirements for banks came into force with the adoption of the relevant secondary legislation in 2021, and public disclosure of MREL will be required from 2024 onwards[249]. Nevertheless, the evaluation draws from the data collected by European public authorities and bodies (i.e. SRB, EBA) on the basis of rules, which were in place when the analysis was conducted, as well as the responses to the public consultations. For a comprehensive view, please refer to Annexes 7 and 13 of the impact assessment.

Fourth, the database which informed the quantitative analyses for this evaluation and impact assessment reflects a limited sample of EU banks, while remaining nevertheless a representative subset (see Annex 7 for details). Additionally, some evidence provided in this evaluation is drawn from SRB sources of data only, meaning that it is only limited to

[247] In 2023 as regards the SRF.

[248] Implementation policies created by resolution authorities evolved between 2017 – 2019 to reflect developments in delegated regulations, new legal interpretations, increase in coverage (number of institutions) of applicability of the rules by resolution authorities as part of their phase-in of the rules and the coming into force of the 2019 Banking package.

[249] Public disclosure is only required from 2024 onwards (or from the date of the transitional period set for each entity, if the period ends after 2024), see Article 3(1), 3rd subparagraph, BRRD II.

banks under its remit and it does not cover less significant institutions in the Banking Union and other non-Banking Union banks.

6. IMPLEMENTATION STATE OF PLAY (RESULTS)

Overview of requirements in place[250]

The CMDI framework is in force since 1 January 2015 for the BRRD (except the bail-in provisions which came into effect one year later), 1 January 2016 for the SRMR and 3 July 2015 for the DGSD with the exception of certain provisions, which became applicable on 31 May 2016.

The framework provides for a set of instruments that can be used before a bank is considered failing or likely to fail (FOLF). These allow a timely intervention to address a financial deterioration (early intervention measures) or to prevent a bank's failure (preventive measures under the DGSD or precautionary measures under the BRRD). In particular, the CMDI framework includes measures that could be used in exceptional circumstances of serious disturbance to the economy. In these circumstances, it allows external financial support for precautionary purposes (precautionary measures) to be granted.

When a bank is considered FOLF and there is a public interest in resolving it,[251] the resolution authorities will intervene in the bank, absent of a private solution, by using the specific powers granted by the BRRD[252]. In the Banking Union, the resolution of significant institutions (or cross-border less significant institutions) with a positive public interest assessment is carried out by the SRB. In the absence of a public interest for resolution, the bank failure should be handled through winding-up under normal insolvency proceedings available at national level.

The CMDI framework provides for a wide array of tools and powers in the hands of resolution authorities as well as rules on the funding of resolution actions. These include powers to sell the bank or parts of it, to transfer critical functions to a bridge institution and to transfer non-performing assets to an asset management vehicle. Moreover, it includes the power to bail-in creditors by reducing their claims or converting them into equity capital, to absorb the losses of the bank and recapitalise it to the extent required.

When it comes to funding, in order to reduce moral hazard, the overarching principle is that the bank should first cover losses with private resources (through the reduction of shareholders' equity and the bail-in of creditors' claims) and that external financial support can be provided only after certain requirements are met (access requirements to resolution funds and DGS). In line with their resolution strategy and preferred tools (e.g. open bank bail-in, sale of business, bridge banks, asset separation), banks are required by resolution authorities to hold MREL instruments in an amount determined in order to

[250] See also Annex 4 of the impact assessment.

[251] Resolution is considered in the public interest when resolution is necessary for and proportionate to one or more of the resolution objectives (Article 31 BRRD) and normal insolvency proceedings would not meet those objectives to the same extent.

[252] In the following, reference to the BRRD should be understood as including also corresponding provisions in the SRMR.

facilitate the execution of the selected strategy. The primary sources of external financing of resolution actions (should the bank's own resources be insufficient) are provided by a resolution fund and the DGS, funded by the banking industry, rather than taxpayers' money. Other (public) sources of external funding are possible under certain conditions. In the context of the Banking Union, for banks under the SRB remit, funding was further integrated by providing for a Single Resolution Fund (SRF) composed of contributions from credit institutions and certain investment firms in the participating Member States of the Banking Union. However, a common deposit guarantee scheme in the Banking Union is still missing.

Deposits are protected up to EUR 100 000 regardless of whether the bank is put into resolution or insolvency. In insolvency, the primary function of a DGS is to pay out depositors within seven days of a determination of unavailability of their deposits. In line with the law, DGSs may also have functions other than the payout of depositors. As payout may not always be suitable in a crisis scenario due to the risk of disrupting overall depositor confidence[253], some Member States allow the DGS' funds to be used to prevent the failure of a bank (preventive measures) or finance a transfer of assets and liabilities to a buyer in insolvency to preserve the access to covered depositors (alternative measures). The DGSD provides a limit as regards the amount of funds allowed to be used for such preventive and alternative measures. Moreover, DGSs can contribute financially to a bank's resolution, under certain circumstances.

State of play of transposition of the Directives (BRRD/DGSD)

Both Directives have been transposed in all Member States.

The transposition deadline for the BRRD was 31 December 2014. Only two Member States notified complete transposition of the BRRD within that deadline. To date, all Member States have notified complete transposition and the respective infringement cases for non-communication were closed. The deadline for DGSD transposition expired on 3 July 2015 and all Member States notified a complete transposition[254]. The Commission has verified that the BRRD and the DGSD are fully transposed in all Member States. The Commission is currently concluding its verification of the correctness of national transposition measures, with only a limited number of outstanding issues concerning a small group of Member States needing to be finalised.

State of play of implementation of the resolution framework by resolution authorities

The implementation of BRRD/SRMR is ongoing in the EU. Since its introduction, a number of resolution colleges were set up with the objective to jointly agree resolution plans, conduct resolvability assessments and set MREL requirements among home and host authorities in charge of resolving banking groups in the EU[255]. In the Banking

[253] The main challenges are related to (i) the short-term interruption of depositors' access to their deposits for payouts, (ii) the cost to the DGS and to the economy, and (iii) the inherent risk of destruction of value in insolvency.
[254] The transposition deadline of Article 13 DGSD was – under specific circumstances laid out by Article 20(1) DGSD – delayed to 31 May 2016.
[255] EBA (17 August 2021), *Resolution colleges – Annual report 2020.*

Union, the SRB is carrying out the process of preparing resolution plans and, when the need arises, executing resolution actions for banks under its remit.

In terms of coverage, resolution planning, resolution strategies and MREL targets have been set by resolution authorities for the majority of banks under their remit. This has allowed banks to make progress on removing impediments to resolvability and build-up MREL buffers. While good progress has been achieved to date by authorities in setting external MREL requirements and by resolution entities in issuing eligible instruments on the market, the setting of internal MREL requirements for subsidiaries in groups following a single point of entry (SPE) resolution strategy and the pre-positioning of this capacity within groups is still ongoing, following a phased approach.

Since its inception in 2015, the SRB prepared resolution plans for most banks under its remit (104 resolution plans for EU banks)[256].

Table 1: Overview of resolution planning for the Banking Union

MS	Number of SRB banks on 1 January 2021	Number of SRB banks on 31 December 2021	Resolution plans expected to be adopted in the 2021 resolution planning cycle(*)	MREL decisions expected during the 2021 resolution planning cycle
BE	8	7	6	12
BG	1	1	0	4
DE	21	21	21	37
EE	3	3	1	1
IE	6	6	6	15
EL	4	4	4	4
ES	13	11	11	15
FR	12	13	11	22
HR	0	0	0	7
IT	12	12	12	41
CY	3	3	3	5
LV	3	3	1	1
LT	3	3	1	1
LU	5	5	4	12
MT	3	3	2	2
NL	6	7	5	12
AT	8	8	8	23
PT	4	4	3	9
SI	2	3	3	6
SK	0	0	0	5
FI	3	3	2	3
Total	**120**	**120**	**104**	**237**

(*) Resolution Planning Cycle 2021 runs from April 2021 to March 2022 Source: SRB 2021 annual report.

In addition, over the past years, the SRB developed policy guidance to ensure convergence in the implementation of the framework[257]. The SRB published operational guidance on bail-in implementation[258], critical functions[259], the public interest assessment[260] as well as on Brexit and mergers and acquisitions expectations. In its

[256] SRB (2022), *SRB Annual report 2021.*
[257] *SRB policy documents*.
[258] SRB (2020), *Operational guidance on bail-in implementation*.
[259] SRB (2017), *Critical functions: SRB approach*.
[260] SRB (2019), *Public interest assessment (PIA): SRB approach,* and 2021 and 2022 updates on *system wide events in the PIA* and on *deposit guarantee scheme considerations*.

expectations for banks[261] policy document, the SRB outlines best practice on key aspects of resolvability and sets out a roadmap with general phase-in dates for compliance with the various dimensions. Over the next four years, banks are expected to develop full capabilities in a number of areas, including governance, MREL capacity, development of bail-in playbooks, liquidity and funding in resolution, operational continuity and access to financial market infrastructures[262], updating management information systems for bail-in execution and valuation as well as communication plans, separability and restructuring, as appropriate.

With respect to the MREL, the SRB's approach has evolved from being based on informative targets in 2016, to the gradual inclusion since 2017 of binding requirements for the largest and most complex banks and the set-up of internal MREL requirements for subsidiaries, as well as bank-specific adjustments addressing both the quality and quantity of the MREL. In particular, the impact of the introduction of the 2019 risk reduction Banking Package has been factored into the SRB resolution planning cycles: already in 2019 with statutory requirements for global systemically important institutions (G-SIIs), and through the subsequent reviews to the MREL policy in 2020, 2021[263] and 2022[264], taking into account developments in level two legislation and other legal interpretations.

In addition to implementation measures taken by the SRB, resolution authorities outside the Banking Union have also published policy documents guiding the operational implementation of the framework.

For the EU as a whole and following the publication of the 2019 Banking package, the Commission services held two transposition seminars (February and July 2020) and published two notices providing answers to transposition questions, which clarify certain legal provisions and are aimed at facilitating implementation.[265] More generally, the EBA's Single Rulebook Questions and Answers tool provides replies to a large number of questions submitted by authorities and industry stakeholders on the interpretation and application of BRRD and DGSD provisions and of related delegated and implementing acts. In complement to level one provisions, seventeen implementing and delegated acts related to the BRRD have been published between 2016 and 2019, providing additional rules on implementation.[266] Finally, a legislative proposal specifying the method for indirect issuances of loss absorbing capacity in groups with more than one layer of ownership (so-called "daisy chains") has been adopted on 27 October 2022[267].

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[261] SRB (April 2020), *Expectations for banks*.
[262] SRB (2020), *Operational guidance on operational continuity in resolution* and *Operational guidance for FMI contingency plans*.
[263] SRB (May 2021), *2021 MREL policy*
[264] SRB (June 2022), *2022 MREL policy*
[265] European Commission (September and November 2020), *(2020/C 321/01) Commission notice relating to the interpretation of certain legal provisions of the revised bank resolution framework in reply to questions raised by Member States' authorities* and (*2020/C 417/02) - second Commission Notice*.
[266] European Commission (2016 - 2019), *Implementing and Delegated Acts on Directive 2014/59/EU*
[267] European Commission (October 2022), *Regulation (EU) 2022/2036 of the European Parliament and of the Council of 19 October 2022, as regards the prudential treatment of global systemically important*

State of play of the implementation of the deposit insurance framework

The DGSD has been implemented in all Member States. Nevertheless, the four EBA reports and opinions[268], a study contracted by the Commission on national options and discretions[269] and the outcome of the transposition check substantiate the need to clarify a number of DGSD provisions in the context of this review[270].

The EBA opinions highlighted the scope for clarification of the current text in many aspects in order to ensure a consistent application of the depositor protection and depositors' equal treatment, but also to protect financial stability. The EBA recommended that the protection of the client funds safeguarded on accounts by non-bank financial institutions, such as payment and e-money institutions, or investment firms merits clarification. The lack of protection of such client funds in some Member States could be acute for both depositors and Fintech providers if bank failures occur and multiply. In particular, in light of the Brexit context, the treatment of third country branches should be clarified. EBA also identified the need to clarify the interplay between the AMLD and DGSD in a payout situation. In terms of robustness of DGS funding (e.g. alternative funding arrangements and investment strategy), it was highlighted that many national transpositions do not cater for concrete measures, available to obtain funds if DGSs are depleted, at the expense of sufficient crisis preparedness. DGS funds are often invested in sovereign bonds and, in two instances, even integrated in the budget, which may have unpredictable consequences in the current COVID-19 induced circumstances[271].

Further, the DGSD contains more than 22 ONDs. In general, those ONDs allow the EU legislator to demonstrate respect for national legal traditions and regulatory practices as well as to reduce implementation costs, especially in Member States with existing national frameworks. However, ONDs also have the potential to distort the level playing field and lead to fragmentation in the single market. In addition, they can create higher complexity, including higher compliance costs, and reduce transparency.

Most notably, the Commission's conformity assessment of national transpositions revealed different approaches with respect to a number of issues and confirmed the need

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institutions with a multiple point of entry resolution strategy and methods for the indirect subscription of instruments eligible for meeting the minimum requirement for own funds and eligible liabilities.

[268] See also section 1 of the evaluation and Annex 1.

[269] CEPS study prepared for the Commission on national options and discretions under the DGSD and their treatment under EDIS (November 2019), *CEPS study*.

[270] See also Annex 6 of the impact assessment for more details on the DGSD review.

[271] In its opinion of *23 January 2020*, on the funding and use of DGSs funds, EBA highlighted that in a number of cases funds are invested exclusively or almost exclusively in national debt, despite the requirement to ensure sufficient diversification, the EBA discussed the rationale for requiring that DGS funds should be invested in a sufficiently diversified manner. In this regard, it should be considered that the funds are available when needed in a crisis, irrespective of the situation in the market for a particular type of instrument; in particular, where funds are invested in national debt, to break the nexus between banking and sovereign crises (p. 106).

to clarify certain provisions within the context of the DGSD review. While several of them could negatively impact either the deposit protection or the equal treatment of depositors, there are also issues which do not seem to give rise to substantial problems (e.g. as there are no third country branches in the respective Member States). The majority of instances identified were divergent approaches i.e. to the determination of unavailable deposits under Article 2(1)(8) and 3(2) DGSD, the transfer of contributions, the protection of temporary high balances, alternative and preventive measures, client funds safeguarded by payment institutions on bank accounts, to the protection of public authorities[272] or to the share of payment commitments of the total available financial means under Article 10(3).

State of play of the common deposit guarantee scheme (EDIS) in the Banking Union

The Banking Union from its inception in 2012 was conceived to have three pillars, with the third being a common system for deposit guarantees[273]. The Commission adopted a legislative proposal to this end on 24 November 2015 on EDIS[274], followed by the publication of an effects analysis in 2016[275]. This proposal was contentious from the start and political discussions have been stalled for some time, though technical work remained ongoing. Discussions on the interaction between risk reduction and risk sharing had an impact on the EDIS negotiations, both within the Council and the European Parliament, despite continued acknowledgment of the importance of EDIS as part of a fully-fledged Banking Union, such as in the Five President's Report of 2015[276]. This is also reflected in the 2016 Banking Union roadmap[277] by the Council, which signalled that negotiations at political level on EDIS would start as soon as sufficient further progress has been made on the measures on risk reduction.

A comprehensive package of risk reduction measures was put forward by the Commission and negotiated by the co-legislators since then. A Communication that set out an ambitious yet realistic path to ensure agreement on all the outstanding elements of the Banking Union, based on existing commitments by the Council, was put forward by the Commission in 2017[278]. Therein, suggestions were also outlined with regard to the EDIS proposal in order to facilitate progress in the European Parliament and the Council on the file.

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[272] In some Member States, public authorities do not fall under the scope of the DGSD. For example, the recent Greensill Bank AG case in Germany showed that *public authorities* were not protected by the mandatory DGS. According to the *German press*, some public authorities (with around EUR 340 m) had deposits with Greensill bank. However, it remained unclear if the voluntary top-up scheme reimbursed them.

[273] *Communication* from the Commission to the European Parliament and the Council, A Roadmap towards a Banking Union, 12 September 2012, COM(2012)0510 final, and the *report* by the Presidents of the European Council, the Commission, the Eurogroup and the European Central Bank of 26 June 2012.

[274] Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 806/2014 in order to establish a European Deposit Insurance Scheme, 24 November 2015, COM(2015) 586 final. For a more detailed description of the 2015 proposal, please see Annex 10 of the impact assessment.

[275] *Effects analysis* on the European Deposit Insurance Scheme, 11 October 2016.

[276] *The Five President's Report:* Completing Europe's Economic and Monetary Union, 22 June 2015.

[277] *Council Conclusions on a Roadmap to complete the Banking Union*, 17 June 2016**Error! Bookmark not defined.**.

[278] *Communication* to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions on completing the Banking Union, 11.10.2017, COM(2017) 592 final.

In June 2018, the Euro Summit asked that work would start on a roadmap for beginning political negotiations on EDIS[279] and in December 2020, on a stepwise and time-bound work plan on all outstanding elements needed to complete the Banking Union[280]. This work, which took place in the intergovernmental format within the HLWG on EDIS, was broadened to encompass four files: (i) EDIS, (ii) the review of the CMDI framework, (iii) cross-border integration and (iv) the regulatory treatment of sovereign exposures. Despite intensive discussions among Member States and a major political effort by the Eurogroup president, an agreement for completing the Banking Union in a comprehensive manner did not materialise in the June 2022 Eurogroup[281].

The technical discussions that took place on EDIS over the last years gave rise to various other models than the model proposed by the Commission in 2015[282]. The so-called hybrid model[283] emerged as a possible compromise[284] between those Member States supporting the original proposal and those underlining the pre-condition of risk reduction before agreeing to share risks across the EU banking sector. As outlined in the impact assessment, EDIS and the review of the CMDI framework are closely interlinked. The set-up of EDIS would also unlock further market integration, in particular cross-border consolidation.

7. ANSWERS TO THE EVALUATION QUESTIONS

This section presents the assessment of the CMDI framework based on the five evaluation criteria (effectiveness, efficiency, relevance, coherence and EU value added) and related evaluation questions set out in section 4. This is complemented by an assessment of the main issues coming from past experiences with the framework or raised by stakeholders during the various consultation activities, as summarised in Annex 2 of the impact assessment.

7.1. Effectiveness

How effective has the EU intervention been? To what extent have the general objectives of the CMDI framework (BRRD/SRMR/DGSD) been achieved and what factors influenced the achievements observed?

As depicted in section 3, the general objectives of the CMDI framework are to:

1. limit potential risks of adverse effects for financial stability caused by the failure of banks, including by preventing contagion, moral hazard, ensure market discipline and the continuity of critical functions for the society;
2. minimise losses for the society, in particular mitigate recourse to taxpayers' money and weaken the bank-sovereign nexus;

[279] *Statement* of the Euro Summit, 29 June 2018.
[280] *Statement* of the Euro Summit, 11 December 2020.
[281] Eurogroup (16 June 2022), *Eurogroup statement on the future of the Banking Union*.
[282] For a more detailed description of the other models, please see Annex 10 of the impact assessment.
[283] For a more detailed description of the hybrid model, please see Annex 10 of the impact assessment.
[284] *Letter* by the High-Level Working Group on EDIS Chair to the President of the Eurogroup, 'Further strengthening the Banking Union, including EDIS: A roadmap for political negotiations', 3 December 2019.

3. enhancing the functioning of the single market in banking, including by handling of cross-border crises and fostering level playing field among banks from different Member States, particularly in the Banking Union; and
4. protect depositors (covered deposits), investors (covered by investor compensation schemes) and client assets and funds, thereby ensuring consumer confidence across the EU, irrespective of the place of incorporation of the bank.

Summary assessment:

Evidence regarding the treatment of bank crisis situations since the adoption of the framework shows that two of the four objectives of the framework have been partially achieved, while the others have not been achieved in a satisfactory manner, except in a limited number of cases.

More specifically, the framework partially achieved its objectives of containing risks to financial stability and protecting depositors, but it failed to achieve other key overarching objectives, notably facilitating the functioning of the single market when handling cross-border crises, including by ensuring level playing field, and minimising recourse to taxpayer money. In a significant number of cases, the fulfilment of objectives cannot be directly attributed to the framework, but to the application of tools at national level, outside of resolution and with recourse to public budgets (taxpayers' funds). The management of bank failures differed across Member States, depending on the existing national regime, which raises questions about the coherence of the framework, resulting in sub-optimal outcomes for level playing field and the single market in banking.

The assessment of the framework's effectiveness has been done objective by objective.

7.1.1. Objective (1): did the framework achieve the objective of limiting risks to financial stability, including by preventing contagion, moral hazard, ensuring market discipline and the continuity of critical functions for the society?

Risks to financial stability, contagion and spillover effects from the banking sector to the real economy were significantly reduced after the global financial crisis and the society's access to critical banking functions[285] was preserved. Certain elements of the framework and their application such as pre-resolution preparedness had a positive impact on financial stability, the containment of contagion, reduction of moral hazard and ensuring market discipline. Similarly, the resolution framework introduced strategies, powers and tools to restructure failing banks while protecting depositors, financial stability and tax payers. However, so far resolution has only scarcely been applied, in particular in the Banking Union under the SRMR. A lack of application of those critical elements of the

[285] Examples of critical functions include the continued access to deposits and client funds, to payment and settlement systems, lending or other banking services which cannot be easily and timely substituted in case of a bank failure.

framework in the majority of assessed cases of banks in distress[286] was observed. In those cases, the preservation of financial stability was possible, to a great extent, through the application of other tools and funding resources at national level, which were available to manage failing banks or to intervene before failure. The conditions to activate such tools vary substantially across countries, are sometimes not fully framed in the EU legislation or leave room for arbitrage[287]. In addition, when funding (mostly from public budgets) was used to support such measures, the requirements to access such funding were very different (and more specifically, funding outside resolution is generally more easily accessible than in resolution, in particular for certain banks, as explained in more details in section 7.1.2.3). All in all, despite the good progress made in resolution preparedness and contingency planning, the lack of application of the resolution tools (in many cases), led to a lack of certainty and predictability in the handling of a distressed bank (break in the continuum of outcomes from going to gone concern) while the central principle that taxpayers' money should not be used in the handling of a bank failure, was not fully respected.

In conclusion, the partial achievement of this objective can only be partially credited to the CMDI framework, which was applied in a restricted manner, especially in the Banking Union.

Main factors influencing the objective's achievement

Factors influencing performance against objective	**Overall impact on objective**
1) *Level of crisis preparedness and resolvability of banks*	**Positive** (*ex ante* contingency planning in form of recovery and resolution plans, resolution strategies, enhanced coordination, increased banks' resolvability with some aspects still work in progress (MREL compliance, management information systems (MIS), liquidity in resolution)
2) *Reduction of "too big to fail" and moral hazard problems*	**Mainly positive** (reduction of funding cost advantage for G-SIIs, increase in bail-inable own resources, more adequate pricing of risk by investors, however most cases of distressed banks dealt outside resolution, senior unsecured creditors did not bear losses)
3) *Effectiveness of the early intervention framework*	**Negative** (scarcely applied)
4) *Availability of resolution processes, powers and tools to intervene in failing banks*	**Mainly positive** (enhanced market discipline, however lack of application)

[286] Since 2015, more than 60% of banks in distress in the EU were managed outside of the resolution framework. (See Annex 9 of the impact assessment: *"Table of Bank cases since 2015"*).
[287] See also sections 7.1.2.3 and 7.1.3 of the Evaluation for further details on the relevant issue.

7.1.1.1. Level of crisis preparedness and resolvability of banks

The BRRD/SRMR requires institutions and authorities to develop *ex ante* contingency planning (recovery and resolution plans) and update these plans on a yearly basis. It requires banks to prepare recovery plans to overcome financial distress and it grants resolution authorities powers to collect information and prepare resolution plans laying out the resolution strategy and tools aimed at an orderly resolution of the failed bank with minimal costs for taxpayers. The framework requires authorities to conduct regular resolvability assessments to identify and remove any impediments to resolvability.

As also described in section 6, significant progress was achieved by resolution authorities in drawing up resolution plans, assessing banks' resolvability and setting MREL requirements and by banks in drawing up recovery plans and, generally, becoming more resolvable than they were before the introduction of the framework. While implementation in certain areas is still ongoing (e.g. setting internal MREL for subsidiaries, overall MREL compliance and enhancement in other areas of resolvability), the enhanced level of preparedness of the financial system contributed to achieving financial stability.

7.1.1.2. Reduction of 'too big to fail' and moral hazard problems

Prior to the CMDI reforms, the failure of a vast majority of financial institutions (including in particular the ones deemed too big to fail) was addressed through government bail-outs to prevent contagion and financial instability or to mitigate significant negative consequences for the real economy. The option of placing financial institutions in insolvency was deemed likely to lead to great destruction of value, costly litigation and contagion, threatening financial stability. The expectation that a bank may be bailed-out represented an implicit government subsidy, with implications on the behaviour of banks and markets[288]. With the granting of public support, such implicit subsidies turned into explicit subsidies, discouraging the banks from bearing the consequences of their decisions. Such resulting moral hazard caused economic distortions by providing funding cost advantages, conducive to insufficient market discipline and excessive risk-taking to the detriment of competition. The latter also weakened the overall resilience of the financial system and the provision of financing to the real economy.

The Financial Stability Board (FSB) assessed in 2020–2021 the impact of resolution reforms in member jurisdictions on reducing the too big to fail problem.[289] In the absence of concrete cases of G-SIIs failing, the FSB report looked at how the reforms, including the CMDI framework in the EU, addressed the observed shortcomings, i.e. reduced the implicit funding subsidies enjoyed by large banks, increased the creditors' risk sensitivity, the de-risking of balance sheets and corporate/legal changes as a result of resolvability improvements. The FSB's report concluded that, while the indicators of

[288] E.g. creditors may be more willing to fund banks that are too big to fail at lower rates than other banks and may be insensitive to the credit risk of the borrower.

[289] Financial Stability Board (April 2021), *Report on the Evaluation of the Effects of the Too Big to Fail Reforms*

systemic risk and moral hazard have moved in the right direction with potential net benefits to the society, there are still gaps to be addressed. These include: obstacles to resolvability (e.g. resolution funding mechanisms, build-up of buffers, valuation capabilities, cross-border coordination), continued state support for some distressed banks (EU examples[290]), room to improve on data disclosure and transparency to markets and potential risks arising from a shift of credit intermediation to non-bank financial intermediaries.

Judging from the practical application of the CMDI framework, the moral hazard problem is not satisfactorily reduced, as senior unsecured creditors continued in some cases to avoid bearing losses, with direct consequence for public finances.

7.1.1.3. Effectiveness of the early intervention framework

The BRRD provides supervisory authorities with the powers to apply EIMs, which are intended to prevent further deterioration of the financial conditions of an institution and to reduce, to the extent possible, the risk and impact of a possible resolution One of the operational objectives of the EIM framework was to allow the competent authority to intervene rapidly in order to address the financial deterioration of banks in case of breaches/likely breaches of prudential requirements. These powers are activated when specific triggers[291] are met, to allow competent authorities to take measures such as requiring the institution's management to draw up an action programme or to change the institution's business strategy or its legal and operational structure. Competent authorities can, in this context, also replace the institution's management[292].

As also pointed out by the Commission's 2019 report on the application of BRRD, while the policy objectives of the EIMs are to strengthen financial stability, avoid contagion and moral hazard, its application so far has been extremely limited. The EBA indicated that, in most situations where the EIM triggers were met, competent authorities decided to address the situation through the use of supervisory powers (e.g. measures based on Article 104 CRD, which are mirrored in Article 16 of the SSMR)[293]. The EBA grouped the challenges that competent authorities encountered in the application of the current regulatory framework on EIMs in three categories[294].

[290] See Annex 9 of the impact assessment: "Table of Bank cases since 2015".
[291] Article 27 BRRD provides power to competent authorities to activate early intervention measures when "an institution infringes or due, *inter alia*, to a rapidly deteriorating financial condition, including deteriorating liquidity situation, increasing level of leverage, non-performing loans or concentration of exposures, as assessed on the basis of a set of triggers, which may include the institution's own funds requirement plus 1.5 percentage points, is likely in the near future to infringe the requirements of Regulation (EU) No 575/2013, Directive 2013/36/EU, Title II of Directive 2014/65/EU or any of Articles 3 to 7, 14 to 17, and 24, 25 and 26 of Regulation (EU) No 600/2014 […]"
[292] Such a decision was taken in 2019 by the ECB with respect to Carige bank (Cassa di Risparmio di Genova e Liguria). See ECB's press release (2 January 2019), *ECB appoints temporary administrators for Banca Carige*.
[293] See EBA (27 May 2021), *Report on the application of early intervention measures in the European Union in accordance with Articles 27-29 of the BRRD*, EBA/REP/2021/12 (EBA report) pp 17-19.
[294] See EBA report, pp 23-25.

The first set of challenges in the application of EIMs, relate to the interaction between, and potential overlap[295] of, early intervention powers conferred to competent authorities on the basis of national laws implementing the BRRD and the supervisory powers which they can exercise under CRD. The overlap between these two sets of measures creates legal uncertainty and procedural challenges for competent authorities and merits further analysis. Also, with respect to the Banking Union, the provisions on early intervention powers contained in the BRRD are not replicated in a uniform and directly applicable legal basis, i.e. their application by competent authorities may hinge on potentially diverging national transposition measures.

A second set of challenges, relates to disclosure requirements and the signalling effect that the EIMs may entail. According to the EBA, there is uncertainty whether institutions are obliged to disclose to market participants the fact that EIMs have been applied to them under the EU market abuse regime. In case the adoption of the EIMs has to be disclosed, there could be a risk of signalling to markets that the bank is in a deteriorating situation, leading to adverse investor reactions and ultimately accelerating instead of mitigating an ongoing crisis.

A final challenge in the application of the EIMs relates to the specific triggers for their application. Article 27(1) BRRD includes one example of EIM quantitative trigger *'the institution's own funds requirement plus 1.5 percentage points'*. However, it is not clear from the BRRD text, which "own funds requirement" should be used for the purposes of this provision i.e. the one corresponding to the minimum capital requirement (Pillar 1) or also taking into account additional own fund requirements (Pillar 2).

7.1.1.4. Availability of resolution processes, powers and tools to intervene in failing banks

The BRRD/SRMR provides extensive processes, powers and tools for resolution authorities to handle failed banks in an orderly manner, while respecting the framework's objectives. The framework sets comprehensive coordination processes among various authorities to assure the necessary exchange of information underpinning resolution decisions concerning both preparation and execution. It ensures that shareholders and creditors effectively support losses and establishes a number of resolution tools for the authorities to deal with banks in resolution. Depending on the specific case, authorities may decide to use the sale of business tool, to create a bridge bank or an asset management vehicle, and to carry out bail-in[296]. The framework also provides for rules concerning the provision of external financial support to banks in resolution through the creation of resolution financing arrangements, funded by levies *ex ante* collected from the banks.

The set-up and availability of said resolution processes, powers and tools has an overall positive effect on financial stability, potentially reducing moral hazard and ensuring the

[295] This overlap can be verified in what concerns the powers at the disposal of competent authorities under the two different legal bases and also the conditions for the respective use.

[296] Bail-in is defined in BRRD/SRMR as "*the mechanism for effecting the exercise by a resolution authority of the write-down and conversion powers in relation to liabilities of an institution under resolution […]*" (Article 2(1)(57) BRRD and Article 3(1)(33) SRMR).

preservation of critical functions. However, existing exogenous and endogenous incentives, not to apply the resolution framework[297] cause significant drawbacks in achieving other objectives, i.e. enhancing the functioning of the single market and level playing field, reducing moral hazard and the recourse to taxpayer money (see next *Sections*), while preserving financial stability.

7.1.2. Objective (2): Did the framework achieve the objective of minimising losses for the society, in particular mitigating the recourse to taxpayer money and weakening the bank-sovereign nexus?

One of the cornerstones of the current framework is the objective of shielding public money from the effects of bank failures, while protecting depositors and preserving financial stability. In order to limit the extensive use of public funds observed during the global financial crisis, the framework created resolution tools and financing arrangements complementing the internal loss absorption of banks (e.g. RF/SRF, national DGS funds) aimed at shielding national budgets.

Nevertheless, in the Banking Union, while there were only three cases of a positive PIA[298] under the SRMR, SRF resources were not used and the accumulated resources remain idle since 2016. National RFs have been used in ten out of 13 cases of failing banks[299] with positive PIA determination, representing less than half of the total number of cases of distressed banks. On the contrary, public funds have provided support in 2 out of 9 of the cases of distressed banks with negative PIA, amounting to over EUR 17 bn, while an additional amount of almost EUR 40 bn of public funds were used for precautionary aid measures (of which around EUR 28 bn was for precautionary liquidity support). This evidence indicates that the framework failed to achieve this objective in a satisfactory manner in all cases.

[297] See for more details section 7.1.2.1 of the Evaluation.

[298] Two out of these three cases concern the resolution of entities belonging to the Sberbank Europe AG group (see Annex 9 for more details), whereby due to the very special circumstances the group was faced with (experiencing significant deposit outflows due to the reputational impact of geopolitical tensions) there was a deviation from the resolution plan (which provided for the preservation of the group structure) and different solutions (resolution/liquidation) where applied to different banking entities of the group.

[299] In seven of those cases, the intervention took place before the minimum BRRD bail-in requirement entered into force on 1 January 2016. In addition, four of those cases concerned Banking Union Member States, but they took place before the SRB becoming the responsible resolution authority.

Main factors influencing the objective's achievement

Factors influencing performance against objective	Overall impact on objective
1) Availability and usage of private financing arrangements for bank resolution	**Negative** (private financing arrangements scarcely used under the SRMR)
2) Timeliness of FOLF determination	**Negative** (timing for triggering FOLF can be improved to address the depletion of resources and destruction of value in the run up to resolution, and the related need for more external funding (possibly public))
3) Conditions to access external funding	**Negative** (divergent access requirements for the resolution fund *versus* funding outside resolution, difficulty in accessing resolution funding by certain banks, limited scope to grant DGS funding in resolution and insolvency)

7.1.2.1. Availability and usage of private financing arrangements for bank resolution

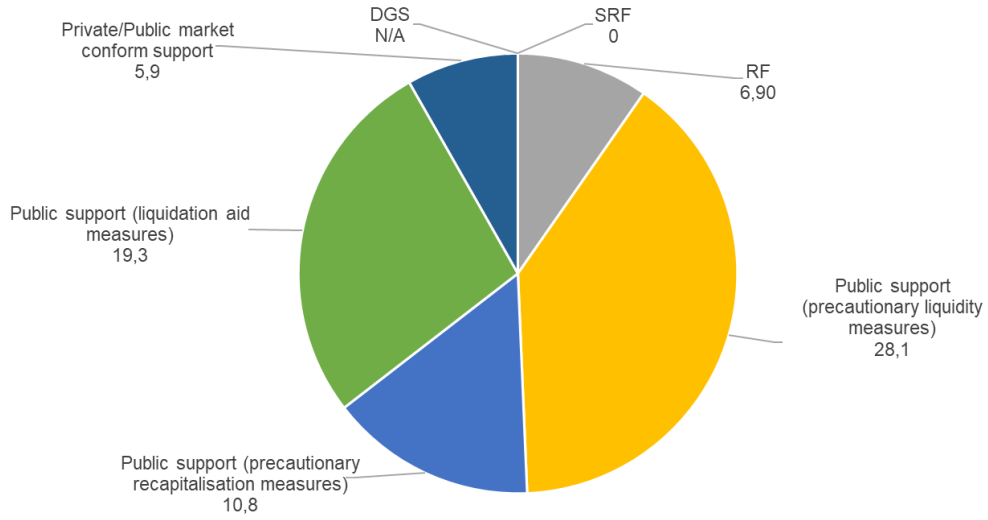
The framework provides for rules concerning the provision of external financial support to banks in resolution and requires the creation of national resolution financing arrangements (outside the Banking Union) and the SRF (in the Banking Union) – funded by the industry – which, according to the BRRD/SRMR, should be the main sources of external financial support for banks in resolution beyond the own resources of the banks. The SRF was established under the control of the SRB as an essential part of the Single Resolution Mechanism and is governed by a complementary inter-governmental agreement. The total target size of the funds/ SRF will equal at least 1% of the covered deposits of all banks in the respective Member States/ Banking Union. *Ex ante* contributions to national resolution funds/ SRF are accruing over eight years, beginning in 2016 until the end of 2023 and 2024 for the SRF and national RFs, respectively. Subject to conditions laid out in BRRD/SRMR (a minimum level of bail-in of the bank's own resources), the national RF/SRF could be accessed, and in that case *ex post* contributions may be called on to rebuild the funds (in case the *ex ante* contributions are not sufficient to cover the losses, costs or other expenses incurred).

Subject to the availability of funds in the national RF/SRF, the legislative intention was for these resources to be used to support resolution action when the private means available in the bank did not suffice to execute the resolution strategy. In the Banking Union, while there were only three cases of a positive PIA[300], SRF resources were not used and the accumulated resources remain idle since 2016. National RFs were used in non-Banking Union Member States and in some Banking Union Member States, but

[300] Two out of these three cases concerned the resolution of Sberbank group (see Annex 9 for more details).

before the 8% minimum TLOF bail-in requirement entered into force[301], in ten out of 13 cases of banks placed in resolution for a total amount of at least EUR 6.9 bn[302][303]. However, when looking at the broader picture, the contribution of the RFs dwarfs in comparison to the amount deriving from other sources of funding (mostly from public budgets) to handle distressed banks, outside of resolution, which exceeded EUR 58 bn (of which EUR 28.1 bn was provided for liquidity purposes)[304,305].

Figure 15: Sources of complementary external funding in crisis cases (in EUR bn)



Source: European Commission calculations, based on bank cases between 2015 – 2022.

The causes for this situation seem to be twofold. First, certain banks would face structural difficulties in fulfilling the conditions to access resolution funding where the bail-in requirement would entail bailing-in ordinary unsecured creditors, including non-preferred, non-covered deposits[306], which could be politically unpalatable and creating financial stability risks. Second, different resolution authorities would seemingly have different propensities to deploy the resolution funds.

[301] On 1 January 2016.
[302] Includes an amount of EUR 1.4 bn, contributed jointly by the Polish RF and DGS, in the case of resolution of Getin Noble Bank SA (see Annex 9 for more information).
[303] Information on the amounts of national resolution funds contributed in some of the bank cases are not publicly available.
[304] As also mentioned in section 5, while legacy issues may have played a role in past cases and can be expected to have a lesser impact going forward, this does not impair the validity of the considerations made in this or other Sections of the evaluation, nor it puts into question the need to reform the framework to ensure efficacy in managing potential future crises.
[305] Without counting support channeled to preventive private or preventive public measures that have been assessed as market conform.
[306] See section 7.1.2.3 and Annexes 7 and 8 of the impact assessment for further details. As explained in Annex 8, section 2, non-covered, non-preferred deposits rank together with ordinary unsecured claims in 19 Member States (no depositor preference). Moreover, as presented in Annex 7, section 3, depending on the equity depletion at the moment of failure and the liability structure, in particular the deposit prevalence of medium-sized banks, preferred and even covered deposits could be impacted when bailing-in 8% TLOF, in order to gain access to the RF/SRF.

Recent cases of distressed banks reveal, therefore, a shift from the intended use of the means of funding available in resolution towards public funds (bail-outs) facilitated by the application of tools outside the resolution framework and with funding accessible under different and often more advantageous conditions from the point of view of the bank's creditors and very discretionary PIA[307]. This means, in practice, that national budgets shouldered distressed banks, while private money raised through *ex ante* industry contributions remained unused, undermining one of the key objectives of the framework. Please refer to Section 7.2.2.2 describing the costs associated with the build-up of resolution funds by the industry.

7.1.2.2. Timeliness of FOLF determination

The timeliness of the FOLF determination is crucial with respect to the amount of private resources left in the bank to execute the resolution strategy. In the current framework, the FOLF determination is usually made by the competent authority[308]. While the competent authority needs to comply with the conditions laid down in Article 32 BRRD/18 SRMR, in the absence of a hard trigger, the framework allows a certain amount of discretion for the supervisor as to the exact timing of the FOLF determination. Therefore, the supervisor needs to balance out the severity of the deterioration in the banks' financial fundamentals against a potential recovery by private means and take a timely decision. While it is very challenging to quantify the impact of a late FOLF triggering on the amount of financing required in resolution, it can be ascertained that a relatively "early" FOLF determination may ensure that more financial resources are left in the bank to absorb losses. On the contrary, a "late" FOLF determination results in a more significant depletion before resolution of equity and potentially other instruments that could be triggered in resolution as well as a depletion of liquidity. As the situation of the bank deteriorates further short-term funding providers may refrain from rolling over their commitments and depositors may potentially run on the bank.

The governance structure and the degree of cooperation between competent and resolution authorities may play a role in the timeliness of the FOLF determination. In Member States outside the Banking Union, where competent and resolution authorities are often part of the same institution, the continuum between going concern, deterioration (FOLF declaration) and resolution may be better served than in the Banking Union, where the governance and hence, the decision-making, in a crisis scenario, are split between the central authorities (ECB and SRB), but possibly also involving national competent authorities and national resolution authorities. Those decisions are, however, interdependent and require the close coordination of the authorities and an alignment of their (sometimes) different incentives for acting early, or waiting for more time to elapse, before taking their respective actions, when faced with a bank crisis situation. On the one hand it is important to ensure that FOLF is declared only when the respective conditions

[307] Paragraphs 40-42 of the 2013 Banking Communication set out the minimum burden-sharing requirement for equity, hybrid capital holders and subordinated debt holders in those cases. See also Box 9 in section 7.1.2.3 regarding the *"Divergences in conditions to access funding for resolution fund and for funding outside resolution under the State aid framework"*.

[308] In addition to the competent authority, the resolution authority may make the FOLF determination, subject to specific conditions set out in Article 32(2) BRRD.

are fulfilled to ensure that the FOLF determination is legally sound. On the other hand, the practice so far showed a risk of overly cautious approach to FOLF declarations in the Banking Union, which may negatively impact the room for manoeuvre in resolution for the resolution authority. The BRRD takes this into account to a certain degree, by providing Member States with the option to enable also the resolution authority to make a FOLF determination, which the SRMR also foresees for the SRB, subject to certain conditions. This procedure, however, encounters other limitations, mainly related to the fact that the elements necessary for a FOLF determination are generally known by the supervisor, which continuously monitors the bank's situation.

7.1.2.3. Conditions to access external funding

The availability of sufficient sources of funding in resolution and the provision of proportionate conditions to access them are central to ensuring that the resolution framework is adequate to cater for potentially any bank's failure. The CMDI framework provides for two sources of funding resolution measures: the national RF/SRF in the Banking Union and the DGS funds, provided that conditions to access these sources are met.

Outside resolution, past experiences with preventive measures (precautionary measures and DGSD preventive measures have shown the use of either public funds under State aid rules (including in the form of market-conform public measures, the conformity of which with market conditions are also assessed under these rules but do not qualify as State aid[309]) or private means to avert the further deterioration of a bank in distress. Also, under certain insolvency proceedings in some Member States, which allow for transfer tools (i.e. the sale of a part of the business/ deposits to an acquirer), State aid funding can be used, provided it complies with the required burden sharing conditions.

The following sub-sections develop: (a) the ineffective funding options for some banks, (b) the divergent conditions for accessing funding from the resolution fund and other sources of funding outside resolution, and (c) the use of DGS funds, which together have contributed to the use of public money (bail-outs) in crisis management.

a) structural difficulties for some banks in fulfilling the minimum conditions for accessing the RF/SRF under the resolution rules, which may incentivise authorities to find other solutions when such banks enter into distress;
b) divergent access requirements for the resolution fund and for funding outside resolution;
c) limited scope to grant DGS funding in resolution and insolvency, with the risk of weakening the available funding sources for handling a bank failure.

[309] Refers to measures carried out by a public body, in line with normal market conditions, therefore are not considered to constitute State aid.

a) Challenges for some banks to access the RF/SRF

Impact of resolution strategies

The CMDI framework makes the access to the RF/SRF conditional on bailing-in shareholders and creditors for no less than 8% of total liabilities including own funds (TLOF) and limits the contribution of the fund to 5% TLOF[310]. The minimum 8% TLOF bail-in requirement and subsequent 5% cap on the use of the RF/SRF do not apply in terms of the use of the RF/SRF for the provision of liquidity in resolution.[311]

As part of resolution planning, resolution authorities are defining the preferred and variant resolution strategies and preparing the application of the relevant tools to ensure their execution[312]. For large and complex institutions, open-bank bail-in is, in general, expected to be the preferred resolution tool, implying the write-down and conversion of own funds and eligible liabilities to absorb losses and recapitalise the bank emerging from resolution. The successful execution of this strategy comes hand in hand with the minimum requirement to hold sufficient own funds and eligible liabilities (MREL), therefore, the calibration of MREL and the build-up of MREL buffers by banks contribute to ensuring that they can fulfil the condition for accessing resolution funding. In view of this principle, the changes to the calibration of the overall MREL requirement and MREL subordination under the 2019 revision of the rules (BRRD II/SRMR II) sought to increase the certainty of meeting the minimum 8% TLOF requirement, especially for large institutions.

In parallel, certain smaller and medium-sized institutions with business models based predominantly on funding through equity and deposits may be candidates for transfer tool strategies. Transfer strategies involve selling parts or all of the business to a purchaser, transferring critical functions and related assets and liabilities to a bridge institution and transferring non-performing assets to an asset management vehicle. A mix of tools can also be part of the optimal strategy, depending on a case-by-case assessment by resolution authorities. The potential benefits of transfer tools depend on the characteristics of the banks and their financial situation and on how the specific transfer transaction is structured. Challenges to transfer strategies may be due, among other factors, to "overcapacity" in the EU banking sector, which, on average, struggles to remunerate capital, further diminishing returns on mergers and acquisitions. Therefore, the "franchise value" of some ailing banks may be small and potential buyers would often be willing to enter into a deal only at negative prices. Hence, depending on the valuation of assets and the perimeter of a transfer, there may still be a need to access the

[310] Article 44(5) BRRD requires a minimum bail-in of 8% TLOF and provides for a maximum RF contribution of 5% TLOF (unless all unsecured, non-preferred liabilities, other than eligible deposits, have been written down or converted in full) when a resolution authority decides to exclude or partially exclude an eligible liability or class of eligible liabilities, and the losses that would have been borne by those liabilities have not been passed on fully to other creditors, or when the use of the RF indirectly results in part of the losses being passed on to the RF (Article 101(2) BRRD).

[311] According to the informal interpretation of the Commission's services of the provisions in Article 101 BRRD, which are replicated in Article 76 in the SRMR and that set out the purposes for the use of the RF/SRF.

[312] In light with recital, 20 of the *Commission delegated regulation (EU) 2016/1075*, resolution authorities should also assess whether liquidation under normal insolvency proceedings can credibly and feasibly achieve the resolution objectives.

RF/SRF[313] by complying with the access conditions, in order to complete the transfer transaction. The level of the MREL requirement reflects the preferred resolution strategy, meaning that banks under a transfer strategy may be allowed lower MREL targets, taking into consideration that the main purpose of these strategies is to facilitate the exit of these banks (in whole or in part) from the market and that MREL will be mainly used, in such cases for loss absorption and only to, a limited degree, for recapitalisation purposes[314]. Conversely, banks under an open bank bail-in strategy, will continue to operate in the market, on a standalone basis, therefore they would require a higher MREL buffer in order to absorb losses and fully rebuild their capital base.

Importantly, the need to access resolution funding may arise for any bank (whether executing an open bank bail-in or a transfer strategy). However, despite differences in MREL requirements reflecting different resolution strategies, in line with the bank's systemic footprint and complexity, the conditions to access the RF/SRF are the same for any bank, without any distinction on grounds of proportionality based on the planned resolution strategy, size and business model. This means that a large bank with open bank bail-in strategy (expected to build-up MREL buffers to cover its loss absorption and recapitalisation needs), must fulfil the same minimum 8% TLOF bail-in condition to access the fund as a smaller, deposit taking bank under a transfer strategy leading to exit of the market and which would be required to hold a lower amount of MREL resources.

The ability of banks to fulfil the access conditions to the RF/SRF depends therefore on the stock of bail-inable instruments[315] available at the time of the intervention. In order to assess the ability of EU banks to access the fund, quantitative analyses have been carried out on (i) the level of MREL shortfalls as of the most recent reporting date (Q4 2020); and (ii) the structure of banks' liabilities, in particular assessing whether deposits would be subject to bail-in in order to access the fund.

MREL shortfalls

The build-up of MREL buffers by banks is in transitional period, with full compliance required for the majority of banks by 1 January 2024, while intermediary targets were to be met by 1 January 2022.

According to the most recent EBA 2022 quantitative MREL report[316], as of Q4 2021, out of 245 resolution groups in the sample, 70 EU resolution groups (and individual resolution entities) had an MREL shortfall estimated at EUR 33 bn, down by 42% compared to Q4 2020 on a comparable basis. The reduction in shortfalls should be considered against strong issuance levels in 2021 and 2022.

[313] The DGS may also be used in resolution, for ensuring continued access for covered depositors to their deposits in line with the access conditions of Article 109 BRRD.
[314] In the case of a bridge institution, the smaller perimeter of the assets transferred and the consequent reduction in the risk weighted assets, as well as the non or limited assumption of new activities, implies a smaller amount of recapitalisation needs than if the bank were to continue to operate in the market on a going concern basis.
[315] These would be instruments that could be bailed-in, without giving rise to a right for exclusions or voluntary exclusions from bail-in, in light of Article 44(3) BRRD (for example for reasons of avoiding widespread contagion, disruption to critical functions, etc.)
[316] EBA (January 2023), *EBA quantitative MREL report and impact assessment*

In the Banking Union, as per the SRB's MREL Dashboard as of Q3 2022[317] showing BRRD II/SRMR II data, the average final MREL target represented 23.3% of total risk exposure amount (TREA) (EUR 1 760 bn), and 26.4% TREA (EUR 1 988 bn) when including the combined buffer requirement, growing over the quarter driven by the expansions of banks' balance sheets. In terms of build-up of eligible instruments, the average stock of MREL eligible liabilities and own funds reached EUR 2 353 bn, up by EUR 134.2 bn (or 6%) year-on-year. This trend was in line with the banks' funding plans to meet the biding final MREL targets by 1 January 2024. The average MREL shortfalls against the final target (2024) amounted to 0.2% TREA (EUR 18.1 bn) in Q3 2022, and 0.4% TREA (EUR 30.5 bn) when including the combined buffer requirement.

While compliance with MREL targets is a matter of transitional period and most banks are expected to fulfil their requirements once the transitional period expired, certain banks may be facing more structural issues to comply with their requirement.

See Annex 13, for a full overview of the MREL shortfalls and the build-up of the buffers during the transitional period.

Structural issues in issuing MREL eligible instruments and the likelihood of bailing-in deposits

Analyses show that certain smaller and medium-sized banks face structural difficulties in fulfilling the minimum 8% TLOF condition to access resolution funding. These challenges are due to the liability structure of these banks, which rely significantly on equity and deposits for their funding and are not into the business of issuing debt to raise (subordinated) resolution buffers. Some of the barriers hindering a switch in business model for such banks include, but are not limited to: (i) increased costs to issue (subordinated) debt in addition to or substituting existing funding due to perceived risks by investors, which would translate into higher spreads[318], (ii) lack of, or poor rating, (iii) not being listed and (iv) potential lack of demand by the market. Such challenges in accessing resolution funding may be difficult to eliminate in the short to medium-term, in particular in the current environment of low profitability driven mainly by over-capacity, competition from the fintech sector and upcoming new regulatory requirements which may impact balance sheets (Basel III).

See also Annex 13 for more information on such structural issues.

[317] SRB (February 2023), *SRB MREL Dashboard Q3 2022*

[318] Replacing deposit funding and/or secured funding by subordinated or even senior unsecured issuances could be costly.

Box 7: Excerpt speech by Governor Visco at Banca d'Italia conference (15 January 2021)[319] on the ability of some banks to issue debt

"One fundamental question concerns the sources of funding to finance a transfer strategy, be it in resolution or in liquidation. Under the current BRRD framework, a successful resolution strategy premised on the bail-in tool requires adequate levels of eligible liabilities (Minimum Requirement for own funds and Eligible Liabilities, MREL), preferably subordinated, to avoid losses being imposed on depositors and other retail creditors.

However, most medium-sized banks (not to mention smaller ones) are not equipped to tap capital markets in order to issue MREL instruments. Around 70% of the significant banks under the direct supervision of the ECB are not listed, 60% have never issued convertible instruments, and 25% have not even issued subordinated debt. These shares rise sharply, of course, for smaller institutions. Requiring these banks to issue MREL eligible liabilities to non-retail investors would therefore force them to resort to the wholesale market, obtain a credit rating and change their funding structure significantly. It could therefore have a strong impact on banks' margins and even force some of them out of the market, since issuance costs could prove too high to bear."

Analysed data shows that for some banks, the stock of bail-inable liabilities excluding deposits is lower than the minimum requirement for bail-in in order to access the RF/SRF. This means that, in order for these banks to gain access to resolution funding (i.e. minimum 8% TLOF bail-in condition), some deposits[320] would need to be bailed-in. While in some Member States this is feasible and has been done in the past, in the majority of Member States bailing-in deposits may not be socially acceptable, since depositors are considered differently from investors. Depositors use banks, primarily, as a secure place for placing their savings, for meeting future needs, while the investors take a claim in the bank after having analysed the related risks and rewards. Moreover, bailing-in deposits would negatively impact the franchise value, which would impair the success of a transfer transaction to a purchaser, who may be interested in acquiring the entire deposit book. In the majority of Member States, maintaining the integrity of deposits is considered by the national authorities, instrumental to bank intermediation in the economy (i.e. channelling savings into investments and lending) and an important element to financial stability and the functioning of the payment system. [321]

[319] Banca d'Italia (15 January 2021), *Welcome address by Governor Ignazio Visco*.
[320] Such as deposits not covered and not preferred, i.e. deposits to corporates, governments, other financial institutions, other institutions.
[321] The significance of deposits for the banking systems is recognised in the BRRD. Article 108 BRRD requires from Member States to give deposits of individuals and SMEs a higher ranking in national insolvency than the claims of ordinary unsecured, non-preferred creditors.

Box 8: Case illustrating issues regarding funding options - the Getin Noble Bank S.A. case

Getin Noble Bank S.A. was among the ten largest Polish banks with total assets of approximately EUR 9.2 bn (PLN 44 bn). On 30 September 2022, based on the opinion of the Polish Financial Supervision Authority (Komisja Nadzoru Finansowego, 'KNF'), the Polish national resolution authority (Bankowy Fundusz Gwarancyjny, 'BFG') formally declared the bank to be FOLF and determined that placing the bank into resolution (rather than to follow insolvency proceedings under national law) was in the public interest (positive PIA). Subsequently, the bank was resolved with the use of the bridge bank and bail-in tools. Equity and subordinated debt were fully written down to absorb (part of) the losses. The bridge bank serves as a temporary solution to provide sufficient time to organise an orderly sales process for the assets and liabilities transferred to the bridge bank. The BFG, which is responsible for both the resolution of banks and the guarantee of deposits in Poland provided the newly created bridge bank with direct support measures in the form of cash injections worth around EUR 1.4 bn (PLN 6.9 bn) that were financed through (i) the national resolution fund; and (ii) the national deposit guarantee fund, both under the BFG's responsibility.

In addition, the Polish Commercial Banks' Protection System (System Ochrony Banków Komercyjnych, 'SOBK'), comprising the eight largest commercial banks active on the Polish market, was created and decided, on a voluntary basis, to (i) support the operation with approximately EUR 735 million (PLN 3.5 bn) to absorb further losses; and (ii) temporarily purchase a 49% share in the bridge bank[322]. In this particular case, the balance sheet structure of the bank was mainly funded by deposits[323]. Instead of liquidating the bank and paying out covered depositors, authorities decided to resolve the bank (preparing for future sale and exit from the market). Meeting the conditions (i.e. minimum 8% TLOF bail-in) for accessing resolution funding would have implied compromising the integrity of its deposits book and imposing losses on depositors. This situation is likely to have motivated the decision of other commercial banks in Poland to voluntarily intervene and contribute to the resolution cost (complementing DGS support) and, in that way, avoid risks of widespread contagion in the national financial market that could have stemmed from the bailing-in of (some) deposits in Getin Noble Bank S.A. This multi-layered funding arrangement illustrates the weakness of the current framework, in particular, the difficulties encountered by certain banks in meeting access conditions for resolution funding and the importance of exploiting synergies between DGSs and RFs[324].

In what concerns the general depositor preference, consultations with stakeholders confirmed that the bail-in of any deposits is deemed to carry a significant contagion risk to the financial system and to entail political sensitivities, so much so that, despite only covered deposits being in the list of mandatory exclusions from bail-in in Article 44(2)

[322] Source: European Commission's press release (01 October 2022) *State aid: Commission approves aid to support the resolution of the Polish Getin Noble Bank S.A.*
[323] Source: BGF (3 October 2022) – *Resolution of Getin Noble Bank SA*.
[324] Relates to problem 2 and its first driver addressed in this impact assessment (Chapter 2, section 2.2.1) and in section 7.1.2.3 of the evaluation.

BRRD, resolution authorities generally expect to have to exclude (all) other deposits on a discretionary basis from bearing losses in resolution under Article 44(3) BRRD. When some of those deposits rank *pari passu* with senior bail-inable liabilities, their exclusion has the potential to create NCWO[325] problems, particularly considering that they tend to represent a significant percentage of the total senior class.[326]

Besides the challenges described above in meeting the minimum 8% TLOF[327] condition to access resolution funding, the 5% TLOF cap on the usage of such funding[328] may also be problematic for certain banks, in particular when it results in a small amount of funding allowed to be used, which may not be deemed sufficient to ensure the execution of the resolution strategy.

It is arguable that a proportionate approach to managing bank failures should ensure that entities can access funding sources without having to structurally modify their business model. The existence of a variety of business models is an important element to ensure a diversified, dynamic and competitive banking market.

a) Divergent access requirements for the resolution fund and for funding outside resolution

In two cases of banks for which a FOLF determination was issued by the competent supervisory authority, there was no need to look into possible difficulties in accessing resolution financing due to a negative PIA and the usage of tools outside resolution and, inarguably, with more easily accessible sources of funding. In the Banking Union, in the above-mentioned two cases where resolution was not deemed to be in the public interest, banks benefited from public support under national insolvency proceedings (including from the public budget). In other past interventions observed, national authorities granted support to banks, which were rather close to a situation of failure, in the form of preventive measures under Article 11(3) DGSD. Both the use of aid under national insolvency proceedings and Article 11(3) DGSD are subject to different (and arguably less-stringent) conditions than those for the use of the resolution funds under the SRMR and BRRD leading to a disincentive to use resolution.

In particular, public support may be available outside resolution and accessible under more advantageous conditions from the point of view of allocating losses to the bank's creditors. Some of these solutions are of preventive nature, and the lower burden sharing is combined (and justified) by additional conditions ensuring that the bank is not FOLF. First, public funds can be used to provide capital injections or liquidity support to banks in a "precautionary" way, under specific circumstances, set out in the BRRD. The relevant provisions (Article 32 BRRD) provide requirements and conditions to ensure that the intervention is timely and precautionary in nature, in particular, that the support is granted to a solvent bank whose financial condition has not deteriorated to a point of

[325] Resolution authorities must ensure that the application of resolution tools would not make creditors worse-off than they would have been in insolvency ("no creditor worse off" (NCWO) principle).
[326] See also Annex 8 of the impact assessment.
[327] As explained in sub-section (a), according to the informal interpretation of the Commission's services of the relevant legal provisions in the BRRD/SRMR, the use of the RF/SRF for the provision of liquidity in resolution is not subject to the 8% minimum bail-in requirement.
[328] The cap could be exceeded under condition that all unsecured, non-preferred liabilities, other than eligible deposits, have been written down or converted in full (Article 44(7)(b)).

failure and that the aid is minimised. Second, DGS funding of measures, pursuant to Article 11(3) DGSD which can be used to prevent the bank's failure (preventive measures) may also qualify, as State aid or not, depending on the circumstances of the case.[329] Also, in this case, conditions exist to ensure that the support is granted as a preventive measure to a non-FOLF bank. As outlined in Chapter 2 of the impact assessment, the functioning of these measures in line with the logic of resolution is dependent on these conditions being clear and correctly applied.

In addition to these precautionary and preventive measures, funding of the failure of a bank through public budgets is possible, in insolvency proceedings, when the PIA is negative (liquidation aid). Alternative measures financed by the DGS in insolvency proceedings may also be subjected to the State aid conditionality for liquidation aid, on a case-by-case basis.

Compared to the 8% TLOF bail-in requirement to access resolution funding, which could entail bailing-in senior unsecured creditors, including non-preferred, non-covered deposits[330], access conditions under the State aid rules (mainly governed by the Commission's 2013 Banking Communication[331]) require adequate burden-sharing entailing, after losses are first absorbed by equity, contributions by hybrid capital holders and subordinated debt holders, which may be less demanding. The fact that external financing outside resolution could be easier to access and could be provided with fewer limitations for the bank's creditors, than financing arrangements in resolution, creates room for arbitrage and may incentivise resolution authorities to look for solutions outside the resolution framework. This effect is exacerbated by the fact that, in applying the PIA so far, resolution authorities have not in all cases taken into consideration the possibility of granting aid in insolvency (which would matter from the perspective of ensuring the minimisation in the use of extraordinary financial support, see *Section 7.1.3.4* for more details).

Box 9: Divergences in conditions to access funding for resolution fund and for funding outside resolution under the State aid framework

Access conditions to resolution funding

The BRRD (recital 73, Article 44(5) and 37(10)) stipulates that, when discretionary exclusions to bail-in are applied in connection with certain creditors (e.g. on grounds of protecting financial stability or because such creditors would be difficult to bail-in within a reasonable timeframe), and where the losses cannot be passed to other creditors, the resolution financing arrangement may make a contribution to the institution under resolution subject to a number of strict conditions. These conditions include the requirement that losses totalling not less than 8% of total liabilities including own funds (TLOF) have already been absorbed, and the funding provided by the resolution fund is limited to the lower of 5% of TLOF or the means available to the resolution fund and the

[329] See sub-section (c) for more details on the alternative and preventive measures under DGSD.
[330] See Annex 7 on the impact of bail-in on uncovered (and in some cases covered) deposits under different scenarios.
[331] European Commission (2013), *Banking Communication*.

amount that can be raised through ex post contributions within three years. In accordance with the changes introduced in Article 59 BRRD by the 2019 Banking Package, the amount by which CET1 items are reduced to absorb losses as identified in the valuation carried out under Article 36, including the valuation for the purposes of assessing whether the conditions for resolution are met, count towards the 8% of TLOF threshold.

Access conditions under State aid rules

The 2013 Banking Communication (paragraphs 40-42) sets out the minimum burden-sharing requirement that would, provided that other considerations are also met, enable the granting of aid. To reduce the moral hazard that State aid could cause, aid should only be granted on terms which involve adequate burden-sharing by existing investors. Adequate burden-sharing will normally entail, after losses are first absorbed by equity, contributions by hybrid capital holders and subordinated debt holders. Hybrid capital and subordinated debt holders must contribute to reducing the capital shortfall to the maximum extent. Such contributions can take the form of either a conversion into Common Equity Tier 1 or a write-down of the principal of the instruments. The State aid rules do not require contribution from senior debt holders (in particular from insured deposits, uninsured deposits, bonds and all other senior debt) as a mandatory component of burden- sharing whether by conversion into capital or by write-down of the instruments.

For a significant number of banks in the EU, bailing-in 8% TLOF to access resolution funding would also entail bailing-in senior unsecured creditors, including non-preferred, non-covered deposits. This concludes that the access conditions are stricter in resolution than under the State aid rules. The design and interaction between funding solutions in and outside the framework play a central role in the shaping of incentives to apply the CMDI framework.

The divergences mentioned above can create a risk of inconsistent solutions across Member States and reduce the predictability of the framework. Moreover, the possibility to use public budgets (i. e. taxpayers' funds) outside resolution, which in principle should be avoided or strictly limited to avoid risks of moral hazard, creates a need to reconsider whether the framework can be improved to achieve its objectives with more clarity and predictability. This would in turn promote a more consistent approach to the management of bank failures, including in terms of increased level playing field at EU level.

DGS funding in resolution and insolvency

Article 109 BRRD provides for the use of DGS funding in resolution, in addition to the resolution fund. The provision sets out several conditions for the intervention. The DGS support in resolution is established, in principle, to an amount equal to the losses borne by covered deposits if they were exposed to bail-in or could bear losses under another resolution strategy. In addition, the DGS's liability is limited to the amount of losses that the DGS would have borne under an insolvency counterfactual[332]. This provision has not

[332] Based on the so-called least cost test.

been used, so far, in practice. The difficulties in providing funding in resolution from the DGS relate to certain other conditions set out in Article 109 BRRD.

Particularly, conditions under paragraphs (1)(a) and (b) are restrictive and difficult to operationalise, particularly the limitation that the DGS is liable for the losses that covered deposits would have suffered had they been bailed-in at the same time as creditors with the same ranking. Considering that covered deposits benefit from super-preference in the ranking of claims and that the value of assets in resolution is in principle higher than in insolvency, in most cases covered deposits would not have been called upon to bear losses in resolution to enable the DGS to step in. Additionally, this provision introduces limitations on the maximum amount of the DGS contribution, which may not exceed the losses that the DGS would have borne in an insolvency counterfactual nor 50% of its target level.

In order to operationalise the application of the provision, and to preserve its *effet utile* the Commission services support the interpretation[333] that under Article 109 BRRD, DGS funds may be used to support the transfer of eligible deposits in resolution provided that such contribution is instrumental to ensuring access of depositors to their covered deposits. In particular, DGS funds may be used to inject an amount equal to the difference between eligible deposits and assets, provided that the "least cost" principle is respected (i.e. provided that the costs borne by the DGS do not exceed the net amount of compensating covered depositors at the credit institution concerned, in the context of national insolvency proceedings.) Notwithstanding this interpretation, it is appropriate to consider revising the wording of the provision to clarify the reading of the provision in line with the approach mentioned here.

As mentioned in sub-section (b) funding sources from the DGS are also available for banks that do not meet the PIA and are put in insolvency according to the applicable national law (alternative measures). The DGS can provide funding to support a transfer transaction to the extent that this is necessary to preserve access to covered deposits and that it complies with the least cost test (LCT) and State aid rules, as applicable. The LCT requires that the loss for the DGS is lower than the loss it would have borne in case of payout in insolvency, while the qualification of the DGS use as State aid would entail a minimum burden sharing by shareholders, hybrid capital holders and subordinated debtholders, for its authorisation. Also in this case, the DGS' super preference creates a substantial limitation to the possibility for the DGS to provide funding.

The access conditions to DGS funding in resolution and insolvency are not aligned, which makes the use of funds subject to uncertainty. Finally, the opportunity to use DGS funding in resolution or insolvency entails different arbitrage depending on whether the potential intervention is in a Banking Union or non-Banking union context. For non - Banking Union Members States, both resolution and DGS funds are financed by the domestic industry, possibly facilitating the combination of the funds. In the case of Banking Union Member States, the SRF is financed by all banks in the Banking Union while the financing of DGS is national, creating an "asymmetry" in the burden of the

[333] This interpretation has not been formally adopted yet by the Commission.

costs in case DGS would "substitute" resolution funds. Moreover, in the absence of EDIS there may be a risk of a shortfall in DGS funds.

It is important therefore to review the access conditions for DGS funding in resolution and insolvency to ensure level playing field, consistency and proportionality between the applications of procedures.

7.1.3. Objective (3): Did the framework achieve the objective of enhancing the functioning of the single market including by handling of cross-border crises and fostering level playing field among banks from different Member States, particularly in the Banking Union?

Many aspects of the CMDI framework improved the functioning of the single market in banking and the level playing field among banks. The framework created a centralised mechanism and governance for resolution (SRM) in the Banking Union, cross-border coordination processes as well as tools and cooperation requirements (e.g. creation of resolution groups and internal loss absorbing capacity for subsidiaries in host Member States) to handle the failure of cross-border banking groups.

Cross-border coordination among national DGSs was enhanced by the DGSD, which also facilitated access to the internal market through the freedom of establishment and the freedom to provide financial services while increasing the stability of the banking system and the protection of depositors.

Yet, despite these achievements, the operational handling of recent bank failures in some Member States, was characterised by a lack of consistency and uneven playing field. This was mainly caused by broad discretion in the conditions for the application of the BRRD/SRMR measures, which leaves room for arbitrage in the decision of the public authorities to resort to resolution or insolvency tools, depending on the solutions available for a specific failing bank. This arbitrage is fuelled by several factors, the most important being (i) divergent access conditions for the resolution funds and for funding outside resolution and difficulties for certain banks in accessing resolution funds (see Section 7.1.2.3), (ii) differences in the track record between resolution authorities to make use of industry-funded resolution funds and (iii) the availability of various national tools which may be similar to resolution tools, with often heterogeneous and unclear activation conditions.

The divergent application of rules, lack of harmonised hierarchies of claims and the uneven playing field for banks, depositors and taxpayers emerging as a consequence of these issues, among other elements, also contribute to market fragmentation in the EU, reducing the level of cross-border market integration and the functioning of the single market in banking. While the reduced incentives for cross-border market consolidation through mergers and the more reduced volume of cross-border banking transactions cannot be entirely linked with the application of the CMDI framework, the resolution regime does have a bearing on it and its improvement would be conducive to more market integration in the medium and long run.

The DGSD's contribution to EU level playing field could also be further improved, in particular with regard to ONDs and their potential impact on the internal market.

Moreover, the differences in robustness and firepower among national DGSs combined with the lack of EDIS in the Banking Union may further exacerbate the uneven playing field, especially if a large shock event were to materialise in one of the participating Member States.

Overall, evidence from the application of the framework points out to the achievement of a sub-optimal functioning of the single market and the need for significant improvements to remove differences in treatment among banks, creditors, depositors and taxpayers in different Member States.

Main factors influencing the objective's achievement

Factors influencing performance against objective	**Overall impact on objective**
1) Centralised governance in the Banking Union	**Positive** (creation of SRM, SRB, SRF)
2) Supervisory cooperation and EU oversight on convergence of supervisory practices	**Positive** (enhanced cross-border cooperation, EU resolution colleges, EBA's convergence mandate, positive impact on market integration)
3) Precautionary and preventive measures	**Negative** (lack of clarity and framing of precautionary and preventive measures, divergent access requirements vs resolution)
4) Predictability of legal framework and the approach to PIA	**Negative** (lack of predictability of application, restrictive approach and across EU, divergent application of PIA, conducive to market fragmentation).
5) Interaction between national insolvency proceedings and resolution triggers	**Negative** (lack of legal certainty due to divergent triggers, legal limbo situations)
6) *National ranking of claims in insolvency*	**Negative** (unharmonised)

7.1.3.1. Centralised governance in the Banking Union

One of the most important achievements of the framework with respect to the single market functioning was the creation of the Single Resolution Mechanism (SRM), the second pillar of the Banking Union. The centralised decision making is built around the Single Resolution Board (SRB) consisting of a Chair, a Vice Chair, four permanent members, and the relevant national resolution authorities[334]. The SRB is directly responsible for the resolution of the entities and groups directly supervised by the European Central Bank (ECB) as well as other less significant cross-border groups. The functioning of the SRM is enabled, among other factors, by its governance, in particular, the strong cooperation and coordination between the SRB and national resolution authorities via its Plenary Session[335], various task force groups, forums and committees.

[334] Composition of the Governing Body of the SRB in its extended Executive Session.
[335] In the Plenary Session of the SRB, all of the NRAs are represented, together with the SRB Chair and the four permanent Board Members.

This centralised decision-making system for the Banking Union contributed significantly to the functioning of the single market in banking and to fostering consistent policies and approaches, mainly in cases of cross-border resolution preparedness (and to, a lesser extent, in terms of resolution execution).

7.1.3.2. Supervisory cooperation and EU oversight on convergence of supervisory practices

The CMDI rules create a framework for coordination and communication processes, exchange of information, as well as tools for competent and resolution authorities from different Member States to cooperate and communicate effectively on crisis preparedness and execution for cross-border banking groups. The legislation provides joint decision-making processes for critical elements such as: the preparation of group recovery and resolution plans, removal of impediments to group resolvability and setting up resolution buffers (MREL).

Furthermore, the BRRD requires the creation of EU resolution colleges as a forum for the group- level resolution authorities, other relevant resolution authorities, supervisory authorities, competent ministries and authorities responsible for DGS, to collectively plan for and coordinate the resolution of cross-border banking groups[336]. The BRRD also provides the rules for communication and exchange of information between EU and third country resolution authorities and other international institutions.

In this context, the EBA is mandated by the framework to develop a wide range of technical standards, guidelines and reports with the aim of ensuring effective and consistent procedures across the Union, in particular with respect to cross-border financial institutions. To fulfil the EBA's role in ensuring EU convergence in the application of the rules, national authorities must notify the EBA of any relevant information as well as of any actions taken under the framework. The EBA publishes non-confidential elements of these notifications on its website together with its assessment of the supervisory convergence, including in the continuum between ongoing supervision, recovery and resolution.[337]

The creation of these effective cooperation and coordination arrangements and of a centralised oversight of convergence of supervisory practices helped with tackling challenges of cross-border banks vulnerabilities and failures and creating a level playing field in the single market for EU banking products.

7.1.3.3. Precautionary and preventive measures

Precautionary measures allow the provision of extraordinary financial support from public resources to a solvent bank, to diffuse the risks of a serious disturbance in the economy of a Member State and to preserve its financial stability.[338] The available measures comprise capital injections (precautionary recapitalisation) as well as liquidity support. Possible uses of precautionary recapitalisation also include relief measures

[336] Third country authorities may also be invited to attend colleges as observers.
[337] EBA (14 March 2019), *EBA notes good progress in convergence of supervisory practices across the EU*.
[338] These measures are provided in Article 32(4)(d) BRRD.

through the transfer of impaired assets[339], and similar considerations have been extended to asset protection schemes[340]. The provision of such support is an exception to the general principle that the recourse to extraordinary public financial support to maintain the viability, solvency or liquidity of a bank should lead to the determination that the bank is FOLF. For this reason, specific requirements must be met in order to allow such measures under the BRRD/SRMR[341] as well as under the State aid rules for banks[342]. Notwithstanding the correct application of these safeguards in past practice, it also occurred that two banks benefitted from multiple public supports in the form of precautionary liquidity on grounds, *inter alia*, of being declared solvent by the competent supervisor, only months before being assessed as FOLF. Based on this experience, practices of the Commission and authorities involved in such situations were already enhanced. For precautionary recapitalisation, the rules should take stock of the adjusted approach developed based on past experience (see Annex 9 of the impact assessment), to enforce the very stringent conditions already established, which are key to ensure that aid in this form can be granted without impinging on the overarching objective of avoiding moral hazard. Nonetheless, there is scope to improve the clarity of the relevant legal provisions and to ensure the predictability and consistency of the outcome going forward.

In certain circumstances, DGS funds can be used to prevent the failure of a bank (preventive measures under Article 11(3) DGSD) and be very useful in averting further financial deterioration, which could lead to a crisis. Currently, the legal provisions enabling the use of DGS funds for such preventive measures are optional and not all Member States have transposed them into national law. Only nine Member States (Austria, Croatia, France, Germany, Ireland, Italy, Malta, Poland and Spain) have transposed this option in national law[343].

Such measures are possible only if not qualified as State aid. Depending on several elements, the DGS intervention could be qualified as private or public for the purpose of State aid control by the Commission. Such an assessment is made on a case-by-case basis, taking into consideration elements such as the governance and decision-making procedure of the DGS, and the circumstances relating to the measure. It is therefore hard to predict whether the intervention would qualify as State aid or not. However, this qualification has an impact on the legal treatment of the DGS intervention. In particular, the qualification of the intervention as State aid would *de facto* impede the intervention of the DGS in a preventive capacity, as this would trigger a determination of FOLF under

[339] The necessary conditions to allow the use of precautionary recapitalisation to support an impaired asset relief measure are outlined in detail in the Commission Asset Management Companies blueprint, page 36, see European Commission staff working document (March 2018), *AMC Blueprint*.
[340] European Commission (16 December 2020), *Communication from the Commission to the European Parliament, the Council and the European Central Bank: Tackling non-performing loans in the aftermath of the COVID-19 pandemic (COM(2020) 822 final*, p. 16).
[341] In particular, BRRD and SRMR require that the measure is limited to solvent banks and it does not cover incurred and likely losses. Also, the amount is limited to the shortfall identified in an asset quality review, stress test or equivalent exercise.
[342] Out of which rules, the most relevant for the purpose of this impact assessment, is the 2013 Banking Communication, see European Commission (2013), *Banking Communication.*
[343] Source: CEPS study, p. 124.

the BRRD[344]. Available evidence shows that some preventive measures were assessed as being private or in line with market conditions (i.e. EUR 5.92bn funded by private arm of DGS fund or market-conform public measures) and therefore not qualified as State aid (see Annex 9).

Moreover, the conditions for application of DGSD preventive measures should be clear, harmonised, and consistent with other elements of the framework (e.g. FOLF criteria), while safeguards should be applied to ensure that such interventions are sufficiently sound from a financial perspective and would not impinge excessively on the DGS' resources. However, the current legislative text does not provide adequate clarity on such safeguards and conditions[345]. In past interventions observed, national authorities granted support to banks, which were rather close to a situation of failure. While the current rules do not prevent this, there is scope to reflect on possible improvements in the legislative framework to reinforce the role of these measures as preventive actions, which should, in principle, intervene in presence of a deterioration of the bank's financial condition but still far from a condition of failure. The interactions between preventive, precautionary tools, early intervention measures and the timing and process of the FOLF determination (laid down in Article 32 BRRD) are also unclear, which may lead to overly extensive use of public/RF/DGS funds. In particular, the framework, gives the supervisor, significant discretion for determining solvency, capital requirements, FOLF, as well as for the timeframe handed to the bank for averting its failure (e.g. through a private solution or early intervention measure). All these discretions interact with the conditions for the use of preventive and precautionary tools. As mentioned above, this ambiguity led to situations where banks received State aid in the form of precautionary liquidity on grounds, inter alia, of being declared solvent, by the competent supervisor, only months before being assessed as FOLF, as the banks' solvency was assessed on the basis of a point-in time (thus not forward looking) definition.

For both, DGSD preventive measures and BRRD precautionary measures, amendments improving the clarity of the relevant legal provisions would help limiting the risk that preventive support would allow existing senior creditors to exit their claims on the bank shortly before FOLF is triggered and resolution/insolvency is applied, which may in turn result in a higher use of financing sources (RF/SRF in resolution or DGS funds under insolvency proceedings).

Box 10: Example of unclear interaction between precautionary measures and FOLF determination – Case of the Venetian banks

In January 2017, two mid-sized Italian banks, Banca Popolare di Vicenza and Veneto Banca (the "Venetian banks"), benefited from precautionary liquidity support, on grounds, inter alia, of the bank being declared solvent by the supervisor, amounting to EUR 6.5 bn, which was supplemented in April 2017 by another EUR 3.6 bn. The total amount of the precautionary liquidity measures represented 16% of the banks' combined

[344] That is because according to Article 32(4)(d) BRRD the use extraordinary public financial support (State aid), except in limited exceptions (such as in the case of precautionary measures) is one of the criteria for FOLF determination and hence may lead to the resolution or insolvency of the bank.
[345] See also Annex 6.

balance sheets at the time of the intervention. A few months later, in June 2017, both banks were declared FOLF by the ECB, followed by a negative PIA by the SRB. As a consequence, the banks entered compulsory administrative liquidation under the management of the national resolution authority which approved a sale of business transaction under national rules, funded by a cash injection (EUR 4.8 bn) and guarantees by the State (EUR 12 bn) in order to facilitate the transfer to the acquirer.

Overall, the total amount of aid (precautionary and under national insolvency proceedings) amounted to EUR 26.9 bn, representing 43% of the total combined balance sheet size of both banks at the time of the intervention.

Thanks to the significant discretion left to supervisors for determining solvency, capital requirements, FOLF, as well as for the timeframe handed to the bank for averting its failure (e.g. through a private solution or early intervention measure), the Venetian banks received a significant amount of public support (EUR 10.1 bn) in the form of precautionary liquidity (which can only be granted to solvent banks) to, only a few months later, be declared FOLF. These unclear interactions between precautionary tools, lack of forward looking solvency assessment and the process of the FOLF determination[346], affected the predictability of the framework and did not act as strong filter to prevent an extensive use of public funds.

7.1.3.4.Predictability of legal framework and the approach to PIA

Beyond other factors described above, the use of tools outside resolution was made possible by the sometimes restrictive approach to the PIA as the entry gate to resolution.

The BRRD and the SRMR provide in Article 32 and Article 18 respectively that resolution authorities should take a resolution action in relation to institutions only if they consider that a number of conditions are met. One of those conditions is that the resolution action is necessary in the public interest[347] and this determination is made by carrying out a PIA. This assessment requires a comparison between resolution and insolvency, in order to decide which procedure better meets the resolution objectives[348]. The resolution objectives are considered to be of equal importance and must be balanced as appropriate to the nature and circumstances of each case. Moreover, the framework also requires that, when pursuing the resolution objectives, the resolution authority should seek to minimise the cost of resolution and avoid destruction of value unless necessary to achieve the resolution objectives. Additionally, the BRRD[349] provides that authorities should have the possibility to resolve any institution, in order to maintain financial stability.

However, the BRRD and SRMR leave a margin of discretion for resolution authorities when carrying out this assessment, which led to divergent applications, as well as to

[346] Relates to problem 1 and its first driver addressed by this impact assessment (chapter 2, section 2.1.1) and evaluation (section 7.1.3.3).
[347] Article 32(1)(c) BRRD and Article 18(1)(c) SRMR.
[348] As per Article 31 BRRD, continuity of critical functions, avoidance of significant adverse effect on the financial system, protection of public funds, protection of deposits and investors covered by investor compensation schemes, protection of client funds and client assets.
[349] See recital 29 BRRD.

interpretations which may not fully reflect the logic and intention of the legislation. While in the Banking Union, the test has been applied rather restrictively and resolution was used only three times[350] so far under the SRMR, outside the Banking Union, resolution has been used more extensively (six out of 13 cases)[351].

Some resolution authorities have taken the approach that only a limited number of institutions should meet the PIA. However, several factors are relevant when carrying out the PIA and the assessment should not be reduced simply to a matter of size of the institution.

A first factor in the assessment is the type of normal insolvency proceedings available at national level (the counterfactual to resolution), which may lead to different PIA results for banks in different Member States. A national insolvency law allowing only piecemeal liquidation is likely to be considered inadequate to manage the failure even of a medium-sized entity, as the sudden interruption of certain functions (e.g. deposit taking and payment services) could have a negative effect on financial stability and depositors' confidence and undermine the payment system. A different conclusion could be reached if the national insolvency proceedings allow additional ways to manage the bank's failure, such as the transfer of the bank's deposit book.

A second factor in the PIA is the impact on financial stability, which should be assessed taking into consideration the economic environment at the moment of failure. In the event of a widespread crisis, which would potentially weaken several institutions at the same time, even the failure of a smaller institution may create ripple effects and impact other players in the market. This could justify a decision to put that respective bank in resolution rather than insolvency.

A third factor which is crucial to the PIA is the assessment of the impact on critical functions. The conclusion that winding up the institution under normal insolvency proceedings would disrupt its critical functions provides a strong basis for a public interest finding. The critical nature of a function depends on the effect of an abrupt interruption on the economy, the possibility for substitution and other factors. There are divergences among resolution authorities in the interpretation of the PIA with respect to the geographical reach of critical functions, i.e. whether a function can be deemed critical only when its interruption has an impact on the economy of an entire Member State or whether local/regional impact can be deemed sufficient. Similarly, the scope of the assessment of the impact on financial stability was set at the level of one or several Member States.[352] However, the BRRD/SRMR refer also to effects *within* a Member State (i.e. within a region) and do not restrict the assessment to impacts on the financial stability of (at least) an entire Member State. Additionally, the relevant Delegated

[350] Two of those cases relate to the failure of banking entities belonging to the Sberbank Europe AG group, which took place under special circumstances (see also Annex 9 for more information on the resolution of the Sberbank group)
[351] The remaining four cases with a positive PIA, concerned resolution in Banking Union Member States but before the entry into force of the minimum 8% bail-in requirement and before the SRB became responsible for the resolution handling of these cases.
[352] SRB (3 July 2019), *Public Interest Assessment: SRB Approach*, p. 8.

Regulation[353] also provides for the assessment of critical functions on a local, regional, national or European level, as appropriate for the market concerned. The SRB is revising its PIA policy, which may incorporate an approach more considerate of local implications.[354]

A fourth important factor for the PIA is the link with the funding sources which would become potentially available, i.e. resolution fund/DGS funding in resolution *versus* aid in insolvency. At the time of the PIA, due account should be given to the available sources of funding under various tools and a comparison should be made in light of the best fulfilment of the resolution objectives and the overarching principle underlying the resolution framework i.e. avoiding recourse to bail-outs. Past applications of the PIA did not manage to avoid a use of large amounts of public support in insolvency, leading to sub-optimal results from the perspective of preserving financial stability, preventing moral hazard or safeguarding level-playing field. Also, the objective to limit the cost for taxpayers could benefit from a further distinction between the use of public funds from the State budget and the use of the RF/SRF or the DGS, which are financed by the industry.

Consultations with stakeholders[355] showed that most stakeholders consider that the provision, as regulated now, gives opportunity for too many different interpretations and therefore creates level playing field issues and uncertainty. Many respondents argue that the outcome of the PIA in the planning phase should be more predictable.

7.1.3.5. Interaction between national insolvency proceedings and resolution triggers

National insolvency proceedings have been so far chosen over resolution in most of the recent cases of bank failures. However, these proceedings are very heterogeneous across EU Member States, not always tailored to the specificities of banks. Therefore, there is no consistency EU-wide as to how a bank failure will be managed if resolution is not used. For example, some Member States have special regimes applicable only to banks, while others have ordinary insolvency regimes applicable to all kinds of firms; some implement judicial-based frameworks, while others administrative-based frameworks. Some Member States aligned the triggers for commencing national insolvency proceedings with the BRRD FOLF triggers. However, in many Member States, a lack of such alignment may result in legal uncertainty in the management of the banks that are not resolved (lead to a break in the continuum between going and gone concern), in particular in cross-border cases.

This variety of procedures creates a level playing field problem, as creditors and depositors may be treated differently across the EU, potentially impairing the single

[353] Commission Delegated Regulation (EU) 2016/778 of 2 February 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to the circumstances and conditions under which the payment of extraordinary *ex post* contributions may be partially or entirely deferred, and on the criteria for the determination of the activities, services and operations with regard to critical functions, and for the determination of the business lines and associated services with regard to core business lines, OJ L 131, 20.5.2016, p. 41.
[354] SRB (May 2021), *PIA policy* considerations.
[355] Annex 2 of the impact assessment and the published summary of the consultations.

market in banking and fuelling financial fragmentation. Importantly, the lack of sufficient clarity on the need for exiting the market in a timely manner, in case of winding up following a negative PIA, could be an incentive for governments to also extend some forms of support to banks that lack a sustainable business model, particularly contributing to generating a heavy legacy of excess capacity in the system.

The underlying assumption with respect to an insolvency procedure is that once the bank is put in insolvency it must exit the market. This does not have to happen immediately nor following a single procedure. A bank may be sold through liquidation (i.e. in a piecemeal fashion) or (partial) sale of the business. However, a market exit should take place within a reasonable timeframe.

Under the current rules on insolvency, however, this outcome is not necessarily guaranteed. In certain cases, it is possible that no action at all can be taken, because when the bank is declared FOLF as per the BRRD and there is no PIA to resolve it, the triggers to initiate insolvency are not met. To address this potential "limbo" situation, the 2019 Banking Package introduced Article 32b BRRD, requiring Member States to ensure the orderly winding up in accordance with the applicable national law of failing banks which cannot be resolved due to negative PIA. However, it is still unclear whether the implementation of this Article in the national legal framework would address any residual risk of standstill situations, in particular in those cases where the bank was declared FOLF on the basis of forward looking triggers ("likely to fail").

These differences in insolvency that can be observed across the EU have consequences even for banks that are resolved. This is due to the fact that normal insolvency proceedings are used in resolution as the main element of comparison for assessing compliance with the "*no creditor worse off*" (NCWO) principle.

The problem driver described above may further complicate the handling of failures of cross-border banking groups, as the entities of the group are handled according to a mix of European and national rules for triggering resolution and insolvency, respectively.

Box 11: Example of unclear interaction between FOLF triggers and national insolvency triggers - Case of ABLV

In February 2018, the ECB's FOLF decision for both the Latvian parent and its Luxembourg subsidiary[356], was based on an assessment that the bank would likely be unable, in the near future, to pay its debts or other liabilities as they fall due. Following the FOLF determination, the SRB assessed that a resolution procedure was not in the public interest (i.e. negative PIA)[357]. Consequently, the winding up of the parent and the subsidiary had to take place, under the national insolvency law of Latvia and Luxembourg, respectively.

However, the Latvian insolvency law does not provide for the immediate start of the liquidation of an entity, as long as, it still possesses a licence to operate and is able to

[356] ECB (24 February 2018) *Press release on FOLF determination for ABLV Bank*
[357] SRB (24 February 2018) *Press release on SRB's decision not to take a resolution action for ABLV Bank and its subsidiary in Luxembourg*

meet its payment obligations. As a result, although an assessment of the likely inability of the bank to meet its payment obligations was sufficient reason for ECB to determine that the parent and its subsidiary were FOLF, it did not constitute sufficient grounds for opening winding up proceedings, under the national insolvency laws of Latvia and Luxembourg, for the two FOLF entities. To end this limbo situation, the shareholders of the Latvian parent bank had to be convinced to liquidate the bank, voluntarily. In contrast, the Luxembourg subsidiary was subject to a suspension of payments regime (moratorium) until the start of the judicial liquidation process almost two years later. Consequently, the Luxembourg subsidiary was faced with a situation of legal uncertainty, because it was declared FOLF, but could not exit the market for a prolonged period of time[358].

Feedback from the consultations with the stakeholders[359] revealed that the majority is in general, supportive of a full or maximum possible alignment between national insolvency proceedings and resolution triggers bearing in mind restrictions in national law (such as Constitutional features). Some of the stakeholders explained that such alignment is already in place in some jurisdictions.

7.1.3.6. Non-harmonised national ranking of claims in insolvency

Insolvency proceedings as a counterfactual to resolution play an important role when assessing the application of resolution tools. Concretely, resolution authorities must ensure that the application of resolution tools would not make creditors worse-off than they would have been in insolvency (NCWO principle). Furthermore, liabilities absorb losses and contribute to the recapitalisation of an institution in resolution in an order that is largely determined by the hierarchy of claims in insolvency.

The BRRD harmonised certain rules on the priority ranking in national laws governing normal insolvency proceedings of the following liabilities: (i) covered deposits and DGS (Article 108(1)(b)), (ii) the part of eligible deposits from natural persons and micro, small and medium-sized enterprises (SMEs) exceeding the DGSD coverage level (Article 108(1)(a))[360], (iii) senior non-preferred debt instruments (Article 108(2) and (3)) and (iv) own funds items (Article 48). However, important divergences in the hierarchy of claims remain when it comes to the ranking of ordinary unsecured claims, other deposits and exclusions from bail-in.

Such divergences have the potential to create uneven playing field in cross-border resolutions and uneven treatment of creditors in resolution and in insolvency, as well as additional complexity when conducting the NCWO assessment for cross-border groups, particularly among jurisdictions participating in the Banking Union.

[358] Relates to problem 1 that groups together all identified issues of legal certainty in the existing framework, addressed by this impact assessment in chapter 2, section 2.1 and chapter 5, section 5.5, as well as in annex 8 (section 6) and the evaluation (section 7.1.3.5).
[359] See Annex 2 of the impact assessment.
[360] As well as deposits that would be eligible deposits from natural persons and SMEs were they not made through branches located outside the Union of institutions established within the Union.

Feedback from the consultations with the stakeholders confirmed that a large majority of the respondents perceived that the differences between bank creditor hierarchies across Members States could complicate the application of resolution action as they viewed these divergences as a source of increased fragmentation in the EU and differentiated treatment amongst creditors.

Box 12: Overview of main differences in national ranking of deposit claims

In recent years, an increasing number of Member States (BG, CY, EL, HR, HU, IT, PT, SI)[361] have granted a legal preference in insolvency to the remaining deposits as a complement to the protection already afforded to covered deposits and eligible deposits of natural persons and SMEs under Article 108(1) BRRD.[362] While those deposits now rank in insolvency above ordinary unsecured claims (including senior bondholders eligible for MREL), they continue to rank below the deposits referred to in Article 108(1) BRRD.

7.1.4. Objective (4): Did the framework achieve the objective of protecting depositors and ensuring depositor confidence across the EU? In the Banking Union, what is the impact of the absence of EDIS?

Overall, the framework achieved the objective of protecting depositors and ensuring depositor confidence across the EU. In particular, the coverage level contributes to the effectiveness of the DGSD framework and to depositors' confidence, as it allows protecting almost all deposited amounts and a very large part of the depositors' wealth. However, as the framework is not consistently applied across the EU, depositor protection and confidence is achieved in a sub-optimal way.

Box 13: Information on covered deposits, available financial means[363] and target level

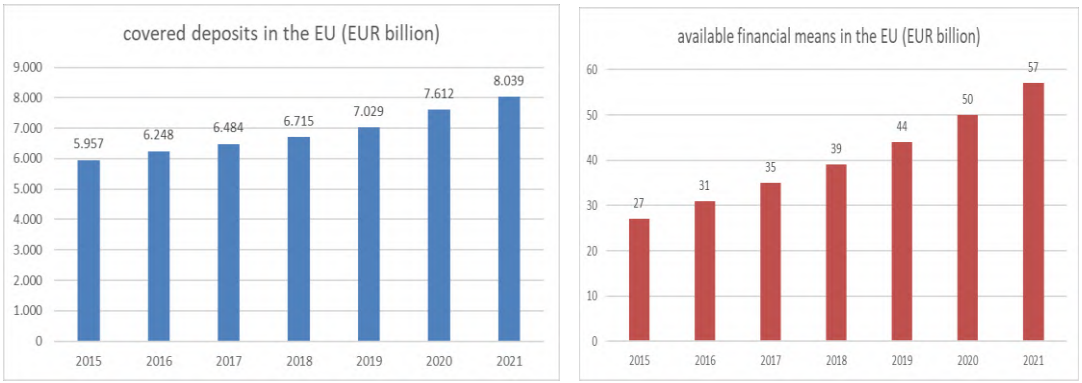
The amount of covered deposits is increasing. By the end of 2021, the target level of 0.8% of all covered deposits in the European Union amounted to EUR 64 bn, though the DGS's available financial means were 0.71% of covered deposits (or EUR 57 bn), a difference which is consistent with the objective set in the Deposit Guarantee Schemes Directive of reaching the target level by July 2024.

[361] SRB *Liability Data Report and related guidance*.

[362] More specifically, these Member States have granted a preferred ranking to eligible deposits of large corporates, in the part exceeding the coverage level of the DGS, and to deposits excluded from repayment by the DGS pursuant to Article 5(1) DGSD, such as deposits held by public authorities, financial sector entities and pension funds.

[363] In the year 2021, the EBA published data for available financial means, make a delineation between "*qualified available financial means"* (QAFM) and "*other available financial means"* (other AFM). The QAFM constitute funds raised directly, or indirectly, from the banks, which count towards reaching the minimum target level of 0.8% of covered deposits. Other AFM constitute funds which have not been contributed by the banks but derive e.g., from taking a commercial loan. These funds do not count towards the target level of 0.8% of covered deposits. Taken together, QAFM and other AFM add-up to the DGS's available financial means. For the years 2015-2020 the EBA data for available financial means did not make such a delineation (see *EBA Deposit Guarantee Schemes data* for more information). As regards 2021, the European Commission calculations, for the purposes of this Annex, are based on the EBA QAFM, which are relevant for the measurement of the target level of 0.8%.

Figure 16: Overview of covered deposits and available financial means in the EU



Source: EBA data and European Commission calculations

Main factors influencing the objective's achievement

Factors influencing performance against objective	**Overall impact on objective**
1) Level of depositor protection across Member States	**Positive** (most of depositors are fully covered)
2) Harmonised rules for depositors across Member States	**Mainly positive** (there are still discrepancies in depositors protection among Member States)
3) DGS contribution in resolution	**Negative** (never used)
4) Robustness of DGS funds	**Mainly negative** (vulnerability to large shocks, lack of EDIS)

7.1.4.1. Level of depositor protection across Member States

The level of depositor protection remains high since the entry into force of the DGSD, as most of depositors are fully covered with a coverage level of EUR 100 000. The Commission's impact assessment of 2010 reported that the unweighted average ratio of fully covered depositors to eligible depositors was 95.4% in 2007[364]. According to EBA data of 2017[365], 98.1% of depositors and 61.2% of eligible deposits are fully protected with a coverage level of EUR 100 000 (i.e. the amount of their deposits is lower than

[364] The weighted average ratio in terms of sums deposited i.e. the ratio of the amount of covered deposits to eligible deposits was 71.8% in 2007.
[365] EBA Opinion on 'the eligibility of deposits, coverage level and cooperation between deposit guarantee schemes' (p. 37).

EUR 100 000). Moreover, JRC's quantitative analysis[366] showed that the coverage levels of the temporary high balances allow protecting a very large percentage of depositors' wealth. In almost all Member States, the coverage level for temporary high balances allows protecting more than 95% of depositors' wealth.

7.1.4.2. Harmonised rules for depositors across Member States

As set out in Annex 6, despite improved depositor confidence, the experience with the framework so far has also shown some weaknesses. A lack of clear and consistent rules in the DGSD as well as certain flexibility for national interpretation/ discretion/ transposition of the rules seems to lead to discrepancies and coverage issues when it comes to depositor protection across the EU.

In terms of scope of protection, the coverage level for THBs varies between Member States from EUR 200 000 to an unlimited amount. While practical experience on this matter has only been recorded in two Member States, it is estimated that up to 10% of covered deposits[367] are impacted by this non-harmonised approach.

Consequently, depositors enjoy different levels and types of guarantees depending on their location, leading to inconsistent access to financial safety nets for EU depositors. Other ONDs lead to discrepancies in depositor protection. For instance, small public authorities and agencies distinct from the government could be protected in some Member States, but not across the EU. Similarly, clients whose funds are held through the intermediary of non-bank financial institutions as payment or e-money service providers may be covered only in some Member States.

In addition, the level playing field varies among Member States due to differences in the implementation of the alternative funding arrangements. Some Member States put in place concrete alternative funding arrangements, while other Member States did not. This lack of additional resources to rely on in case the DGS were depleted could impact the ability to payout depositors and endanger consumer confidence and financial stability.

Furthermore, some Member States transposed Articles 11(3) and/or 11(6) DGSD, while others did not. As mentioned earlier in Section 7.1.3.3, nine Member States transposed Article 11(3) DGSD allowing financing measures to prevent the failure of credit institutions. Moreover, 11 Member States transposed Article 11(6) DGSD allowing financing alternative measure to payout aiming at preserving the access to covered deposits. These measures allow to use DGS funds to prevent the failure of the banks or to finance alternative measure to payout respectively. The implementation of these options may create unlevel playing field. Some DGSs could be more cost-effective as transferring the bank to a buyer in case of alternative measure would preserve the franchise value better than by selling assets in a piecemeal approach. Following the same logic, preventive measures could minimise the costs for the DGS even more than when the FOLF/insolvency trigger is reached as a result of higher losses. These differences in

[366] See JRC report on THB's (Annex 12) and Annex 6 of this impact assessment on DGSD review related matters.
[367] Source: CEPS study.

tools available could also lead to efficiency discrepancies among Member States (see Section 7.2 on efficiency).

Another issue of consistency is related to the DGSD conditions associated with the application of preventive and alternative measures, which are unclear and differently interpreted among Member States[368]. Regarding the alternative measures, Article 11(6) DGSD provides that "*the costs borne by the DGS do not exceed the net amount of compensating covered depositors at the credit institution concerned"*. This least cost test aims at comparing for the DGS, the cost of a payout with the cost of the alternative measure. The less costly measure must be applied. However, Member States use different methods in calculating this least cost test. For instance, some Member States include indirect costs like potential cost for the banking sector, opportunity cost for the DGS, impact on depositors' confidence in calculating the cost of a payout. By contrast, other Member States use a stricter method, only including direct costs (costs related to the liquidation and payout process). As regards preventive measures, Article 11(3)(c) DGSD provides that "*the costs of the measures do not exceed the costs of fulfilling the statutory or contractual mandate of the DGS*". Some Member States use the same least cost test for both preventive and alternative measures, while other Member States did not develop a least cost test methodology in case of preventive measure, considering that comparing the cost of the preventive measure with the cost of a payout is not relevant as no insolvency proceeding is expected.

7.1.4.3. DGS contribution in resolution

Under the existing CMDI framework, the main sources of funding in resolution, are the bank's own liabilities, which have to contribute through a minimum amount of bail-in (8% of TLOF) before external funding in the form of the SRF under the SRM for the Banking Union and national resolution funds for non-Banking Union Member States may contribute to the resolution cost. DGS funding is a complementary source of funds in resolution: in order to guarantee access to deposits in case of bank resolution, the CMDI framework requires that national DGS contribute funds to finance certain resolution actions and for alternative measures to depositor payouts in insolvency[369]. The exact calibration of the amount depends on the used resolution tool.

Although the use of DGSs is foreseen in the existing framework, the access conditions seem to prevent this because of the current methodology used to calculate the least cost test and/or their super-preference in the creditor hierarchy[370]. Moreover, the funds available in national DGSs are limited and, so far, the shortfall in available means often required additional financing by the public budget. As a result, this instrument has so far never been used.

[368] For more details see also Annex 6 of the impact assessment.
[369] This possibility is currently available as a national option under the DGSD enabling the DGS to finance alternative measures in insolvency.
[370] For more details see also Annex 6 of the impact assessment.

7.1.4.4.Robustness of DGS funds

Member States are steadily building up their DGS means to reach 0.8% of total covered deposits by 2024 as provided for by the DGSD. Through their nature, DGS funds are intrinsically linked to the contribution capacity of banks in their jurisdiction. This, notwithstanding a significant crisis, may put under stress a national DGS, making it difficult to settle individual depositor claims within the statutory time or to intervene through another measure than payout. In such situations, a DGS may find it difficult and pro-cyclical to call upon *ex post* contributions from its members to make up for the shortfall. The next course of action available to the DGS would be to seek funding from alternative arrangements pursuant to DGSD, which could include private or public sources. Ultimately, the sovereign gives an explicit or implicit backing to the DGS and it acts as ultimate guarantor to national DGSs.

DGS funds continuously increased over the past years. In terms of available financial means, the volume rose from EUR 26.7 bn in 2015 to around EUR 57 bn at the end of 2021[371]. Yet, they remain vulnerable to asymmetric shocks, as deposit guarantee schemes are organised at national level and no EDIS is in place. In recent years, some national DGSs faced important funding needs, representing a significant share of their available financial needs. The latter demonstrates that the risk of bank failures is relevant for all institutions, from large to small and that payout is cash consuming for the DGS, even though the final loss could be limited at the end of the insolvency proceedings.

Box 14: Impacts of covered deposit payouts in insolvency on the DGS robustness

In 2018, the failure of ABLV Bank depleted the Latvian DGS' available financial means by 312%, while the payout event in 2020 for Commerzial Bank Mattersburg im Burgenland AG's failure costed an equivalent of 72% of the available financial means of the respective Austrian DGS. In Italy, one DGS intervention in 2020 amounted to 67% of the available financial means of the involved DGS. In Germany, the cost in the NordLB case amounted to 21% of the available financial means of the DGS related to the saving banks. Some of these interventions led to an increase in *ex post* contributions raised from the banking sectors, to avoid reducing the financial capacity of the DGS for a lengthy period of time and to reach the target level by 2024. Similarly, and more recently, the payout in the Greensill Bank case caused in 2021 a loss of 31% of the available financial means of the respective German DGS and the payout in the Sberbank failure amounted to an equivalent of 211% of the respective Austrian DGS's available financial means. These examples clearly show that failing smaller and medium-sized banks have material impacts on the DGS robustness, even during a period without systemic financial trouble.

More generally, the ECB's occasional paper advocating for DGS' intervention in transfers of assets[372] shows that 261 banks, banking groups or hosted subsidiaries in the

[371] *EBA Deposit Guarantee Schemes data* and European Commission calculations.
[372] ECB (October 2022), *Protecting depositors and saving money - why DGS in the EU should be able to support transfers of assets and liabilities when a bank fails*.

Banking Union could individually deplete their fully-filled DGSs with a single covered deposits payout event in insolvency. While 129 of these banks are significant institutions likely to involve resolution rather than a depositor payout in insolvency, the 132 remaining are less significant institutions or their hosted subsidiaries, which also have covered deposits exceeding the target level of their DGSs.

The above also recalls one of the lessons of the euro area sovereign debt crisis from 2011/12 to weaken the link between banks and their national sovereign. A strong bank-sovereign nexus may create risks to financial stability through contagion and negative consequences for the single market. A decade later, the continued reliance by national DGSs on the State as a buffer for depositor protection is a source of vulnerability that needs to be addressed.

Where the payout ability of one national DGS could be impaired under a severe crisis, mutualising resources would optimise the allocation of financial means where the funding needs arise, significantly increasing the efficiency of the scheme. Based on available evidence[373], in case of a crisis similar to the 2008 one, the probability that some depositors would not be fully reimbursed in at least one Member State is 87%.[374] The analysis also showed that mutualising resources (at least partially) reduces the probability of not being able to reimburse some depositors in case of crisis by 80%-90%. The more resources are mutualised, the more effective the system is.

The lack of EDIS may also trigger movements in deposit location. For instance, under a severe crisis in one bank or Member State, depositors could be enticed to transfer their funds in another bank or even another country. Such practices may exacerbate the financial difficulties of one bank or one national banking sector. One of the key principles of EDIS is to provide a similar guarantee to depositors regardless of the institution and their location, which means that depositors would not need to withdraw/ transfer their deposits, even under a severe crisis, contributing to stabilising the financial situation.

The robustness of the DGS funds also relies on the investment policy. The DGS financial means must be invested in a low-risk and sufficiently diversified manner (Article 10(7) DGSD). For many DGSs, the investment policy leads to a very large exposure to their sovereign. According to the EBA opinion on the uses of DGS funds[375], nine Member States reported that DGS funds are invested exclusively, or to a large extent, in national debt. Moreover, the DGSD transposition checks revealed that, in three Member States, the DGS deposited its available financial means (at least part of them) in an account in the national budget or Treasury. These practices may strengthen the links between the DGS and their sovereign. The DGSs that have invested most of their financial means in national debt, could suffer a decrease of their available financial means in case the sovereign bonds market is under pressure. In those Member States where DGS available

[373] See also Annex 10 of the impact assessment – section "Establishment of a common scheme for liquidity support".
[374] However, in some cases, the amount of covered deposits that cannot be reimbursed are very low.
[375] *EBA opinion* on DGS funding and uses of DGS funds (p. 103).

financial means are integrated into their national budget, a payout, following a bank failure, would require the national treasury to issue sovereign bonds on financial markets in order to fund the DGS, maintaining the sovereign-bank loop.

Lastly, the robustness of the DGS funds also relies on the available sources of funding which are raised yearly and *ex post* contributions and alternative funding arrangements. The latter take the form of loans from the private sector in case the available financial means of the DGS are insufficient. The DGSD conformity checks showed that some Member States did not put in place concrete alternative funding arrangements. The EBA opinion on DGS funding and DGS funds also highlights that in nine Member States, there is no concrete alternative funding arrangement in place[376]. In the absence of EDIS, this could also compromise the ability of the DGS to reimburse depositors when its financial means are depleted, at the risk of financial stability and depositors' confidence.

7.2. Efficiency

How efficient has the EU intervention been? To what extent have the rules regarding the recovery and orderly resolution of banks under the BRRD/SRMR and the ones regarding depositor protection under the DGSD been cost-effective? Are there significant differences in costs or benefits between Member States and what is causing them?

Summary assessment:

The evaluation found that the CMDI framework is not sufficiently cost-effective.

On one hand, the main benefits of the framework include enhanced crisis preparedness, contingency planning and the disciplining influence that the existence of the framework exerts on banks and markets (i.e. through the creation of powers, loss absorption requirements, resolvability requirements, reporting and more transparency and disclosure, EU-wide DGSs). However, some of these benefits remain rather theoretical, as the contingency planning measures, on several occasions, were not implemented and alternatives to resolution were followed.

On the other hand, the implementation and operationalisation of the CMDI framework came with significant costs for the banking industry, Member States, resolution authorities. Yet despite the costs, the framework and its tools and powers have been scarcely used in practice, especially in the Banking Union under the SRMR. In addition, the use of public funding in recent cases of bank failures indicates a redistribution of costs from banks' senior unsecured creditors to the taxpayers, despite scrutiny on such usage of public funds through the EU State aid rules. As taxpayers continue to bear the cost of bank failures, contributions raised from the industry for the same purpose remain idle. Furthermore, available evidence suggests that these costs are uneven between Member States, as national requirements and practices diverge widely.

[376] *EBA opinion* on DGS funding on uses of DGS funds (p. 44).

7.2.1. Benefits of the framework

An accurate quantification of benefits generated by the implementation of the CMDI framework is very challenging as it cannot be disentangled from other prudential policies (e.g. Basel III), macroeconomic measures and central bank monetary policies which were pursued in parallel with the implementation of the framework, following the global financial crisis. Besides this complexity, many bank failures were handled using powers, tools and funding outside of the resolution framework.

However, evidence by resolution authorities and the EBA, stakeholder feedback to our consultations and the FSB's *Too big to fail report* show some positive impacts of the framework in reducing risks to financial stability, "too big to fail" and moral hazard on one hand, and increasing market discipline, level of preparedness, resolvability and crisis contingency planning on the other hand. In addition, some of these impacts can be expected to be further supported by the fact that banks have been building their loss absorbing capacity over the last few years. Moreover, depositors have been protected and the society's access to critical banking services preserved.

The main benefits of the framework are linked to the disciplining effects that the existence of the framework had on banks and markets (i.e. through the creation of powers, loss absorption requirements, resolvability requirements, reporting and more transparency and disclosure, EU-wide DGSs). Yet, these benefits remain difficult to disentangle and challenging to attribute directly to the application of the framework.

7.2.2. Costs of the framework

The implementation of the CMDI rules did not come without costs for the industry, authorities, Member States and citizens.

7.2.2.1. Creation and set-up of new resolution authorities

First, the BRRD and SRMR mandated the creation and operationalisation of resolution authorities in each Member State as well as the creation of the SRB as the central resolution authority in the Banking Union. While there may have been some cost synergies in creating the resolution authorities in Member States, especially in relation to already existing supervisory and financial stability teams in central banks, the SRB had to be created from scratch. The SRB's annual budget for administrative expenses is funded through *ex ante* industry contribution in accordance with the SRMR and Commission Delegated Regulation (EU) 2017/2361[377]. According to the SRB's budget for 2022[378], the amount for the administrative contributions by the industry is budgeted to EUR 120.4 m (up from EUR 119 m in 2021). The cumulative administrative costs of the SRB, from 2014 to 2020, can be approximated from the administrative contributions raised by the SRB over the same period, which amount to EUR 479 m[379]. The 2022 establishment plan

[377] Commission Delegated Regulation (EU) 2017/2361 on the final system of contributions to the administrative expenditures of the Single Resolution Board.
[378] SRB (September 2021), *Budget 2022*.
[379] SRB, *Administrative Contributions*.

included in the budget showed a budgeted headcount of 450 employees, which is same as in 2020 and up from 400 in 2021[380].

7.2.2.2. Contributions to resolution financing arrangements

Second, in order to finance resolution actions, the framework created national resolution funds in each Member State (Article 100 BRRD) and the SRF in the Banking Union (Article 70 SRMR). The resolution funds must reach at least 1% of the amount of covered deposits of all credit institutions authorised in the participating Member States by 31 December 2023. Banks pay yearly contributions towards such target. Resolution authorities are responsible for the calculation of *ex ante* contributions by applying the methodology set out in the Commission Delegated Regulation (EU) No 2015/63 and the Council Implementing Regulation (EU) No 2015/81, which guarantees a level playing field among Member States. In the Banking Union, there is a system of transfers from the national resolution funds to the SRF combined with mutualisation at the level of the latter Fund, whereby the national resolution authorities are responsible for the collection of *ex ante* industry contributions and for transferring these into the SRF. During the eight year initial period (2016 – 2023), contributions raised at national level and transferred to the SRF are allocated to national compartments corresponding to each participating Member State. All national compartments will be merged and cease to exist at the end of the eight year initial period[381].

Table 2: 2021 situation of national compartments of the resolution funds (EUR bn)

	Current size of national compartment
AT	1,50
BE	1,96
CY	0,13
DE	13,73
EE	0,05
EL	0,58
ES	5,35
FI	1,08
FR	15,43
IE	0,84
IT	5,23
LT	0,05
LU	0,90
LV	0,04
MT	0,05
NL	4,28
PT	0,79
SI	0,07
SK	0,15
BG	0,10
HR	0,11
Total	**52,43**

Source: SRB data, 2021 compartments, data as of 14 July 2021. Figures are in EUR bn and rounded.

[380] Data on the related costs for the NRAs and the national DGSs are not available. For national DGSs under public governance and NRAs the budgeted headcounts are usually integrated in the budgets of national central banks or other financial market authorities.

[381] Council of the European Union (May 2014), *Intergovernmental Agreement on the transfer and mutualisation of contributions to the Single Resolution Fund* (IGA).

Between 2016 and 2021, banks in the Banking Union contributed a total of EUR 52 bn for the financing of this safety net. Since this target is defined by reference to the level of covered deposits, it is dynamic, and as the latter have been growing more than anticipated in the last couple of years, the yearly contributions by the industry are increasing (i.e. as per the SRB's 2022 budget, it expects to collect EUR 11.2 bn in the SRF in 2021, compared with EUR 10.4 bn collected in 2021). Where the available financial means of the resolution funds/ SRF are not sufficient to cover the losses, costs or other expenses incurred by their use in resolution actions, extraordinary *ex post* contributions may be raised in addition.[382]

In a similar way, banks have also contributed to the funding of national DGS. Between 2015 and 2021, the contributions from the banks in the EU amounted to EUR 30.2 bn. Consequently, the available financial means increased from EUR 26.7 bn to around EUR 57 bn. It should be noted that the costs of depositor protection for the banking sectors are higher than expected: the target level (i.e. 0.8% to be reached by 2024) is defined as a percentage of the covered deposits, which have increased significantly over the past years (from EUR 5 957 bn to EUR 8 039 bn between 2015 and 2021). Based on the amount of covered deposits at end 2021 (EUR 8 039 bn but this amount is likely to increase), the expected contributions amount to EUR 7.3 bn in order to reach the target level by 2024.

Table 3: Situation of available financial means in the DGSs of EU Member States (2021)

	Current level of available financial means in EU Member States
AT	1.08
BE	4.65
BG	0.75
CY	0.17
CZ	1.50
DE	12.15
DK	1.20
EE	0.27
EL	1.65
ES	5.27
FI	1.34
FR	5.84
HU	0.24
HR	0.75
IE	0.71
IT	3.22
LT	0.15
LU	0,29
LV	0.17
MT	0.15
NL	3.19
PL	4.07
PT	1.67
RO	1.38
SE	4.66
SI	0.12
SK	0.30
Total	**56.9**

Source: EBA data and European Commission own calculations, figures are in EUR bn and rounded.

[382] Article 105 BRRD.

7.2.2.3. Costs of enhancing resolvability (MREL issuance, reporting, internal projects geared towards resolvability)

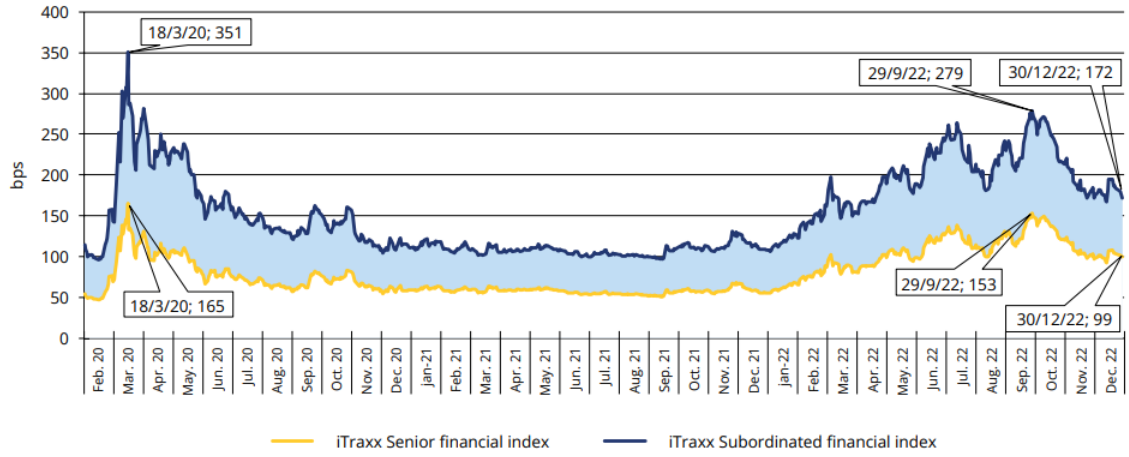
The framework sets out the methodology for the setting up of the MREL on a on a bank by bank basis. The BRRD/SRMR (Art 45b, 12c respectively) specify also the subordinated MREL requirements, which ensure the build-up of a layer of instruments which rank junior in the hierarchy of claims and can, therefore, absorb losses with greater certainty in resolution.

Issuing MREL eligible instruments[383] bears a cost for the industry. Prior to the obligation to hold MREL capacity, banks were funding their activity by issuing mainly senior secured/unsecured debt on the markets or through deposits. With the implementation of the MREL requirement, they must ensure compliance with the MREL eligibility criteria, including, where relevant, subordination. Therefore, one way to approximate MREL-related costs could be through the spread differential between ordinary secured/unsecured debt and MREL eligible liabilities. The spread differential between subordinated and senior instruments issued by banks (the former carrying higher issuing costs) reflects, among other things, the risk assessment by investors. Such an assessment is inherently affected by the prevailing market conditions such as the current low level of interest rate. Looking forward, in view of the continuous roll-over needs to maintain compliance with the requirements it is difficult to forecast the overall burden in terms of funding cost and assess their long-term sustainability or possible impact on the funding structure.

While the cost of MREL debt increased significantly in the first quarter of 2020 on the backdrop of the COVID-19 crisis, it stabilised in Q3 2020 and approached pre-pandemic levels since January 2021. As shown in the SRB MREL Dashboard for Q3 2022, the iTraxx indexes on subordinated and senior financial debt showed for some time a stable trend over the period and a tight spread. As depicted in the next figure, as of Q2 2021 the subordinated debt and senior debt index were 1.1 and 1.2 times pre-COVID-19 levels, respectively, although the recent trend was negatively impacted by the volatile and uncertain environment linked to geopolitical tensions and inflationary pressures.

[383] For a comprehensive view of information related to MREL issuances please refer to Annex 13, section 5 of the impact assessment.

Figure 17: ITraxx Europe Financials (SRB dashboard, data until Q3 2022)



Source: SRB MREL dashboard Q3 2022

Beyond the costs of issuing MREL instruments, banks are also bearing costs associated with the reporting of extensive information to resolution authorities for the preparation or update of annual resolution plans, MREL calibration and for implementing internal projects to remove impediments to resolvability. Banks are subject to legal resolution-related reporting requirements whereby they must provide data in adequate format at pre-defined cut-off dates. In addition to these established reporting requirements, resolution authorities have the power to request ad-hoc data from banks, as considered relevant and needed for carrying out their activity. The Commission's fitness check on supervisory reporting, which spanned several legal instruments, found that, in 2017, the costs associated with reporting of information and potential overlaps among reporting requirements was on average about 30% of total compliance costs or 1% of the annual operating costs for a sample of regulated entities[384].

Other types of costs borne by banks are associated with internal projects aimed at enhancing their resolvability. Examples of such projects include but are not limited to: upgrading management information systems (MIS) in order to enable the gathering of information in a timely fashion to sustain a speedy valuation and other data reporting to resolution authorities in case of, or in the run up to, resolution; implementing additional reporting to monitor liquidity needs (inflow, outflows by counterparty, currency, cross border, etc.); removing impediments to resolvability, for example by ensuring separability of certain critical functions or business centres or entities, divesting certain business lines, setting-up a holding company on top of the operating bank, transforming subsidiaries into branches, or other structural changes that bear important costs.

Such costs may be difficult to quantify and potentially disentangle from other internal projects implemented by banks, such as in the context of implementing digitalisation strategies, or operational efficiency and in the absence of a comprehensive survey across all EU banks.

[384] European Commission (November 2019) *Commission staff working document – Fitness check of EU Supervisory reporting requirements*.

7.2.2.4. Costs for taxpayers

As illustrated in section 7.1.2.1, available evidence show that the use of significant amounts of public money from State budget has been necessary to manage past cases of distressed banks. In this context, we could also speak of a potential redistribution of costs away from the banks' senior unsecured creditors who hold financial claims against the banks, to taxpayers who did not have such financial claims. At the same time, some of the safety nets financed by the industry (SRF/RF, DGS) remained sometimes idle. This means that the implementation of the framework has not yet triggered a full mentality shift from bail-out to bail-in, putting a burden on public finances, and that certain aspects, such as enhancing access to funding solutions within the resolution framework, should be reviewed, so as to further reduce recourse to the public budget and ultimately the cost to the taxpayers.

7.2.2.5. Mutualising national resources of DGS

DGS are managed at national level. This means, that national deposits are covered by national resources. The JRC quantitative analysis on various depositors protection designs[385] highlighted that mutualising resources creates synergies that could be exploited to reduce the target level. Indeed, when mutualising resources, it would be possible to maintain (or even increase) the current level of depositors' protection with a lower target level (i.e. lower contributions from the banking sectors). The more resources are mutualised the lower the target level could be. Consequently, the cost-effectiveness of the system is suboptimal and could considerably be improved[386].

7.2.2.6. Other measures than payout could lead to a better cost-effectiveness for the DGS

The DGSD allows financing other measures than payout (preventive and alternative measures) that could be more cost-effective. Indeed, transferring the bank to a buyer in case of alternative measure would preserve the franchise value better than by selling assets in a piecemeal approach, thereby minimising the cost for the DGS. Following the same logic, preventive measures could minimise the costs for the DGS even more than when the FOLF/insolvency trigger is reached as a result of higher losses.

Even though it is very challenging to calculate the gain of efficiency resulting from alternative and preventive measures, the EBA analysed data regarding four preventive measures that tend to confirm the cost-effectiveness of measures other than payout. For three preventive measures, the national DGS compared the cost of liquidating the bank with the cost of the preventive measure.

[385] JRC presentation on 'measuring the effectiveness and the pooling effect of EDIS (CWP of 2 February 2021, slide 15).
[386] See also Annex 10 of the impact assessment– section "Establishment of a common scheme for liquidity support"

Box 15: Extract EBA analysis of impact of three preventive measures on DGS

For bank 1, the cost of liquidating the bank was estimated at 32% of the bank's covered deposits, while the cost of the preventive measure amounted to 31%.

For bank 2, the cost of the liquidation was estimated at 22% of covered deposits, while the cost of the preventive measure amounted to 3% of covered deposits.

For bank 3, the cost of the liquidation was estimated between 4 and 9% of covered deposits, while the cost of the preventive measure amounted to 3% of covered deposits.

Even though these numbers have to be interpreted cautiously as they are based on national data and methodologies not harmonised at the European level, they indicate that allowing the DGS to finance other measures than payout could be efficient.

7.2.2.7. Differences in benefits and costs among Member States

The benefits arising from increased crisis preparedness and contingency planning, more resolvable banks and reduced moral hazard are equally shared among Member States. However, the incidence of costs varies greatly, mainly because the incentives not to apply resolution in favour of national insolvency proceedings are Member State-specific. They are enabled by the particular set-up of the national insolvency regimes, tools and funding sources available to deal with failures outside the EU resolution framework.

As shown in Annex 9 of the impact assessment, since the application of the CMDI framework in 2015, measures other than resolution (precautionary measures, preventive measures and national insolvency proceedings) have been applied to more than 60% of cases of distressed banks. The public aid resulting from these operations amounted to EUR 58.2 bn (of which EUR 28.1 was for liquidity purposes), not counting the amounts spent by national DGSs or public budgets on preventive measures qualified as private or market-conform public measures (which do not constitute State aid).

7.3. Relevance

How relevant is the EU intervention? To what extent are the rules still relevant and how well do the original objectives of the legal instruments correspond to the current needs within the EU? To what extent do the risks to financial stability stemming from bank crises continue to require action at EU level? Have new challenges arisen which were not existent at the time of introduction of the CMDI framework and which need to be tackled by the framework? How is the absence of a common guarantee scheme for depositors, in the Banking Union, such as EDIS affect the relevance of the framework?

Summary assessment:

Despite certain important problems identified in this evaluation that need to be addressed in the legislative review, the relevance of the CMDI framework remains intact. The evaluation found that the initial policy objectives of protecting financial stability, reducing the burden on public finances, increasing level playing field in the single market and protecting depositors remain valid. In particular, the rationale for completing the Banking Union and implementing its third missing pillar, a common guarantee for depositors is still valid. The addition of a mutualised safety net such as EDIS would further boost the framework's relevance.

The CMDI framework represents one of the EU's key responses to the global financial crisis from 2008 and continues to remain very relevant also in today's context.

Since its implementation, banks and resolution authorities are better prepared and equipped to deal with crises. Contingency plans are drawn (recovery and resolution plans) and resolvability assessment cycles carried out each year. Banks have become more resolvable and are in the process of raising resolution buffers to secure sufficient internal loss-absorbing capacity and reduce the likelihood of recourse to taxpayer money. Compared to the period following the global financial crisis, the number of failing banks has decreased substantially since the implementation of the rules in 2015: Between 2007 and (December) 2014, 112 European banking institutions were subject to restructuring or orderly resolution with State aid support[387], while since the entry into force of the resolution framework, in 2015, the number of distressed banks in need of an intervention (including precautionary measures or preventive private or market conform public measures) fell to 33. While this positive outcome cannot be solely attributed to the CMDI framework (as also other measures have been enacted approximately at the same time, such as the CRR/CRD, EMIR) it nevertheless contributed to maintaining financial stability and changing banks' behaviours in a way that is more closely aligned to social objectives.

The DGSD improved depositors' protection and the level playing field. Depositors are better-informed about their level of protection and the payout process in their Member State, which enhances their confidence in the banking system. The introduction of the risk-based contributions improved the level playing field, as the banks contribute to the DGS funds based on their risk profile. Even though the methodology for calculating the risk-based contributions is not fully harmonised among Member States, it is framed by an EBA guideline, which aims to ensure some level of convergence.

Yet, the implementation of the CMDI framework is not yet complete. The 2019 Banking package is being implemented and operationalised, related level-2 measures are being finalised and the transitional period for banks to comply with their MREL buffers runs

[387] European Commission (February 2015) *Competition policy brief* - State aid to European banks: returning to viability.

until 2024. The RF/SRF and DGS funds are also expected to reach their target level by 2024, as well as a common backstop to the SRF to be provided by the ESM.

Despite certain important problems identified in this evaluation that need to be addressed in the legislative review, the relevance of the framework remains intact. The initial policy objectives of protecting financial stability, reducing the burden on public finances, increasing level playing field in the single market and protecting depositors remain valid (see also Chapter 6 of this Evaluation, *Section* "*State of play of the common deposit guarantee scheme in the Banking Union"*).

The COVID-19 shock struck European economies at a time when the Banking Union is still incomplete. As its impact may be increasingly felt, the COVID-19 crisis may put to the test the viability of the post-financial crisis framework and exacerbate the pre-existing challenges and vulnerabilities of the banking sector. Judging by the data available to date, the increase in the resilience of the sector, combined with the flexibility provided by supervisors and regulators to banks has helped them be part of the solution to the crisis and continue financing households and businesses, albeit at a declining rate following the start of the pandemic.

7.4. Coherence

How coherent is the EU intervention? To what extent are rules on the recovery and resolution of banks and depositor protection in the BRRD/SRMR/DGSD coherent as a framework, but also with provisions in other pieces of relevant legislation or communications?

Summary assessment:

This evaluation assessed the overall internal coherence of the framework (BRRD/SRMR/DGSD), as well as its coherence with provisions in other pieces of relevant legislation or Communication, in particular, State aid rules, national insolvency rules, the Capital Requirements Directive (CRD), AML Directive, and Payment services and e-money Directives.

Regarding internal coherence, the evaluation found that there is room for improvement, in particular as regards certain important BRRD provisions, such as the EIMs that are not replicated in the SRMR. Internal inconsistency issues are also found to be present, as regards provisions in the BRRD and DGSD concerning the access to DGS funding for distressed banks, as well as, in the misalignment between control and liability, i.e. the centralised SRM governance architecture *versus* the national funding of measures respectively.

Regarding coherence with provisions in other pieces of relevant legislation or Communication, the evaluation found that there is also scope for improvement, notably *vis-à-vis*: (i) the State aid rules in what concerns the conditions to access funding to support tools outside resolution; (ii) the interaction between national insolvency features and resolution, in particular with respect to triggers and hierarchy of claims and strengthening predictability and legal clarity in cross-border cases; (iii) the coherence with the CRD/SSMR, in particularly with regard to early intervention measures; (iv) the AMLD, in particularly with regard to clarifying the roles and responsibilities of the DGS and other stakeholders (insolvency practitioner, Financial Intelligence Unit, failed institution) during a payout and strengthening their cooperation and exchange of information; and (v) the Payment services and e-money Directives, and their interaction with the DGSD, in particularly with regard to strengthening the protection by the DGSs of client funds held by non-bank financial institutions such as payment and e-money institutions or investment firms, which varies from one Member State.

7.4.1. Internal coherence: BRRD/SRMR/DGSD

The provisions constituting the three pieces of legislation evaluated are strongly inter-related, which makes their coherence key in the overall functioning of the framework.

First, when assessing the internal coherence between the BRRD and SRMR, it is important to note the intention behind their closely linked construction. The BRRD created a harmonised recovery and resolution framework for the Union, applicable in all Member States through transposition of the respective rules in the national laws and regulations. The SRMR, in addition to creating the SRB and the SRF, laid down uniform rules and procedures for the resolution of the entities established in euro area Member States and in Member States, which chose to join the Banking Union. The SRMR, which adapts the rules and principles of BRRD to the specificities of the SRM, is directly applicable in those participating Member States. While many BRRD provisions have an equivalence in the SRMR, particularly where needed for the purposes of granting specific powers to the SRB, not all BRRD provisions were replicated in the SRMR. Those BRRD

provisions, as transposed by Member States, continue to be applicable in so far as they do not conflict with the SRMR.

However, certain provisions are only found in the BRRD and applicable through national transposition. The EIM is an example of such a set of such provisions. As described under the effectiveness criterion (under the third objective), the choice for the legal implementation of these provisions and the close interaction with CRD provisions on supervisory powers are not conducive to a coherent application.

Second, the coherence between the BRRD/SRMR and the DGSD has also been evaluated. As described under the effectiveness criteria, the coherence issues relate to: insufficiently clear conditions to access DGS funding in resolution as per Article 109 BRRD, inconsistent access conditions to DGS funding as preventive measures and national insolvency proceedings, where feasible, under Articles 11(3) and 11(6) DGSD respectively.

Another potential incoherence between the resolution and depositor protection legislation is due a misalignment between control and liability, i.e. the centralised SRM governance architecture *versus* the national funding of measures respectively. The application of the CMDI rules in the Banking Union led in the past to situations where the SRB decided that the resolution of the bank was not in the public interest (by delivering a negative PIA), triggering its entry into insolvency and with support from funding at national level (DGS payout or alternative measures). Such a nationalisation of measures in the Banking Union would be mitigated by the existence of a central mutualised fund such as EDIS. The lack of EDIS contributes therefore to weakening the coherence within the framework, as potentially insufficient DGS funds at national level are unlikely to address the need for solid and reliable contributions to resolution funding under BRRD/SRMR.

7.4.2. Coherence with the 2013 Banking Communication (State aid rules)

As shown also in section 7.1.2.3, the coherence between the CMDI framework and the State aid rules could be further improved, most prominently in what concerns conditions to access funding to support tools outside resolution. The focus should be on avoiding unwanted divergences with access to funding in resolution, to avoid risks of moral hazard and promote a more consistent approach to the management of bank failures, including in terms of increased level playing field at EU level. A separate process to assess the need for a review of the State aid rules will be ongoing in parallel to the review of the CMDI framework.[388]

7.4.3. Coherence with national insolvency regimes

As described in section 7.1.3.5, the coherence between the CMDI framework and national insolvency regimes could also benefit from further improvements. Some specific areas include the interaction between national insolvency features and resolution, in particular with respect to triggers. The legal "limbo" situation that may occur in practice could be mitigated.

[388] See section 5.2 in chapter 5 of the impact assessment.

Moreover, the problems identified around the lack of legal certainty in cross-border cases due to NCWO and different hierarchies of claims (for deposits, exclusions from bail-in) also need to be addressed in the legislative review.

7.4.4. Coherence with prudential rules (Capital requirements Directive (CRD)/ Single Supervisory Mechanism Regulation (SSMR))

As mentioned in section 7.1.1.3, the coherence between the CMDI framework and the CRD in respect of the early intervention measures merits further improvement. The overlap between the two set of early intervention powers in the BRRD and the CRD/SSMR creates legal uncertainty and procedural challenges for competent authorities. This issue was further flagged by the F4F Platform in its opinion on the CMDI Review, which called for improvements in this area[389].Also, with respect to the Banking Union, the provisions on early intervention powers contained in the BRRD are not replicated in a uniform and directly applicable legal basis, i.e. their application by competent authorities may hinge on potentially diverging national transposition measures.

7.4.5. Coherence between the DGSD and Anti-money laundering Directive (AMLD)

As regards AML/TF issues, the roles and responsibilities of the DGS and other stakeholders (insolvency practitioner, Financial Intelligence Unit, failed institution, etc.) during a payout are not sufficiently clear[390]. Many Member States underlined that the DGSs may face situations where AML suspicions arise and are concerned about repaying suspicious depositors. They also consider that the DGSs should not be required to carry out AML assessments because they often lack resources, expertise and information.

Consequently, the cooperation and exchanges of information between DGSs, DGS designated authorities and anti-money laundering/counter terrorist financing authorities should be specified. In addition, the tools that could be used if AML concerns arise should also be clarified. The suspension of payout for suspicious depositors could be envisaged in order to give time for further analysis. Yet, the full respect of the fundamental freedoms has to be taken into account, and any withholding of a payout must be based on more than a mere suspicion in order to prevent possible legal challenges by the depositors.

7.4.6. Coherence between the DGSD, payment services and E-money Directives

Payment institutions, e-money institutions and investment firms are required to protect the funds of their clients and have the possibility to do that by placing them in a bank account.

[389] See Annex 2.

[390] In this regard, the EBA opinions of August 2019 on eligibility of deposits, coverage level and cooperation between DGSs and of 23 October 2019 on DGS payouts, highlighted the need for several clarifications of the Union legal framework. On 11 December 2020, the EBA published another opinion on the interplay between the directives on money laundering and terrorist financing (AMLD) and on deposit guarantee schemes (DGSD).

The Payment Services and the E-money Directives contain provisions applicable to protect the client funds held by payment and e-money institutions. Article 10 of the Payment Services Directive regulates the safeguarding requirements for payment institutions. Under this provision, the latter shall safeguard the funds received from the payment service users for the execution of payment transaction either by depositing them in a separate account in a credit institution, by investing in secure liquid low-risk assets or covering by an insurance policy. Similar safeguarding requirements apply to e-money institutions. Investment firms are required to place promptly the received client funds into an account opened with a credit institution, unless they choose a different way to safeguard the funds. However, the protection by the DGSs of these client funds held by non-bank financial institutions such as payment and e-money institutions or investment firms varies from one Member State to another.

The DGS protects persons that are absolutely entitled to the sums held in an account. Article 7(3) DGSD provides that where the depositor is not absolutely entitled to the sums held in an account, the person who is absolutely entitled shall be covered by the DGS provided that such persons have been identified or are identifiable. This provision clearly applies to the beneficiary accounts held for example by notaries. However, Member States do not consistently apply this provision as concerns the client funds of non-bank financial institutions on beneficiary accounts.

This lack of consistent application appears due to other provisions in the regulatory framework. Under Article 5(1)(d) and (e) DGSD, deposits by financial institutions and investment firms are excluded from repayment by a DGS. However, under Article 5(1)(a) DGSD, deposits by credit institutions are excluded from protection when they are 'on their own behalf and for their own account' and 'subject to Article 7(3)'. Under the latter provision, the client funds of credit institutions are eligible for protection. According to recital 29 DGSD, 'electronic money and funds received in exchange for electronic money should not be treated as a deposit and fall outside the scope of the [DGSD]'.

Besides, in view of developments in innovative financial services and required changes in the regulatory framework, their safeguarding is of increasing importance to foster clients' trust towards nonbank financial institutions. The lack of protection by a deposit guarantee scheme (DGS) of such client funds could be critical for depositors and Fintech providers if bank failures occur. The relevant issue was also flagged by the F4F Platform in its opinion on the CMDI Review, which called for improvements in this area[391]. Based on preliminary assessment, the size of client funds of payment and e-money institutions seems to constitute only a small portion of covered deposits[392].

[391] See Annex 2.

[392] Based on information from a limited number of Member States collected in the Commission services' survey of 5 December 2019, the client funds of payment and e-money institutions do not exceed 3% of covered deposits.

7.5. EU added-value

What is the EU-added value of the intervention?

- Compared to the previous national approaches, to what extent have the provisions of CMDI framework (BRRD/SRMR/DGSD) helped improve the functioning of the single market in banking, contributed to financial stability and increasing the level playing field among banks, and consumer confidence taking into account the inherent cross-border nature of banking in the EU;
- How does the gap of the third missing pillar of the Banking Union (common depositor protection) affect the EU-added value of the framework?

Summary assessment:

Overall, the CMDI framework has clear added value by providing a harmonised and comprehensive crisis management framework. In the absence of the framework, national solutions would prevail, impacting the single market in banking and exacerbating risks to financial stability, contagion, uneven playing field as well as worsening the sovereign-bank feedback loop.

The DGSD harmonised the main elements of depositor protection by DGS, which was crucial for maintaining financial stability and promoting depositor confidence across the EU. However, the assessment suggests that a number of discrepancies in depositor protection across Member States (owing to the presence of a range of national options and discretions in the DGSD), are still observed and may need to be tackled, as they could undermine the confidence in the financial safety nets. Nevertheless, the overall outcome in tackling these challenges would still be sub-optimal for the Banking Union in the absence of a mutualised safety net such as EDIS.

The EU-value added of the CMDI framework is undeniable. In a counterfactual where crisis management would be handled purely at national level, all the problems described in this evaluation would be exacerbated and additional issues impacting the single market in banking would emerge. This would have consequences not only from the perspective of risks to financial stability, contagion and unlevel playing field, but also potentially impair business in going concern by cross-border banks, deepening market fragmentation. The issue of unlevel playing field is also present in relation to smaller banks, which may be handled under national insolvency proceedings, subject to a negative PIA. Evidence has shown (see section 7.1.2.3 of the evaluation) that the available national procedures may leave room for arbitrage and incentivise authorities to resort to solutions outside resolution with less stringent conditions to access funding. This creates an unlevel playing field between “purely national banks” and cross-border operating banks that are acting on the same domestic market, but also between Member States in a situation where banks are treated differently or taxpayer money is used in one Member State, while it is not in another. Moreover, national solutions, if left to be used, without proper safeguards, could worsen the sovereign-bank link and undermine the idea behind the Banking Union.

Furthermore, the DGSD covered a gap that existed in legislation (i) by harmonising the coverage, scope and eligibility of depositors, and of payout delays and (ii) by ensuring that credit institutions operating in more than one Member State are subject to the same requirements concerning DGS. In this context EU action is crucial to maintain financial stability, ensure a level playing field, avoid unwarranted compliance costs for cross-border activities and thereby promote further integration within the internal market. Without harmonising the financing of DGS, depositor confidence could not have been maintained. Nevertheless, discrepancies in depositor protection across Member States – for example in terms of the scope of protection and payout processes – are observed and may undermine the confidence in the financial safety nets. These discrepancies emerge from a range of national options and discretions that the DGSD provided for and which were implemented to a different degree.

However, even if addressing all shortcomings of the existing legislative initiatives found by this evaluation, the overall outcome would still be sub-optimal in the absence of EDIS. Having a mutualised safety net, alongside the SRF in the Banking Union would contribute to alleviating in a credible manner some of the problems identified, in particular in the funding solutions, robustness of DGS protection, level playing field and weakening the bank-sovereign loop.

8. CONCLUSIONS AND LESSONS LEARNT

8.1. Conclusions

The evaluation found that the CMDI framework brought benefits to society, in particular through enhanced crisis preparedness and planning, reduced systemic risk and moral hazard, increased market discipline, more resilient banks capable of absorbing losses in case of distress and depositor protection. Yet, significant gaps remain which need to be addressed.

In terms of effectiveness, the framework has partially achieved two out of its four overarching objectives, while the others have not been achieved in a satisfactory manner, except in a limited number of cases. More specifically, the framework partially achieved its objectives of containing risks to financial stability and protecting depositors, but it failed to achieve other key overarching objectives, notably facilitating the functioning of the single market, including by ensuring level playing field, and minimising recourse to taxpayer money. In a significant number of cases, the fulfilment of objectives cannot be directly attributed to the framework, but to the application of tools at national level, outside of resolution and with recourse to public budgets (i.e. taxpayer's funds). The management of bank failures differed across Member States, depending on the existing national regime, which raises questions about the coherence of the framework, resulting in sub-optimal outcomes for level playing field and the single market in banking.

In terms of efficiency, the evaluation found that the CMDI framework is not sufficiently cost-effective. On one hand, the main benefits of the framework include enhanced crisis preparedness, contingency planning and the disciplining influence that the existence of the framework exerts on banks and markets. On the other hand, the implementation and operationalisation of the CMDI framework came with significant costs for the banking industry, Member States, resolution authorities. Yet despite the costs, the resolution

framework and its tools and powers have been scarcely used in practice, especially in the Banking Union under the SRMR. The SRF funding has remained idle so far and beyond the losses absorbed by the banks, DGS funds, often backed by public funds have been used. In addition, the use of public funding in recent cases of bank failures showed a redistribution of costs from banks' senior unsecured creditors to the taxpayers, despite scrutiny on such usage of public funds through the EU State aid rules. Furthermore, available evidence suggests that these costs are uneven between Member States, as national requirements and practices diverge widely.

From a coherence perspective, further improvements are necessary to ensure a better internal interaction and consistency between the various pieces of legislation forming the CMDI framework, but also between the CMDI framework and State aid rules (most prominently in respect of conditions to access funding to support tools outside resolution), the prudential rules (Capital Requirements Directive (CRD) and the Single Supervisory Mechanism (SSMR)) in what concerns the early intervention measures (EIMs), the Anti-Money Laundering Directive (AMLD), the Payment Services Directive and the E-money Directive in what concerns interactions with the DGSD.

The framework remains very relevant and adds EU value because crisis management cannot be left to the unharmonised national proceedings without consequence on public finances, the bank-sovereign nexus, level playing field, proportionality, convergence, equal treatment of stakeholders and operational efficiency of banking operations. This is particularly relevant for cross-border cases but not only. The addition of a mutualised safety net such as EDIS would further boost the framework's relevance and EU-value added.

8.2. Lessons learnt

The following points summarise the lessons learned in this targeted evaluation in terms of the main areas for improvement in the CMDI framework.

The CMDI framework was designed to avert and manage the failure of credit institutions of any size while protecting depositors and taxpayers. This evaluation concludes that the application of the framework brought important benefits in terms of maintaining financial stability, mainly through more robust crisis preparedness and contingency planning, enhanced banks' resolvability, including through the build-up of resolution buffers and pre-funded deposit guarantee and resolution funds, improved market discipline and curbed moral hazard. The implementation of the framework significantly improved depositor protection and contributed to boosting, overall, consumer confidence in the EU banking sector.

Yet, the practical application failed to achieve some important objectives or achieved them only partially. Experience with the application of the EU bank CMDI framework from 2015 until now reveals that there is scope to improve its functioning in the following identified areas for improvement.

Insufficient legal certainty and predictability in the management of bank failures

- The resolution framework introduced strategies, powers and tools to restructure failing banks while protecting depositors, financial stability and tax payers.

However, so far this framework was only scarcely applied, in particular in the Banking Union under the SRMR. Evidence shows that other tools have been more frequently used such as insolvency proceedings involving DGS funds, or precautionary recapitalisation or measures to prevent the failure of the bank altogether.

- The problem is not so much the variety of tools to manage failing banks or to intervene before failure but rather that the conditions to activate such measures vary substantially, are sometimes not fully clear or leave room for arbitrage. In addition, when external funding is used to support such measures, the requirements to access such funding are very different and, more specifically, funding outside resolution is generally more easily accessible than in resolution, in particular for certain banks.

- First, as regards, preventive measures (which are national option under the DGSD), the current legislative text does not provide adequate clarity on safeguards and conditions which are necessary for ensuring that such interventions are sufficiently sound from a financial perspective, will interact correctly with the FOLF determination and would not impinge excessively on the DGS' resources. Similarly, in relation to the precautionary measures under the BRRD, despite the safeguards foreseen and applied under the BRRD, it occurred that two banks benefitted from public support in the form of precautionary liquidity on grounds, *inter alia*, of being declared solvent by the supervisor, only months before being assessed as FOLF. The review could take stock of the already adjusted approach developed by the Commission and authorities involved in such situations, based on past experience and improve the clarity of the relevant legal provisions as well as enhance the predictability and consistency in the use of such measures going forward.

- Second, regarding the EIM, the assessment has shown that they have rarely been applied though forming an integral part of the continuum of measures in the framework. Improvements in this area could reduce the overlap of the EIM with the supervisory powers provided in the BRRD (and also mirrored in the SRMR) in order to reduce legal uncertainty and procedural challenges for competent authorities in their application. In addition, some aspects relating, to the governance structure and the degree of cooperation and exchange of information between competent and resolution authorities could help in improving the timeliness of the FOLF determination, which, is key in ensuring a smooth continuum between going and gone concern.

- Third, the divergent application and interpretation of the different factors relevant for the PIA and the observed very restrictive application of the test in the Banking Union so far, may not fully reflect the intention of the legislation. In particular, the evaluation found that aspects of the PIA relating to (i) the impact on financial stability; (ii) the assessment of critical functions; and (iii) limiting the use of external sources of funding require further clarification.

- Fourth, the current framework could introduce more clarity in Article 32b BRRD in order to address any residual risk with standstill situations whereby a failing

bank for which there is no public interest in using resolution, can also not be placed in insolvency because the trigger to initiate the national insolvency proceedings has not been met.

- Finally, feedback and evidence has shown that certain divergences, in the hierarchy of claims remaining in national laws governing bank insolvency proceedings, in particularly, when it comes to the ranking of ordinary unsecured claims, other deposits and exclusions from bail-in, creates the potential for uneven treatment of creditors, including depositors, in resolution and in insolvency. Such divergences have the potential to create uneven playing field in the single market. It also complicates the NCWO assessment especially for cross-border groups including among jurisdictions participating in the Banking Union.

Ineffective funding options and divergent access conditions in resolution and insolvency

- The CMDI framework introduced a requirement for banks to hold sufficient loss absorbing and recapitalisation capacity (MREL), in order to ensure that banks are able to bear their own losses (and recapitalisation needs depending on the foreseen strategy) and, where that is not sufficient, that they can fulfil the conditions for accessing complementary financing in the form of resolution funding if needed.
- However, feedback and evidence shows that some banks are facing structural issues in building up their MREL buffers and considering their specific liability structure, certain deposits would need to be bailed-in in order to access the resolution fund, which may raise financial stability concerns and operational feasibility in view of the economic and social impact in a number of Member States.
- In addition, the current framework could provide more legal certainty and clarity in areas related to the conditions for the use of DGS funding in resolution (which has never been used in practise) as well as regarding the divergent access conditions to DGS funding in resolution and insolvency, which affect negatively the predictability of the framework.
- There may be a need to further re-assess the DGS' super preference as it creates limitations to the possibility for the DGS to provide funding both in resolution and in insolvency.
- In the Banking Union, the resources accumulated in the SRF have remained idle, while the recourse to DGS (funded by the domestic banking sector only) was more frequent and in some cases complemented by public funds. Access to common safety nets would appear asymmetric for some banks in the absence of EDIS.

Uneven and inconsistent depositor protection

- Depositor protection is central to the CMDI framework. The coverage level contributes to the effectiveness of the DGSD framework and to depositors'

confidence, as it protects almost all deposited amounts and a very large part of the depositors' wealth. However, owing to existing ONDs in the DGSD, the framework is not consistently applied across the EU, leading therefore, to uneven results in depositor protection in the Member States.

- Indeed, in terms of scope of protection, the framework could be improved by addressing divergences, existing in the coverage level of temporary high balances. Improvements in the availability of alternative funding arrangements, which could be relied on in case the DGS were depleted, could further help in boosting depositor confidence.
- Beyond this lack of harmonisation in national rules and their application, depositor protection and confidence in the Banking Union could be undermined in case of asymmetric shocks, to which national schemes remain vulnerable.
- The introduction of an appropriate mutualised safety net (e.g. EDIS) – could help in alleviating the vulnerabilities of national DGSs and delivering equal treatment of all depositors.

ANNEX 6: OVERVIEW OF DEPOSIT INSURANCE ISSUES COVERED IN THE IMPACT ASSESSMENT

The DGSD constitutes a minimum harmonisation framework, with several features of maximum harmonisation. Since its adoption in 1994, it is subject to its third revision[393].

The current text sets a uniform level of protection for deposits[394] throughout the Union based on common requirements for the funding mechanisms of DGSs and the introduction of risk based contributions. The harmonised coverage of EUR 100 000 applies "per depositor per bank"[395]. The latter is complemented with a minimum DGS funding target level of 0.8% covered deposits (to be reached by 2024), improved access to DGSs and information disclosure for depositors, as well as rules for cross border cooperation between DGSs. This set of rules contributed to eliminating market distortions. However, the DGSD also contains more than 22 ONDs to accommodate for various national specificities[396].

The DGSD also provided two specific mandates to the EBA to issue guidelines for specifying *methods for calculating contributions* and *payment commitments* to ensure level playing field. Throughout the years, the EBA also issued on its own initiative a number of other guidelines that have proven beneficial for a consistent application of the DGSD and have become an essential part of the framework[397]. This annex details the elements highlighted in the impact assessment concerning the review of the DGSD. It leverages on the four EBA opinions, additional analysis (e.g. CEPS study, DG JRC's reports) and the transposition check.

1. PROBLEM DEFINITION

The EBA, in cooperation with the DGSs and designated authorities in the EU and the EEA, assessed the progress towards the implementation of the DGSD in accordance with the mandate under Article 19(6) of the DGSD. It also took stock of the experience with the application of the DGSD and analysed policy options to address the identified issues. The EBA saw no need for changes of the key features such as the coverage or target levels. However, it proposed a number of improvements of various other aspects of the depositor protection, as listed in Section 1.2. The EBA's suggestions aimed to improve the level playing field for depositors and to enhance depositor payouts as well as the functioning and funding of the DGS. In addition, the EBA analysis underlines that some of the ONDs in the DGSD lead to divergent treatment of depositors across Member

[393] European Commission (2009 and 2014), *Directive 2009/14/EC of 11 March 2009*, *Directive 2014/49/EU of 16 April 2014*.

[394] See also footnote 57.

[395] The limit of EUR 100 000 applies to the aggregate deposits of a depositor in the same credit institution irrespective of the number of deposits, the currency and the location in the Union.

[396] See Chapter 1, Section **Error! Reference source not found.**.

[397] EBA (2016), *Guidelines on stress tests of DGSs under Directive 2014/49/EU*, *Guidelines on cooperation agreements between DGSs*. The EBA (2021) published a *Consultation paper on guidelines on the delineation and reporting of available financial means*.

States and makes the case for further convergence. The approach of the EBA consisted in either proposing concrete recommendations or setting out the available policy options for further clarification.

In addition, the revised DGSD could also include references to non-legislative initiatives, such as the EBA guidelines. This would, in principle, introduce no substantial new requirements beyond what is already in place and followed by Member States' authorities, while limiting the risk of non-compliance or legal challenges.

2. WHAT ARE THE AVAILABLE POLICY OPTIONS?

Table 4: Policy options for the DGSD review

Option label	Option description
Option 1: Do nothing	This is the baseline. It would imply not following the EBA's suggestion and, hence, envisage no change to a specific provision of the DGSD.
Option 2: Follow EBA advice	Option 2 would imply either following a specific recommendation of the EBA or, where the EBA invited the Commission to clarify a provision, proposing a way forward.

Table 5 sets out the issues proposed for the review as well as the selected policy options. The latter are either technical improvements or amendments that may affect the currently applicable deposit protection across the EU Member States. All policy choices take into account the EBA's suggestions and the subsequent feedback received from Member States' experts in the context of the EGBPI as well as, where available, other analytical evidence (JRC's analysis, CEPS study, public consultation, F4F Platform opinion).

Table 5: Issues proposed for the review

		Policy options	
		1	2
1.	Clarify the definition of deposits which includes: - the concept of 'normal banking transaction' - the treatment of structured deposits	x	
	- the treatment of dormant accounts		x
2.	Clarify the rules on unavailable deposits which includes: - the treatment of deposits that are unavailable because of reasons not directly related to the financial circumstances of the credit institution; - the concept of 'current prospect' of the credit institution to repay deposits and the link to supervisory moratoria;		x
3.	Clarify the treatment of DGS payouts with money laundering or terrorist financing (ML/TF) concerns in consistency with the rules set out in the AMLD which also includes: - the repayment of depositors not previously identified 'through no fault of their own'		x
4.	Clarify the protection of client funds of financial institutions such as payment and e-money institutions or investment firms in consistency with the rules set out in the Payment Services Directive		x
5.	Revise the approach to temporary high balances which includes: - aligning the level of coverage and the duration for depositor claims for temporary high balances across EU Member States; - clarifying the scope of protection of temporary high balances regarding real estate transactions; - increase depositors' awareness about the protection of temporary high balances		x

6.	Revise the protection of deposits of public authorities		x
7.	Revise operational aspects of DGS payouts related to timelines for repayment which includes – repayment of beneficiary accounts – end of the payout period		x
8.	Improve depositor information		x
9.	Improve the cross-border cooperation between DGSs which includes: – enabling the home DGS to repay depositors at branches directly if it is 'at least as easy' as in the currently applicable procedure; – clarifying the treatment of passported services without having established branches; – revising the rules on the transfer of contributions in the event that a credit institution changes its affiliation to DGS.		x
10.	Revise the approach to set-off of liabilities fallen due		x
11.	Clarify the definition of available financial means which include: – the reporting of the borrowed resources; – the administrative fees, funds recovered in insolvency, income from investments and unclaimed repayments;		x
	- irrevocable payment commitments.		x
	- the conditions around the cancellation of payment commitments	x	
12.	Clarify the rules on DGS funding sources and the related investment strategy which includes: - the sequence in the use of DGS funding sources and the related investment strategy; - the use of alternative funding arrangements.		
13.	Clarify the use of DGS funds for alternative uses other than payouts, including the least cost test.		x
14.	Assess the adequacy of the definition of low risk assets	x	
15.	Explore the merits of the use of failed institutions' assets for a DGS payout	x	
16.	Clarify the reference date for covered deposits data for the calculation of the target level in 2024		x
17.	Clarify the treatment of third country branches which includes: - requiring the third country branches of non-EU credit institutions to join an EU DGS, with possible derogations		x
	- clarifying the deposits of the third country branches of EU/EEA credit institutions located outside the EU/EEA are not protected by the DGSD		x

3. WHAT ARE THE IMPACTS OF THE OPTIONS AND HOW DO THEY COMPARE?

This section provides only a high-level summary of the comparison of options, as the EBA assessed the options in detail (including quantitatively when relevant).

3.1. Option 1: Do nothing and maintain the current provisions

This is the status quo. In view of the feedback from the EGBPI on the EBA's suggestions on **issue 1** and **14**, no change is considered necessary to the applicable DGSD provisions to be interpreted in line with recent case law[398]. Option 1 would also seem suitable concerning the use of failed institutions' assets for a payout as a new tool in the DGSD **(issue 15)** because of limited evidence to assess its costs and benefits. While this tool seems available in two Member States, there is a low likelihood that a failed institution would have important amount of liquid assets to pay depositors in the DGS' stead. Where a DGS would lack sufficient financial means, the presence of the common scheme would achieve the same policy objective.

3.2. Option 2: Follow the EBA advice

[398] The EU CJEU has clarified the meaning of the concept 'normal banking transactions' in the judgment of 22 March 2018 (Joined cases C- 688/15 and C- 109/16 Anisimovienė and Others v. Snoras).

Option 2 would improve the depositor protection, while clarifying the existing provisions to remedy the application issues. Lack of clarity also exists in the interplay between DGSD rules and other sectoral legislation (see sections **Error! Reference source not found.** and 7.4.6).

3.2.1. Treatment of structured deposits and dormant accounts

Issue

The EBA identified the lack of clarity and inconsistent application regarding the treatment of the structured deposits under Article 4(1)(43) of MiFID II[399] and of the dormant accounts. Both issues appear relatively immaterial but, if encountered, may create operational difficulties. Notably, the market size for structured deposits seems small[400].

Analysis

In relation to dormant accounts, the best approach would be to clarify that DGSs are required to aggregate the deposits on multiple accounts of a depositor if at least one of them is active. In addition, the revised framework would modify the current rule that prevents a DGS from repaying dormant account below a certain administrative threshold. In principle, the DGSs should be in the position to repay also a dormant account because, in practice, this may be less costly. The depositor should be entitled to request the repayment of his/her dormant account, even if it is below an administrative cost.

3.2.2. Unavailable deposits

Issue

The key task of a DGS is to protect depositors against the consequences of the insolvency of a credit institution. In this regard, authorities are required to determine unavailable deposits where the credit institution is unable for reasons directly related to its financial circumstances to repay the deposit[401]. The EBA pointed out a number of instances where depositors were unable to withdraw their deposits for reasons other than liquidity issues (e.g. Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) concerns, technical issues). While such cases are likely to remain rare, also in view of the current efforts to strengthen the AML/CFT framework, the DGSD does not cater for a solution for depositors unable to access their deposits for a long period in such rare circumstances.

Analysis

[399] Under Article 4(1)(43) MIFID II, structured deposits are deposits defined in Article 2(1)(3) DGSD, which is "fully repayable at maturity on terms under which interest or a premium will be paid or is at risk, according to a formula on index or combination of indices, financial instruments, commodities, foreign exchange rates."

[400] EBA (January 2019), *EBA report on cost and past performance of structured deposits*.

[401] Article 2(1)(8)(a) DGSD provides: "the relevant administrative authority have determined that in their view the credit institution concerned appears to be unable for the time being, for reasons which are directly related to its financial circumstances, to repay the deposit and the institution has no current prospect of being able to do so".

The subsequent feedback from the EGBPI supported retaining the current responsibility of the DGSs solely for cases where the credit institution has insufficient liquidity to repay the deposits. While the DGSD already provides for stringent rules to make a determination of unavailable deposits within a short timeline, it is somewhat part of an authority's administrative discretion to assess the lacking access to deposits as a 'financial circumstance' preventing the credit institution to repay. The discussions also implied that Member States handle similar cases differently, sometimes triggering the DGS and sometimes not irrespective of the depositors (and their inaccessible deposits).

In any case, there is merit to clarify that where the suspension of payment or delivery obligations (national supervisory moratoria) is not directly related to the financial circumstances of the credit institution (e.g. AML reasons, sanctions), deposits might not be unavailable for the purposes of Directive 2014/49/EU. To maintain depositor trust and confidence in the banking sector and maintain financial stability, it is appropriate to require Member States to ensure that depositors have access to an appropriate daily amount from their deposits, should they be made inaccessible due to a suspension of payments for reasons other than leading to depositor payout.

3.2.3. DGS payouts with ML/TF concerns

Issue

The EBA identified the lack of explicit provisions regarding the interplay between the DGSD and AML/CFT rules. These gaps have contributed to the adoption of divergent approaches across Member States to the treatment of depositors in situations where ML/TF concerns exist. Consequently, the obligations under the AML/CFT and DGSD framework were not applied effectively, failing to reconcile their respective objectives, i.e. to prevent criminals from exploiting the EU's financial system to launder the proceeds of their illicit activities and to protect financial stability.

Analysis

The feedback from the EGBPI supported the suggested enhancements of the cooperation between the respective authorities (also addressed in the review of the AML/CFT framework) and of the DGS preparedness prior and during payouts. In this view, the appropriate approach would be to clarify the legal basis for suspending reimbursements to depositors suspicious of ML/TF, in full respect of fundamental freedoms. Overall, the clarifications aim to minimise the risk of the situations where ML/TF concerns arise close to or during DGS payouts. In line with the feedback received, the mandate of DGSs to repay depositors would remain unchanged. DGSs have no obligations pertaining to the ML/TF assessment and should bear no liability even in the rare events where ML/TF concerns are detected after the actual reimbursement.

3.2.4. Protection of client funds

Issue

The client funds are credited to an account of non-bank institutions at a credit institution on behalf of their clients. Similarly to so-called beneficiary accounts (typically held by notaries), they are characterised by a high number of ultimately entitled beneficial owners and a high turnover of funds. The EBA highlighted inconsistent approaches to the

DGS protection of such client funds across Member States and suggested clarifications in consistency with applicable sectoral legislation applicable to investment firms, payment and e-money institutions.

On 27 October 2021, EBA published the opinion[402] on the treatment of client funds and other aspects, including on the deposited volumes and potential concentration risk.

Analysis

The subsequent feedback from the EGBPI confirmed the importance of such protection in the event of the credit institution's failure. Subject to safeguarding requirements in the sectoral legislation, this protection would benefit from more convergence with respect to the moment when such client funds benefit from the DGS protection[403] . It would remove the discrepancies observed in the protection granted to clients of investment firms, payment and e-money institutions clients. It would also be consistent with the suggestion of the F4F Platform for addressing this issue[404].

Under a bespoke regime applicable for such accounts, DGSs would disburse to the account holder for the benefit of the client (rather than directly to individual clients) where necessary and appropriate to preserve the firms' business continuity and to reduce administrative burden on the part of DGSs. In addition, the sums of each client in client accounts would not be aggregated with the sums on its regular deposit accounts. The fact that depositors are usually neither aware nor in control over the choice of the bank (selected by the account holder) would, therefore, justify a derogation from the principle 'per depositor per bank' whereby deposits are aggregated when calculating a repayable amount. This policy choice, applied only in some Member States, is more favourable to the depositors and conscious of the administrative burden, which would otherwise be likely to increase under alternative policy choices[405].

3.2.5. Temporary high balances

Issue

Temporary high balances are exceptional and short-lived deposits resulting from certain life events including money deposited in connection with a real estate transaction, other social events or insurance benefits. They result in larger balances and benefit from higher protection.

The EBA highlighted divergent approaches to the temporary high balances across Member States, notably in the amount and duration of the protection.[406] It noted that,

[402] EBA/Op/2021/11

[403] Under current legislation, the precise moment when client funds become a deposit varies depending on the product. While investment firms are required to safeguard such funds promptly, payment and e-money institution are required to do so no later than by the end of the business day following the day when the funds were received.

[404] See Annex 2.

[405] Other alternatives were discussed in the EGBPI in order to ensure optimal DGS protection, e.g. requiring the account holder to inform clients about the implications of the choice of the bank from the perspective of DGS protection or placing burden of proof on a client about the inability to choose a different bank.

[406] See CEPS study for their detailed overview; see also evaluation (Annex 5) section 7.1.4.2.

based on current experience, the reported claims for this type of repayment were rare (i.e. on average, one claim per bank failure). Further, it took the view that different cost of living across Member States did not hinder a harmonised coverage level for covered deposits. Thus, a different cost of living should not be a hurdle to harmonise the amount of temporary high balances and for the same duration at 6 months. The EBA also suggested clarifying other related aspects of the temporary high balances, notably regarding the funds placed in an account in connection with a transaction to purchase or sell a private residential property, and the eligibility of legal persons. The EBA also recommended improving depositor information.

Analysis on temporary high balances

The impact assessment conducted by the EBA focused predominantly on the high balances in connection with real estate transactions. Conversely, the other types of balances related to events that serve social purposes and are linked to the life events such as marriage, divorce, retirement, dismissal, redundancy, invalidity or death as well as payment of insurance benefits or compensation for criminal injuries or wrongful conviction, are considered much less material and, absent empirical evidence, also subject to data limitations.

As regards the temporary high balances related to real estate transactions, the CEPS study on the ONDs in the DGSD demonstrated the discrepancies in the coverage of temporary high balances both in terms of coverage level and in term of duration. It also found that their coverage amount could be harmonised at EUR 500 000.

Table 6: Temporary high balances: coverage level and duration of coverage

	3 months	**6 months**	**9 months**	**12 months**
Up to EUR 200 000	BG, CZ, HR, HU, LV, PL	CY, EE		RO
EUR 200 000 – EUR 500 000		EL, LT		SE
EUR 500 000	FR, NL	BE, DE. MT		AT
EUR 1 000 000 – EUR 10 000 000		IE		DK, LU
unlimited	ES	FI, SI	IT	PT, SK

Source: Commission transposition check/CEPS study

The feedback received from the EGBPI showed that a higher number of experts supported the EBA's recommendations to harmonise the duration of the protection at 6 months, including those who currently apply shorter timelines. As the EBA has not proposed a precise amount to be harmonised, the discussions in the EGBPI explored the identified options based on the CEPS' analysis. However, a number of experts had concerns about either lowering or increasing the current protection in their Member State and the impact on cost neutrality. Hence, some of them preferred retaining the national discretion. In this view, the additional analysis by the JRC of a possible threshold for adequate protection largely confirmed the findings of the CEPS study. This analysis also strived to identify an optimal common coverage amount and duration.

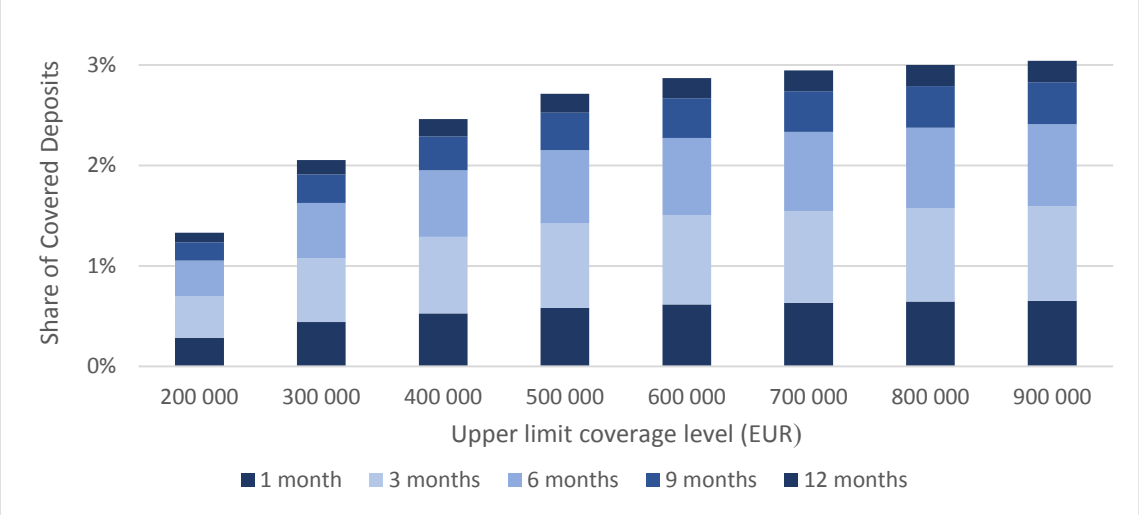
Based on both CEPS' and JRC's quantitative analyses, a very high share of temporary high balances appears lower than EUR 500 000 in all Member States. Therefore, the

level of protection higher than EUR 500 000 would not significantly increase the amount of protected deposits and there is limited risk that depositors could lose protection. In addition, the best option would be to harmonise the duration of the protection at 6 months[407] because the additional amount of temporary high balances protected would only be limited under a longer period. A higher number of Member States supported this policy option, with few exceptions. Therefore, given the political considerations and the available empirical (low number of claims) and modelling evidence, the best option would be to provide for a minimum threshold of EUR 500 000 for the period of 6 months to increase convergence across Member States for the benefit of depositors. It does not prevent Member States from covering a higher amount of temporary high balances, though with funds above the target level.

Box 16: Key results of the CEPS' and JRC's quantitative analyses[408]

Figure 18 shows the sizes of protected THBs depending on different amounts of coverage level and duration (see also Annex 12).

Figure 18: Average EU impact per coverage level and time of coverage (excluding EUR 100 000)



Source: JRC Report, Annex 12

Conclusions:

- A very high share of temporary high balances is protected with the coverage level of EUR 500 000 in the 6-month duration.
- Beyond EUR 500 000, the degree of protection does not significantly increase.

The feedback in the EGBPI was also supportive of clarifications regarding the scope of the temporary high balances. The revised rules should encompass both funds placed for a purchase or sale of a private residential property, combined with a specific provision on a depositor's burden of proof. While the temporary high balances should be in principle

[407] This change would imply a higher duration in nine Member States (which apply a 3-month period) and a lower duration in eight Member States (which apply a 9- or 12-month period). One Member State applies a different timeline depending on the type of temporary high balance. See further CEPS study, p. 48.

[408] See JRC report 'Review on temporary high deposits balances related to certain transactions' p. 6 – 11, and especially section 4.3 p. 9.

limited to natural persons, legal persons would also be eligible for temporary high balances related to insurance benefits.

Given that such reported claims are rare, improved depositor awareness around this type of protection would mitigate any residual adverse effects on depositors as a result of changes to the amount or duration of temporary high balances. These changes, broadly supported by the EGBPI discussion, would improve depositors' understanding how to benefit from optimal deposit protection and encourage them to make the right financial decisions, rather than leaving high balances above the coverage level on their deposit accounts[409].

3.2.6. Protection of public authorities

Issue

Currently, public authorities are excluded from DGS coverage (Article 5(1)(j) DGSD). A number of Member States protect deposits of local authorities with an annual budget of up to EUR 500 000 under a national option in Article 5(2) DGSD[410].

The EBA recommended protecting deposits of all public authorities up to harmonised coverage level irrespective of their budget. In this respect, the main benefit of this approach would be the reduced administrative burden for banks and DGSs. The latter are required to assess the eligibility profile of such depositors and the conditions concerning the size of their budget. In addition, the EBA also highlighted that, in some Member States, public authorities also include hospitals, schools or swimming pools, arguably unsophisticated investors, which benefit from lesser protection compared to large corporates, many of which are sophisticated investors. Most recently, the lack of protection of public authorities emerged as an issue in the payout case of the Greensill bank[411].

Analysis

A high number of Member States supported the EBA recommendation in the EGBPI but some also required further analysis. While the deposits of small local authorities, i.e. a subset of public authorities, appears relatively small (up to 0.1% of covered deposits), there are data limitations as concerns the total volumes of deposits of the public authorities.

Nevertheless, the EBA's qualitative analysis on the pros and cons of the policy options substantiates revising the current approach, notably to address the lack of rationale for a different treatment of the public authorities and large corporates and to reduce

[409] This is consistent with other policies to increase consumer trust in retail investments, e.g. the Commission retail investment strategy.

[410] According to CEPS study, this option is transposed in seven Member States and the amounts protected under this provision are limited, ranging between 0.00% and 0.11% of the total covered deposits.

[411] According to the *FT*, some public authorities (around 50 municipalities that held up to EUR 500 m with the lender) had deposits with Greensill bank. The compensation provided by the deposit guarantee scheme excludes the groups of creditors specified in section 6 of the EinSiG (i.e. public authorities): German towns braced for EUR 500 m in losses from Greensill Bank collapse | Financial Times (ft.com)

administrative burden for all actors involved. Therefore, the revised rules would cover public authorities up to EUR 100 000, just as corporates and other depositors.

3.2.7. Operational aspects of the DGS payout

Issue

The EBA recommended revising two aspects related to timeline for repayments. It suggested replacing the existing 3-month period for repayment of beneficiary accounts by 20 working days. The revised period would start running since a receipt of required documentation because DGSs need sufficient time to verify the entitlements of ultimate beneficiaries. The current period running since the determination of unavailable deposits did not reflect the administrative needs by the DGSs, particularly when depositors provide insufficient information to the DGS. Further, national approaches also vary regarding the end of payout, subject to national option. The EBA considered that such period should be sufficiently long to protect depositors although the effect of this change is likely marginal as most reimbursements take place soon after payout[412].

Analysis

The subsequent feedback from EGBPI supported the clarifications. Many views were in favour of combining the revised timeline for repayment of beneficiary accounts with a specific provision to enable DGSs to require the information about the beneficiaries' entitlement directly from the account holder. This would aim to reduce their administrative burden. The same reasoning applies to client funds and temporary high balances. In relation to the end of payout, a higher number of experts supported a period of 5 years as more beneficial for depositors, while stressing that DGSs should remain able to subrogate into depositors' claims in insolvency proceedings.

3.2.8. Depositor information

Issue

The EBA called for improvements of the depositor information sheet, including by guidelines or regulatory technical standards. It also suggested revising the depositors' entitlement to withdraw eligible deposits without penalties because of changes to the credit institution (e.g. mergers, conversions into branches or subsidiaries) that impact deposit protection. Under a revised setup, while all depositors should be informed about the changes to a DGS affiliation, at least those depositors whose coverage would be adversely impacted, should be informed of their right to withdraw their funds without any penalty up to an amount equal to the lost coverage of deposits.

Analysis

The subsequent feedback from the EGBPI supported the suggestions on the depositor information sheet and the right to withdraw under Article 16(6) DGSD. The EGBPI also

[412] Under Article 9(3) DGSD, Member States may limit the time allowed for depositors to claim repayment in the event that their deposits were not repaid or acknowledged by the DGS within the usual deadlines. CEPS study sets out an overview of the currently applicable timelines and showed some periods may be short.

explored the adequacy of regular communication of depositor information on annual basis. While one expert preferred a disclosure based on actual needs (e.g. upon concluding the contract and in the event of failure) to reduce costs[413], the vast majority supported the EBA's analysis that the annual information disclosure should not be altered because of its positive impact for depositor awareness.

3.2.9. Cross-border cooperation between DGSs

Issue

The EBA called for enhancements of the following three aspects. The regime whereby the host DGS reimburses the depositors in branches on behalf of the home DGS should be rendered more flexible. Under a revised setup, the home DGS could repay depositors at branches directly if it is '*at least as easy*' as in the current default procedure whereby the host DGS receives funding from the home DGS, including the compensation for the costs incurred. Further clarifications would also be suitable for passported services. In the absence of explicit provisions, the latter are currently treated as any other deposit in the home Member State. This raises challenges for the home DGSs when liaising with depositors located in host Member States. Lastly, the transfers of the last annual contributions in the event that a credit institution changes its affiliation to DGS require a revision.

Analysis

The subsequent feedback in the EGBPI broadly supported these clarifications, including developing the revised rules and methodology through regulatory technical standards or guidelines. It agreed with the objective to address the resulting operational hurdles for DGSs, including when communicating with depositors located in the host Member States. The current rules on transfer contributions proved ineffective in the situations where DGSs transferred no contributions due to different contribution cycles or payment deadlines, or because the transferring DGSs no longer raise contributions because their target level was reached[414]. Consequently, they fail to deliver on their intended objective, i.e. to reflect the potential increase in risk for the DGS receiving a new participating member .

[413] The F4F Platform also recommended, in its opinion on the CMDI review, a disclosure based on actual needs for reducing the administrative burden. See Annex 2 for further details.

[414] According to the EBA's mapping of DGS's practices, contributions are raised in monthly, quarterly or on a semi-annual or annual basis. Similarly, DGSs send out the invoices on different days or always on the same day in a year, with a maturity period of usually 60 days or longer. Some jurisdictions also specify the payment date and some do not. As a result of these differences, no contributions were transferred, leaving the receiving DGS and its participating credit institutions at a disadvantage to cover for the risk of a new entrant.

3.2.10. Set off of liabilities fallen due

Issue

Under Article 7(4) DGSD, depositors obtain a reimbursement irrespective of their liabilities (e.g. due loan instalments) towards the credit institution that are handled in an insolvency estate. However, a national option under Article 7(5) DGSD derogates from this principle. The latter allows a DGS to take into account depositors' due liabilities when calculating a repayable amount, if it is possible under statutory and contractual provisions.

The EBA found that the actual set-off was immaterial from a DGS' perspective, involving very small amounts, and conducive to increased administrative burden when determining the due liabilities and its permissibility e.g. in the contractual documents. It also suggested improvements to address insufficient information available to depositors about the set-off. The transposition check also revealed divergent approaches, deducting the liabilities from either the aggregate deposits or the repayable amount (after the application of the coverage limit).

Analysis

The feedback from the EGBPI supported the EBA's suggestions. If this provision were maintained, it would require clarifications that due liabilities are consistently deducted from the aggregate deposits as well as the improvements in the depositor information.

The EGBPI also explored the option to remove the set off from the framework in view of its low materiality and the administrative burden[415]. While the views on this issue were split[416], the best option would be to remove this provision. In line with the EBA's findings, this approach would also simplify the framework and be consistent with the objectives pursued in the CMDI review. The provision applies only in the context of payouts. Its use is already limited and is likely to be even more marginal because of the intended regulatory changes, prioritising bank exits based on transfers of commercial relationships (i.e. deposits and related loans) over payouts. Removing this national option would foster consistent treatment of depositors.

3.2.11. Definition of available financial means

Issue

The EBA highlighted a lack of clarity and divergent national approaches concerning the treatment of borrowed resources, administrative fees, funds recovered in insolvency, income from investment and unclaimed payments in the calculation of available financial means. The clarifications would ensure a more accurate view on the DGS' financial position. The EBA further supported clarifying the cancellation and irrevocability of payment commitments.

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[415] CEPS study also recommended removing of the provision, in view of low materiality, administrative burden and lack of practical use (so far in only two Member States).

[416] Out of 17 Member States, who transposed the option, 7 experts supported removing it from the framework and 9 experts preferred to retain it.

Analysis

In line with feedback from the EGBPI, the best approach would be to report borrowed resources but exclude them from the calculation of the available financial means. This change would ensure that they do not count toward the minimum target level, which was the objective pursued by the EBA. Accordingly, the borrowed resources would be published in the EBA's annual reporting to ensure transparency on DGS funding. For the majority of experts, while administrative fees should be excluded, other funding sources, such as recovered funds from insolvency, investment income, should be included in the calculation of available financial means. Based on the feedback received, the clarifications around the irrevocability of payment commitments aim to increase convergence across Member States .

3.2.12. Sequence in the use of DGS funding sources and the related investment strategy

Issue

DGSs reimburse depositors from available financial means in the pre-funded schemes. They are financed by annual and extraordinary contributions from credit institutions. Alternative funding arrangements must be in place to obtain short-term funding to meet claims against those DGSs.

The EBA highlighted a lack of clarity and divergent national approaches as concerns the sequence of the above DGS funding sources. According to its analysis, there would be merit for flexibility around the use of the different funding sources subject to a cost and benefit analysis and a repayment plan. The EBA further noted the absence of concrete alternative funding arrangements established in some DGSs. Lastly, it also suggested specific improvements of provisions on investment strategy.

Analysis

The feedback from the EGBPI on the sequence of the use of DGS funding sources was mixed. While some supported full flexibility, others had more nuanced views. The latter preferred either a strict sequencing or a certain degree of flexibility, justified by exceptional circumstances or involving no public resources. In view of this feedback, the best way forward is to specify that DGSs may use alternative funding arrangements from private sources before available financial means and funds collected through extraordinary contributions. Such flexibility would allow DGSs to avoid having to immediately raise extraordinary contributions where raising such contributions would endanger financial stability (e.g. in a systemic crisis). Full flexibility is needed also to allow DGSs to use their funds in the most efficient way and avoid a fire sale of their assets (available financial means) at the point of crisis. At the same time, funding from public sources should be constructed as a 'backstop' function in line with the principle of moral hazard that the cost of financing the depositor protection should be first borne by credit institutions themselves.

3.2.13. Use of DGS funds for purposes other than payout

Issue

The EBA pointed out the lack of clarity regarding the cost limitations of preventive and alternative measures under Article 11(3) and (6) DGSD and the need for several technical clarifications. It also took the view that the financing of preventive measures alone should not cause a FOLF determination. It turned out that in some instances those interventions could be assessed as imputable to the State under the applicable State aid rules and hence, have the potential to trigger a FOLF determination under the BRRD, and othes not. The uncertain treatment of DGS interventions financing Article 11(3) DGSD measures in light of Article 32(4)(d) BRRD raises unlevel playing field concerns.

Analysis

Overall, the current provisions provide for a high-level determination of the least cost test, subject to inconsistent application[417]. There is no clear methodology under the current legal framework to calculate this least cost test. The feedback from the EGBPI supported clarifying the main principles of the least cost test in a Level 1 text and specifying the technical details in a delegated act. The views were split as regards the appropriate methodology.

The Commission services set out below the respective findings as regards the application of preventive and alternative measures and available policy options, taking into account the EGBPI feedback.

(i) Preventive measures under Article 11(3) DGSD

Currently, preventive measures are applied for non-failing banks by DGSs including those IPSs that qualify as DGSs whose interventions comply with the applicable State aid rules to be qualified as private support (i.e. non-aid). By contrast, if such interventions amounted to a State aid, they would trigger resolution[418].

Article 11(3) DGSD provides also a set of safeguards for preventive measures. These aim to ensure that the intervention (i) is limited in amount, (ii) precedes resolution, and (iii) is accompanied by adequate commitments and monitoring processes. The available experience reveals inconsistent approaches across Member States regarding the conditions around the preventive measures, including their cost limitations. While some DGSs use the same least cost test for both preventive and alternative measures, others do not use any least cost assessment at all.

Since the entry of DGSD into force in 2014, preventive measures were applied in five instances. In all cases, the preventive measures led to a recapitalisation of the bank in line with its prudential requirements or to an acquisition from a buyer or industrial partner. Two of these institutions were placed under temporary administration. The period

[417] See Annex 5, section **Error! Reference source not found.**.

[418] See Chapter 2, Section **Error! Reference source not found.**; Chapter 5, sections **Error! Reference source not found.** subsection (b) 'Divergent access requirement for the resolution fund and for funding outside resolution' and 7.1.4.2, Annex 9, see overview of **Error! Reference source not found.**.

between the moment the DGS was informed of the distress situation of the bank and the conclusion of the case involving the preventive measure ranged from nine to 16 months. In these instances, the preventive measures were also combined with interventions by other stakeholders (DGS 'voluntary fund', shareholders, acquiring bank/buyer). They took various forms, e.g. capital injections, guarantees, loans, often aiming to reduce with capital relief measures the amount needed in core capital and so facilitate the merger with another bank. As regards the financial impact on the DGS, the final cost of these operations was not always certain in advance (for instance for guarantees or capital injection) and had been estimated in the least cost test.

Box 17: Examples of least cost test calculations under Article 11(3) DGSD[419]

Based on anonymised information received from the EBA, a detailed least cost test methodology was applied in three cases.[420] The different consecutive steps applied for the calculation of the least cost test are explained below:

i) Step 1 aims to calculate the costs of the payout for the DGS.

- The direct cost of the payout for the DGS is mainly related to the value of the assets of the bank in a piecemeal liquidation. The value of the assets of the bank in liquidation is calculated based on the amount of estimated losses. This amount represents the funds that could be recovered during the insolvency proceeding.
- However, some of these assets will be used to pay (i) the preferred liabilities (i.e. the liabilities with a higher rank than the covered deposits, like employees or tax), and (ii) the secured liabilities. The amount of preferred and covered liabilities are then deducted from the value of the assets in liquidation.
- The operational costs related to the payout are also deducted from the value of the assets (legal costs, valuation expertise and so on).

Accordingly, the direct cost of the payout for the DGS is calculated by deducting from the value of assets in liquidation (A), the assets used for paying preferred and secured liabilities (B), the operational and administrative costs (C), and the amount of covered deposits (D). A positive result means that the DGS will recover, during the insolvency proceedings, 100% of its funds. In other words, the direct costs for the DGS, after the insolvency proceedings, is 0.

Subsequently, indirect costs are estimated[421]. In the cases at hand, the indirect costs included the opportunity cost for the DGS (i.e. the lack of profitability resulting from the use of DGS funds), the costs for the member institutions of this DGS that may have to pay *ex post* contributions, additional funding costs for the banks and financial contagion effects to risky banks.

ii) Step 2 aims to calculate the cost of the measure.

[419] These examples are for information only and should not be seen as an opinion of the European Commission. The objective is to illustrate what a least cost test could be, based on an existing methodology applied on real cases.

[420] These cases were notified to the EBA under the Decision of 23 July 2018 on notifications to the EBA relating to the DGSD.

[421] The Commission services do not have at disposal a detailed methodology used to calculate the indirect costs.

The cost of the preventive measure depends on the tools used by the DGS and is a case-by-case assessment. For instance:

- Under case A, the DGS injected capital in the bank and then sold the shares for 1 euro to a buyer. The final cost for the DGS was equal to the amount of the capital injection.
- Under case B, the DGS also injected capital in the bank but considered that it would be able to sell the shares with a discount in several years. The final cost for the DGS was then equal to the amount of the capital injection, minus the following sale of the shares.
- Under case C, the DGS provided a guarantee. It is assumed in this case that the guarantee will be called.

iii) Step 3 is a comparison between the cost of the payout and the cost of the measure.

The DGS opted for the less costly option. It appears that, in these cases, the DGS would not be allowed to finance the measure without the indirect costs and would have been required to reimburse the depositors.

Table 7: Examples of least cost test calculations

The numbers in this table were rescaled for confidentiality purposes. For each case, the proportionality between the numbers is preserved	Case A	Case B	Case C
Step 1 : calculating the cost of a payout			
1.1 Direct costs for the DGS			
A. Value of the assets of the bank in a piecemeal liquidation	645	884	434
B. Preferred and covered liabilities	261	312	156
C. Operational costs	66	64	48
D. Amount of covered deposits	300	400	200
E. Direct costs for the DGS (i.e. A-B-C-D). If positive, the amount retained is O.	A-B-C-D=18 Direct costs for the DGS = 0	A-B-C-D=108 Direct costs for the DGS = 0	A-B-C-D=30 Direct cost for the DGS = 0
1.2 Indirect costs			
F. Opportunity costs	15	28	14
G. Costs for banks related to the additional contributions to the DGS	18	0	4
H. Additional cost of funding for other banks	33	24	0
I. Financial contagion effect on other high risk banks	30	36	0
J. Indirect costs (F+G+H+I)	96 (i.e. 15+18+33+30)	88 (i.e. 28+24+36)	18 (i.e. 14+4)
1.3 Total cost of the payout			

K. Cost of the payout (E+J)	96 (i.e. 0+96)	88 (i.e. 0+88)	18 (i.e. 0+18)
Step 2 : Cost of the preventive measure for the DGS			
Preventive measure	DGS injected capital, and immediately sold the shares for EUR 1 to a buyer.	DGS injected capital and assumed to sell the shares, with a discount, within 4 years.	DGS provided a guarantee to inject capital.
Cost of the preventive measure for the DGS	93	Between 8 and 16	6
Step 3 : Least cost test			
Comparison of the cost of the payout and the cost of the preventive measure	Cost of the payout: 96 Cost of the measure: 93	Cost of the payout : 88 Cost of the measure: 8-16	Cost of the payout : 18 Cost of the measure: 6

Source: Commission services.

In view of the above experience and as mentioned in Chapter 2, there is scope to improve the provision, with a view to ensure more clarity and legal certainty on the use of these measures with a view to preserve DGS financial means, as well as a more consistent application. It would also be important to ensure that the intervention is granted at a sufficiently early time, to avoid granting support to a bank that is too close to failure.

Following the feedback from the EGBPI, the following policy options could appear suitable:

- applying the same least cost methodology as for any other use of DGS (see further point (ii));
- applying a least cost methodology tailored to a specific nature of the preventive measures;
- using additional or strengthened criteria to ensure the timeliness of the intervention and its economic rationale, combined with the least cost test used for any other use of DGS as an additional safeguard.

The first option would have the benefit of ensuring consistency across different DGS uses. At the same time, a least cost based on an insolvency counterfactual might fail to capture all aspects of such a preventive intervention. At the time of a preventive measure, the bank is meant to be 'not yet failing' (or in going concern) and it would not be possible to know whether, in the event of failure, the bank would go into resolution or insolvency as reference for the counterfactual in the LCT. Moreover, such a solution would not improve the necessary safeguards. In particular, the least cost test alone might not help in ensuring that the DGS intervention is sufficiently timely or based on adequate economic rationale (other than being less expensive than an insolvency payout or other counterfactual).

The second option would entail a least cost test that reflects the specific nature of preventive measures and the type of DGS, e.g. the existence of a statutory or contractual mandate to intervene. As explained in Annex 10, Box 19, preventive measures are crucial for IPSs and applying a least cost test before granting support to an IPS member should

take into account the main IPS functions. This option would also require additional technical analysis, developed through regulatory technical standards.

The third option, combining the first or second options, could reinforce the criteria to ensure the timeliness and economic rationale of the intervention. For example, the revised provision could ensure that the bank is solvent at the time of the intervention and that there is no prospect of its failure within a certain period in the future. Also, further conditions could require that the intervention is capable of ensuring the bank's long term viability. In addition to such safeguards, it would be sensible that the intervention meets the least cost test, if compared with an appropriate counterfactual. Such an option would merit further technical analysis through regulatory technical standards.

Finally, the interaction between this provision and Article 32 BRRD should be clarified. At present, depending on the qualification of the intervention for State aid purposes, there is a possibility that some DGSs cannot intervene in a preventive fashion because the measure would trigger resolution. An option to avoid this problem would be to explore a similar approach that already applies for precautionary measures, which constitute an exception to the rule that extraordinary financial support should trigger a FOLF determination for the bank. The exception is based on the fact that precautionary measures are granted to solvent banks and under strict conditions (as to the amount for example). Accordingly, under this approach, even in the event the DGS measures are qualified as State aid (which is the basis to consider it as extraordinary public financial support), it would be possible to use them without triggering resolution subject to required conditions and safeguards.

(ii) Alternative measures under Article 11(6) DGSD

Alternative measures are normally used for banks where there is no public interest in resolution and which are to be liquidated under national insolvency proceedings (if available under national law). In the context of the insolvency proceedings, the DGSs can finance an alternative measure to payout, such as the transfer of the assets and liabilities andor a deposit book, from a failing bank to an acquirer to preserve depositors' access to covered deposits and, at the same time, limit the destruction of value in a piecemeal liquidation.

The Commission services were informed of one instance in which a DGS financed alternative measures. This intervention also involved a least cost assessment, corresponding to the total amount required to reimburse covered depositors *minus* the estimated amount of proceeds the DGS would have received from the insolvency estate. The bank in question was experiencing significant liquidity outflows and facing difficulties to meet its capital requirements. It was declared failing or likely to fail and went in insolvency, while searching for a potential buyer who would be interested in a transfer of the assets and liabilities from the failed bank. The principles of this least cost assessment are set out below.

Box 18: Example of least cost test calculation under Article 11(6) DGSD[422]

i) Calculation of the cost of the payout

A. Value of the assets of the bank	600
B. Preferred liabilities	32
C. Direct and indirect costs related to the liquidation	150
D. Covered deposits	540
Cost of the payout **= A-B-C-D**	**-122**

ii) Calculation of the cost of the alternative measure

In order to facilitate the transaction of the assets and liabilities of the failed bank to a buyer, the DGS compensated the negative value of balance sheet of the failed bank (i.e. the difference between the value of its assets and the value of its liabilities). This compensation represented a loss for the DGS, estimated to 90. As the cost of the transaction (i.e. 90) was lower than the cost of the payout (i.e. 122), the DGS was allowed to apply the alternative measure.

In line with the feedback from the EGBPI, regulatory technical standards on the least cost methodology would be developed based on the principles to be set out in the Level 1 text[423]. The principles would align the calculation of the costs for a payout with the methodology used in the resolution framework based on a so-called valuation 3[424].

The discussions also explored the inclusion of direct costs, such as the cost of reimbursing covered deposits[425], the valuation expertise, legal advisers, possible litigation and costs for the receivers, and indirect costs related to a payout. The views were split on the use of indirect costs, that may reflect the financial contagion effects, additional costs for the banking sector related to the need to raise extraordinary contributions to replenish the DGS and potential additional funding costs related to disturbance on financial markets or opportunity costs for the DGS.

In this respect, for some experts, the argument against including the indirect costs relates to the complexity to quantify them[426] or that they do not represent the direct costs for the

[422] These examples are for information only and should not be seen as an opinion of the Commission services. The objective is to illustrate what a least cost test could be, based on an existing methodology applied on real cases. The numbers have been rescaled for confidentiality purposes, but the proportionality between the numbers is preserved.

[423] 10 Member States agreed on this principle and two disagreed in the replies to the survey circulated by the Commission during the EGBPI of 28 September 2020.

[424] All respondents agreed on this principle in the survey circulated by the Commission during the EGBPI of 28 September 2020.

[425] The cost of reimbursing covered deposits are the amount of covered deposits minus the expected amount recovered during by the DGS during the insolvency proceedings.

[426] For instance, for the impact of a payout on the funding costs of the other banks or on the financial stability.

DGS but for the contributing banks[427]. Some experts were open to including them as long as they allow a more accurate estimation of the overall impact of payout and are based on clear rules enabling their quantification and/or subject to safeguards, e.g. by introducing a cap limiting their amount. Some also considered that, under the current legal framework, the least cost test is unlikely to be met without indirect costs. Indeed, due to the current high ranking of covered deposits in the creditor hierarchy, the likelihood of a loss for a DGS in a payout is very limited and close to zero[428].

The analysis in Annex 7, section **Error! Reference source not found.**, demonstrated that, under the proposed options including notably the changes to the creditor hierarchy (i.e. single-tier class for all deposits), the direct costs would allow 80%[429] of the banks, which cannot reach the 8% TLOF without affecting the deposits, to finance the gap to the 8% TLOF threshold. For the remaining banks (i.e. 20% of the banks that cannot access the RF/SRF without affecting the deposits), the amount of funds meeting the least cost test would not be sufficient to reach the 8% TLOF threshold. If the objective were to allow the DGSs to bridge the gap for more banks, indirect costs would need to be included in the calculation of the least cost test. On average, for the subset of banks, unlikely to meet the least cost test according to the simulation, the funds missing to finance the gap to the 8% TLOF threshold would represent 0.25% of covered deposits[430].

In this context, the impact assessment tested several scenarios of a financial crisis under different versions of creditor hierarchy. The results confirm a low likelihood that DGS funds could be used in crisis management for purposes other than payout under the current least cost test, articulated as in the current framework and including only direct costs. These results also confirm the four examples of least cost tests outlined above in which the DGS would not have been allowed to finance a measure other than payout without including indirect costs.

Therefore, the best option would be to develop a methodology, which includes both direct and, at least to some extent, quantifiable indirect costs subject to further technical analysis performed in the context of the regulatory technical standards. This least cost test should apply also in resolution because of the same counterfactual, i.e. the losses incurred in insolvency in case of payout, to ensure the aligned incentives between resolution and insolvency.

3.2.14. Reference date for covered deposits data for the calculation of the target level in 2024

Issue

The EBA recommended to clarify that the reference date for the calculation of the target level in 2024 should be no earlier than 31 December 2023 and no later than 3 July 2024.

[427] Some indirect costs are costs for the banks (additional costs of funding, *ex post* contributions to replenish the DGS funds).

[428] In addition, in case a loss is expected, its amount is probably very limited, leaving little room to finance an alternative measure.

[429] This conclusion would be different without any change in the creditor hierarchy.

[430] This amount considers a recovery rate set at 85%. It is to be noted that results are strongly dependent on the assumed percentage of recovery rate.

Analysis

While experts largely supported the EBA's clarification, the discussions in the EGBPI subsequently explored another alternative option. According to the latter, the available financial means would at least reach a target level of 0.8% of covered deposits by 31 December 2024. This could take into account the differences in the collection of contributions and allow Member States to report the DGS data for 2024 by March 2025. As the views were split, the best option would be to follow the EBA's advice.

3.2.15. Treatment of third country branches

Issue

The EBA pointed out the inconsistent treatment of third country branches located in the EU and the various practices regarding the national equivalence assessments across Member States. In EBA's view, third country branches should be required to join a DGS in the EU without an equivalence assessment to reduce administrative burden and to align the different approaches. Given that most third country branches are presently members of DGSs in the EU, the impact of this recommendation would be limited. Further, it also proposed clarifications regarding the deposits in third country branches of EU credit institutions, located abroad.

Analysis

The subsequent feedback from the EGBPI supported such clarifications.

There was a broad support for requiring third country branches to join DGSs in the EU without prior equivalence assessment. However, some Member States suggested a possible derogation from the participation of a third country branch in a national DGS. This derogation, to be granted by national authorities, would be contingent on an equivalent DGS protection of the third country at least in terms of coverage and a deadline for repayment. However, any such derogations would also run against the Banking Union objectives, in particular these aiming to decrease unnecessary national discretions and the risk of regulatory arbitrage. The treatment of third country branches and their possible authorisation requirements is currently assessed in the ongoing revision of the CRD/CRR framework. These developments could address the concerns raised in the context of the CWP discussion on EDIS[431] regarding the risk of third country branches for the common scheme although the latter would remain under national supervision and/or where they cumulate larger amounts of deposits in the EU.

Likewise, the clarification of the territorial scope of the DGS protection also received broad support in the EGBPI to avoid exposing DGSs to risks in the third countries, which is also important in the context of the common scheme. Taking this forward, this discussion also highlighted a possible coverage of the deposits outside the EU as an area for further work, mainly from the perspective of better competitiveness of EU banks and the fact that branches are not separate legal entities.

[431] European Council (2 June 2021), *Portuguese Presidency Progress Report on strengthening the Banking Union*.

4. OVERALL ASSESSMENT OF BENEFITS AND COSTS UNDER OPTION 2 (FOLLOWING EBA'S ADVICE)

4.1. Benefits

Option 2 (following EBA's advice) would foster a consistent application across Member States and clarify the interplay with other sectoral legislation. This would also enhance legal certainty and depositor confidence as depositors increasingly navigate through different legal regimes as the consequence of the cross-border and Fintech services. New, or more detailed, rules would mainly reassert the principles laid down in the DGSD where the evidence suggests ineffective outcomes, insufficient transparency and scope for improvements compared to the current rules. Some of these modifications would aim to improve the administrative burden of DGSs, while leaving the administrative burden of the banking sector broadly unaltered. More harmonised rules would be necessary to address divergences among Member States that have significant adverse impacts on depositors. The DGSD framework should also be consistent across all EU Member States, irrespective of whether these are members of the Banking Union, to ensure their equal treatment. In several instances, detailed rules to be adopted through empowerments for the delegated and implementing acts would be more suitable to prevent from overburdening the generally applicable legal framework and ensure a consistent use of DGS funding (e.g. through a least cost assessment). Overall, following EBA's advice would better contribute to the objectives to protect depositors and financial stability.

4.2. Costs

Option 2 (following EBA's advice) would extend the coverage for certain types of depositors and deposits, such as the inclusion of public authorities within the scope of covered depositors (Issue 6), which could create additional costs for the contributing banks and the DGS. Currently, the concrete costs for such an amendment cannot be quantified as only eligible deposits are reported to the EBA. However, the subset of such public authorities, currently protected in several Member States, as well as the reflection in the contribution for all affiliated institutions, suggest the overall financial impact to be relatively small. Conversely, other policy options likely to impact the coverage, e.g. temporary high balances, client funds or other (Issues 4, 5, 14), would have a limited financial impact for the DGS and contributing banks because such deposits are either rare, relatively small in terms of volume and/or already covered by the DGS. Likewise, as explained in Annex 7, the changes to the least cost test for the use of DGS other than for payout and to the creditor hierarchy, could also have a financial impact for the DGS, although difficult to quantify in net terms *ex ante*. However, more robust deposit protection and effective CMDI framework constitute sufficient trade-offs of these potential costs.

The revised rules may lead to certain implementation costs. However, as the revised criteria aim to enhance clarity and hence reduce the incurred costs under the current framework, the implementation costs are expected to decrease quickly over time.

ANNEX 7: ANALYTICAL METHODS

1. OBJECTIVE AND SCOPE

The objective of this Annex is to provide detailed quantitative information (static statistical analysis and model-based simulations) to support the assessment of the policy options set out in Chapters 5, 6 and 7 as well as certain aspects pertaining to funding in Chapter 2 and the evaluation (Annex 5). In terms of scope, this Annex covers a wide range of technical topics linked to the components of the CMDI framework and the design of EDIS, as well as methodological sections. More specifically, it covers:

- An overview of the methodology (section 2)
- Analysis of banks' capabilities to meet the condition to access the RF/SRF (section 3)
- The potential for DGS intervention under the least cost test (LCT) and related considerations (section 4)
- Caveats and disclaimers (section 5)
- Other methodological considerations (section 6).

The analyses on the banks' capabilities to meet the conditions to access the RF/SRF and the potential for DGS intervention are featuring a static statistical part and a model-based dynamic approach. For the static and model-based analyses, the Annex refers to the EBA report replying to the Commission's Call for Advice regarding funding in resolution and insolvency as part of the CMDI review (hereafter "EBA CfA report"), presenting the main conclusions in the context of the assessment of the policy options following different scenarios. The EBA's CfA report was prepared in cooperation with the Commission's Joint Research Centre that provided the underlying quantitative analysis necessary to conduct the assessments included in that report. Detailed information on methodological assumptions is available in each section where these analyses are presented.

2. OVERVIEW OF THE METHODOLOGY

2.1. Data sources and references

Each area of analysis outlined above builds on the data provided by the SRB and the data used in the EBA CfA report collected by the EBA directly from resolution authorities. ***Table 8*** provides a mapping of the data sources used in this Annex.

Table 8: Mapping data sources and references

Section #	Data sources and references
Conditions to access the RF/SRF	EBA CfA report[432] SRB data
DGS interventions *Least cost test* *Use of DGS in resolution* *Use of resolution fund* *Availability of DGS funds and EDIS design*	

2.2. Use of models

The simulations reported in this Annex and in the EBA CfA report are based on the Systemic Model of Banking Originated Losses (SYMBOL). SYMBOL simulates crisis scenarios in the banking sector. In each scenario, a number representing a realization of the single risk factor is randomly generated for each bank. To represent the fact that all banks operate in the same economy, the risk factors are correlated between themselves. Given the realisation of the risk factors, individual banks' losses are generated via Monte Carlo simulations using the Basel III Fundamental Internal Risk Based (FIRB) loss distribution function and are based on an estimate of the average default probability of the portfolio of assets of any individual bank, which is derived from data on banks' minimum capital requirements and total assets. These losses can then be applied to the bank's liabilities by respecting the waterfall in the hierarchy of claims, possibly triggering the use of resolution/insolvency tools and corresponding funding sources. Given a sufficient number of loss scenario simulations (hundreds of thousands to millions), it is possible to obtain statistical distributions of outcomes for the banking sector as a whole. This concerns mainly the dynamic simulation related to DGS interventions (section 4). More detailed information on SYMBOL, including model structure, analytical approach, key assumptions, limitations and simplifications are available in section 3.2 of the EBA's CfA report.

2.3. Assumptions and scenarios for the static and model-based analyses

The static analyses and the simulations are based on a set of common assumptions to address data quality issues (e.g. missing values), data processing (e.g. size classification criteria, level of consolidation of the analyses, mapping of national creditor hierarchies into a simplified hierarchy of claims which is used for all banks in a Member State) and data aggregation (e.g. presentation of the results). The main scenarios tested relate to equity (CET1) depletion, depositor preference in the hierarchy of claims, loss simulations and loss allocation within banking groups depending whether the resolution group structure holds or not in resolution and the run on short-term liabilities. Detailed information on these assumptions and scenarios is available in sections 3.1 and 3.2 of the EBA CfA report.

[432] EBA (2021), *Call for advice regarding funding in resolution and insolvency*

The most relevant assumptions and scenarios used in analyses relying on the EBA CfA report are described below.

- **Size classification**

  - For the purpose of the assessments conducted in sections 3 and 4, institutions are classified as "large", "medium" or "small and non-complex" by the EBA in accordance with the criteria in CRR.[433] Such criteria relate to balance sheet size and systemic risk importance, but also elements of complexity such as trading activities and the location of activity outside of the European Economic Area.
  - On the basis of this classification, the sample used in the EBA CfA report is made of 368 institutions (parent and standalone entities)434, out of which 49 large, 124 medium and 195 small and non-complex institutions located in 27 Member States. When also considering subsidiaries, the total sample of entities is made of 862 entities out of which 58 large, 304 medium and 500 small and non-complex entities.
  - Where appropriate, other analyses use size classification based on total assets.

Table 9: Size clustering criteria used in the EBA CfA report

Category	Criteria
Large	**The institution meets <u>any</u> of the following conditions, with the exception of condition (d) which acts like a binding threshold for all other conditions[435]:** (a) Identified as G-SII in accordance with Article 131(1) and (2) of Directive 2013/36/EU (b) Identified as O-SII in accordance with Article 131(1) and (2) of Directive 2013/36/EU (c) One of the three largest institutions in terms of total value of assets in the Member State in which it is established (d) The total value of the institution's assets on the basis of its consolidated situation is equal to or larger than EUR 30 bn
Small (and non-complex)	**The institution is not a 'large' institution and meets <u>all</u> of the following conditions:** (a) The total value of its assets on an individual basis or, where applicable, on a consolidated basis in accordance with Regulation (EU) No 575/2013 and Directive 2013/36/EU is on average equal or less than the threshold of EUR 5 bn over the four-year period immediately preceding the current annual disclosure period (b) The total value of its derivative positions is less than or equal 2% of its total on- and off-balance sheet assets, whereby only derivatives which qualify as

[433] Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019, OJ L 150, 7.6.2019, p. 1–225. The proposed criteria were simplified; see section 2.3.1 of the EBA CfA report.

[434] This statistic is based on the sample of institutions at point of entry or parent entity level, irrespective whether they have strategy resolution or liquidation (i.e. excluding subsidiaries).

[435] i.e. banks with a balance sheet size below EUR 30 bn are not captured in the "large" category even if they are O-SIIs or among the third largest institutions in their Member State.

	positions held with trading intent are included in the calculating the derivative positions (c) More than 75% of both the institution's consolidated total assets and liabilities, excluding in both cases the intragroup exposures, relate to activities with counterparties located in the European Economic Area
Medium	**The institution is neither "large" nor "small"**

Source: EBA CfA report.

- **Funding structure classification**

For the purpose of the assessments conducted in sections 3 and 4, institutions are also classified according to their funding structure through an indicator describing the prevalence of deposits in their balance sheet. The indicator takes into account all forms of deposits, irrespective of the counterparty or the nature of the deposit (non-preferred, preferred, covered). Banks are distributed in four categories of deposit prevalence: "low", "mid", "mid-high" and "high". On the basis of this classification, the sample used in the EBA CfA report is made of 368 institutions, out of which 107 with a low, 44 with a medium, 63 with a medium-high and 154 with a high prevalence of deposits.

Table 10: Funding structure – deposit prevalence as per criteria used in the EBA CfA report

Category	Share of deposits over TLOF
Low	[0-60%]
Mid	]60-70]
Mid-High	]70-80]
High	>80%

Source: EBA CfA report.

- **CET1 depletion scenarios**

Five scenarios of CET1 depletion (presented in decreasing order of severity) are envisaged in the analyses:

- **Baseline (Scenario 1)**: assume no CET1 depletion, i.e. all the CET1 (including the Pillar 1, Pillar 2 requirement, combined buffer and any management buffer) is available to absorb losses at the moment of failure (in addition to other bail-inable liabilities);
- **Scenario 2**: assume a 75% depletion of the combined buffer requirement at the moment of failure (including any management buffer in addition to the buffer requirements) i.e. CET1 held as Pillar 1, Pillar 2 requirement and 25% of the combined buffer requirement are available to absorb losses at the moment of failure (in addition to other bail-inable liabilities);
- **Scenario 3**: assume a 100% depletion of CET1 held as capital buffers, i.e. CET1 held as Pillar 1, Pillar 2 requirement are available to absorb losses at the moment of failure (in addition to other bail-inable liabilities);

- **Scenario 4**: assume the depletion of CET1 where only Pillar 1 and 50% of Pillar 2 requirement are available to absorb losses at the moment of failure (in addition to other bail-inable liabilities);
- **Scenario 5:** assume only Pillar 1 is still available to absorb losses at the moment of failure (in addition to other bail-inable liabilities).

Five scenarios of equity depletion are considered when assessing the institutions' ability to reach 8% TLOF and access the RF/SRF. As explained in Chapter 2 and Annex 8, the timing of triggering FOLF determines the amount of capital and liquidity remaining in the bank. At the same time, the supervisor can only make the FOLF determination if the conditions foreseen in Article 32 BRRD are fulfilled, which in the case of FOLF due to (likely) breaches of capital requirements foresee that the (likely) breach needs to be severe enough to justify withdrawal of the authorisation. It should therefore be acknowledged that in particular scenarios 1 and 2 would only be possible under very exceptional circumstances based on the existing legal framework. It has been decided to include these scenarios in order to provide a more comprehensive sensitivity analysis, also taking into account the possible impact resulting from the treatment of historical losses according to the BRRD II which establishes that all equity used to absorb losses identified in the resolution valuations counts toward the calculation of the 8% TLOF benchmark, even if depleted at the moment of FOLF triggering (Article 59(1b) BRRD).

- **Short-term funding with a remaining maturity of less than 1 month**

When allocating losses or analysing the incidence of the 8% TLOF to access the RF/SRF, one relevant question is whether short-term liabilities can be relied upon to absorb losses or whether those investors are likely to withdraw or not roll over their claims in the bank. A single assumption is considered, namely that short-term liabilities with a remaining maturity below 1 month cannot be relied upon at the moment of failure and only liabilities with a longer remaining maturity can be used to absorb losses. However, it is assumed that the exclusion of short-term liabilities below 1 month does not affect the total size of the balance sheet or the TLOF, as these liabilities would be replaced by secured ones. Other types of short-term instruments such as sight deposits are included in the analysis because their exclusion would require additional assumptions of deposit runs difficult to extrapolate to the entire sample.

- **Loss allocation within banking groups**

When performing the allocation of losses, the group structure should be considered. In particular, for subsidiaries which are part of resolution group and which are not resolution entities themselves, two scenarios are relevant when performing the allocation of losses in cases where the losses exceed the internal MREL requirement:

- **Scenario 1:** The resolution group structure holds and the losses of a subsidiary exceeding its pre-positioned internal MREL requirement are transferred to the resolution entity. Under this scenario, only the instruments pre-positioned by the parent to the subsidiary can be written down (up-streamed to the parent) and it is

assumed that the parent entity will support its subsidiary beyond the internal MREL eligible instruments present in the subsidiary. Concretely, at subsidiary level, the allocation of losses starts with own funds and other internal MREL eligible liabilities of the subsidiary at solo level up until the internal MREL requirement is exhausted. Possible remaining losses are transferred to the parent level, where together with the parent's own losses they will be covered by taking into account the own funds and liabilities in the order of hierarchy of the parent from its solo balance sheet.

- **Scenario 2**: The resolution group structure breaks-down triggering the resolution of the subsidiary and the allocation of the subsidiary's losses is done at the subsidiary solo level only, covering all the subsidiary's balance sheet, according to the applicable hierarchy of claims.

- **National creditor hierarchy assumptions**

As also described in Annex 8, the hierarchies of claims are defined by national laws and differ across Member States. While the ranking of certain types of claims are more harmonised across Member States than others (own funds and subordinated instruments, preferred and covered deposits) the ranking of a certain claim in a bank balance sheet may also be driven by contractual clauses, which banks report to NRAs/SRB. Since the same typology of claim can rank differently for the same bank and/or among banks within the same Member State in function of contractual clauses, an assumption was necessary in order to generate an allocation of claims to a simplified creditor hierarchy and build the scenarios of depositor preference upon this foundation.

In this context, for liabilities in the dataset, which had an outstanding amount different from zero, a mapping was performed into a simplified hierarchy of claims (section [X] of the EBA CfA report).

- **Depositor preference**

In order to assess the possibility to access resolution financing arrangements, the degree of depositor protection or exposure to losses in this context (section 3 of this Annex) and the potential use of DGS funds in resolution or under alternative measures in insolvency under the LCT (section 4), five scenarios of depositor preference have been considered:

- **Baseline (Scenario 1):** current hierarchy of claims, i.e. three-tier depositor preference unharmonised across Member States. In most Member States, covered deposits are super-preferred, ranking above preferred deposits (natural persons and SMEs above EUR 100 000), which in turn rank above other deposits, the latter ranking *pari passu* with ordinary unsecured claims. However, some Member States have a three-tier depositor preference where covered deposits rank above preferred deposits, which rank above non-preferred deposits, the latter also ranking above ordinary unsecured claims);

- **Scenario 2:** a single-tier depositor preference for all Member States, i.e. all types of deposits rank *pari passu* among themselves and above ordinary unsecured claims;
- **Scenario 3:** a three-tier depositor preference harmonised for all Member States, i.e. covered deposits rank above preferred deposits, which rank above non-preferred deposits, the latter also ranking above ordinary unsecured claims;
- **Scenario 4**: a two-tier depositor preference in all Member States, where covered deposits are super-preferred to preferred deposits, which rank *pari passu* with non-preferred deposits, the latter ranking above ordinary unsecured claims;
- **Scenario 5:** a two-tier depositor preference in all Member States, where covered deposits rank *pari passu* with preferred deposits, all of which rank above non-preferred deposits, the latter ranking above ordinary unsecured claims.

All these alternative scenarios prefer depositors in relation to ordinary unsecured claims, however with varying distinctions in terms of the relative order of deposits covered by DGSs, preferred and non-preferred deposits. Out of the four alternative scenarios, two propose removing the super-preference of covered deposits (scenarios 2 and 5), while the other two scenarios retain the super-preference of covered deposits in a tiered approach (scenarios 3 and 4).

These scenarios (including the baseline) are applied under various quantitative analyses throughout sections 3 and 4 of this Annex, aiming at assessing the access condition to the RF/SRF (8% TLOF minimum bail-in requirement) and the DGS contribution to resolution and insolvency under the LCT respectively. The quantitative outcome of these analyses are presented in detail under the respective sections. The outcome of the analyses of the different scenarios of depositor preference informed the assessments in Chapters 2, 5, 6, 7 as well as Annexes 5 and 8 of this impact assessment.

- **Mandatory exclusions from bail-in**

Mandatory exclusions from bail-in under Article 44(2) BRRD were considered in the analyses presented in this Annex. For a complete view of the types of liabilities excluded from bail-in and their materiality in the banks' balance sheets, please see Annex 8.

The ranking of these liabilities diverges across Member States, in line with national specificities pertaining to areas such as taxation, employee protection, social security or civil law. In some Member States some of these excluded liabilities rank above deposits, in others, some they rank below or among deposits. The relative ranking of these liabilities in relation to deposits (in particular when ranking below or among deposits) has an impact on the allocation of losses in the waterfall of claims and the assessment of banks' ability to meet 8% TLOF to access the RF/SRF, including the potential for DGS intervention. In order to reflect this, assumptions were taken with regard to the ranking of excluded claims at the level of each Member State, by extrapolating the ranking occurring most frequently by type of excluded liability, as reported by banks.

- **Least cost test (LCT) – Insolvency haircut scenario**

The objective of the LCT is to safeguard the DGS against losses when contributing to various measures alternative to payout and to determine whether and for what maximum amount (if any) the DGS could make such contributions in a less costly way than under a payout event in insolvency. Assumptions with respect to losses in an insolvency counterfactual with a payout event are therefore required for the purpose of conducting the LCT. The following primary assumption is considered for all banks in the sample:

- a 15% average haircut (loss) on all assets in insolvency (corresponding to a recovery rate of 85%), on top of the entity's losses.

The assumption takes into account the fact that a haircut on assets in insolvency is greater than a haircut on assets in a scenario of sale of business using "disposal value" in the resolution valuation. The assumption of 15% haircut in insolvency which is applied to EU banks in the sample is slightly higher than the one taken by the SRB in its internal policy on the NCWO assessment (10%) for banks under its remit, which also requires a comparison against a loss in an insolvency counterfactual. The insolvency haircut of 15% on total assets has been already used by the Commission when presenting quantitative examples of DGS intervention in its Expert Group and the HLWG.

However, because the levels of insolvency haircuts (losses) and related recovery rates vary greatly across banks and Member States, this Annex aims to show some of the results also for a 50% haircut in insolvency and 50% related recovery rate, as a secondary assumption, in order to give a flavour of the scale of the differences in results (see section 4.5).

The assumptions on insolvency haircuts and recovery rates come with important caveats and limitations. The heterogeneity of recovery rates across banks and Member States is driven by a series of factors: (i) they are bank-specific, depending on asset quality, bank's financial position and market situation; (ii) they are strongly influenced by the national insolvency laws and judicial systems, and in particular the duration of the proceedings; (iii) an EU benchmark on average recovery rates or insolvency haircuts is absent and (iv) they may be also influenced by the severity of the crisis. These limitations are also confirmed by the EBA's findings on DGS funding and uses of DGS funds published in 2020. An EBA-led survey of Member States concluded that, 13 respondents reported recovery rates between 1-100% in cases of DGS payout since the implementation of the DGSD, while two respondents reported recovery rates between 20-95% in cases prior to the implementation of the DGSD[436].

To mitigate the uncertainties deriving from these limitations, the interpretation of the results provides qualitative clarifications to show how the results would be impacted if higher or lower insolvency haircuts/recovery rates were considered.

[436] EBA (January 2020), *Opinion of the European Banking Authority on deposit guarantee scheme funding and uses of deposit guarantee scheme funds*, paragraph 27, p. 23, 24.

- **Bail-inable capacity**

In order to assess the possibility to access resolution financing arrangements and the related use of DGS in resolution or under alternative measures in insolvency, sections 3 and 4 of this Annex also look at the banks' internal loss-absorbing capacity under two scenarios of bail-inable capacity to assess whether deposits would be bailed-in to access resolution financing arrangements, and what is the eventual bail-inable capacity:

- **Scenario 1:** Use of the amount of bail-inable liabilities with complete or partial exclusion of deposits, including MREL eligible deposits (shown in the tables presented in the next sections);

- **Scenario 2:** Use of a proxy of the bail-inable capacity at least equal to steady-state MREL requirements.

The first scenario allows measuring various degrees of severity based on the current bail-inable capacity, singling out the types of deposits affected by the simulations. The complete or partial exclusion of deposits also serves to cater for possible concerns related to the bail-in of deposits for financial stability reasons. The second scenario assumes an estimated stock of eligible liabilities held by the institutions assuming they will meet their MREL requirements by the end of the transition period. This latter scenario does not take into account a change in the structure of the balance sheets due to compliance with future MREL levels, as institutions retain discretion on how they plan to comply with the requirements by the end of the transition period[437].

- **MREL requirements**

When the MREL requirement is not reported for some resolution entities, a proxy is used, in function of the strategy: for banks with liquidation strategy, the proxy MREL requirement equals own funds requirements and for banks with resolution strategy, the proxy MREL requirement is twice own funds requirements.

Where internal MREL requirement is not available for subsidiaries, a proxy is used, in function of the materiality[438] and the strategy defined for the entity. For non-material entities and entities with strategy liquidation, internal MREL is assumed to equal own funds requirements. For material subsidiaries and those with strategy resolution, internal MREL is assumed to be equal to twice own funds requirements.

- **Hybrid EDIS scenarios**

[437] In particular, the impact assessment does not make general assumptions applied to all banks on the type of liabilities that would be issued, replaced or renewed and their relative location in the hierarchy of claims, nor on other strategic choices made to comply with future requirements (restructuring, disposal of assets, etc.).

[438] Material subsidiaries defined as representing 5% of resolution group TREA for non-Banking Union entities and 4% for Banking Union entities.

For the purpose of assessing the effectiveness and efficiency of the hybrid/EDIS[439] models compared to national DGSs to finance banks in resolution and insolvency, three scenarios of hybrid EDIS calibration are considered, where the total DGS financial means amounting to 0.8% of covered deposits are distributed as follows:

- **Scenario 1**: Central fund 75% of the available funds, DGS 25%.
- **Scenario 2**: Central fund 50% of the available means, DGS 50%.
- **Scenario 3**: Central fund 25% of the available means, DGS 75%.

2.4. Key steps in the static and model-based approaches

In line with the policy options presented in Chapter 6, the analyses related to the access to resolution financing arrangements and the DGS interventions are inter-related. Sections 3 and 4 of this Annex cover the analysis of banks' ability to reach 8% TLOF to access the RF/SRF and the potential to unlock DGS funding under the LCT for DGS interventions in resolution (i.e. stand-alone or to bridge the gap towards 8% TLOF and accessing RF/SRF) and alternative measures in insolvency, and must be considered following a consistent sequence of steps.

The assessments described in sections 3 and 4 are based on a two-fold approach.

First, a statistical analysis of the 8% TLOF requirement, the ability of DGS to intervene under the LCT safeguard and the availability of DGS financial means are carried out under a baseline scenario as well as under various assumptions related to CET1 depletion, depositor preference and bail-inable capacity. This approach allows to test a wide variety of assumptions and determine the relative and incremental impacts of changes to certain dimensions that can support the design of policy options.

The outcome of this first analysis serves as a basis for comparison and defines the most relevant scenarios (notably of depositor preference) to be used in a second approach, where a model-based analysis relying on SYMBOL-generated losses is carried out, using a dynamic approach whereby losses are allocated to each entity according to the waterfall of liabilities as per the applicable hierarchy of claims, in line with the resolution group structure. The outcome of the model-based approach is used to test the ability of DGS to intervene under the LCT, assess the 8% TLOF requirement and the possible contribution of resolution funds, and ultimately stress the DGS financial means under various hybrid EDIS designs, in particular with different distributions of funds between national DGSs and the central fund.

This modelling approach complements the statistical analysis by using actual losses simulations based on bank-specific characteristics and by adding a resolution group

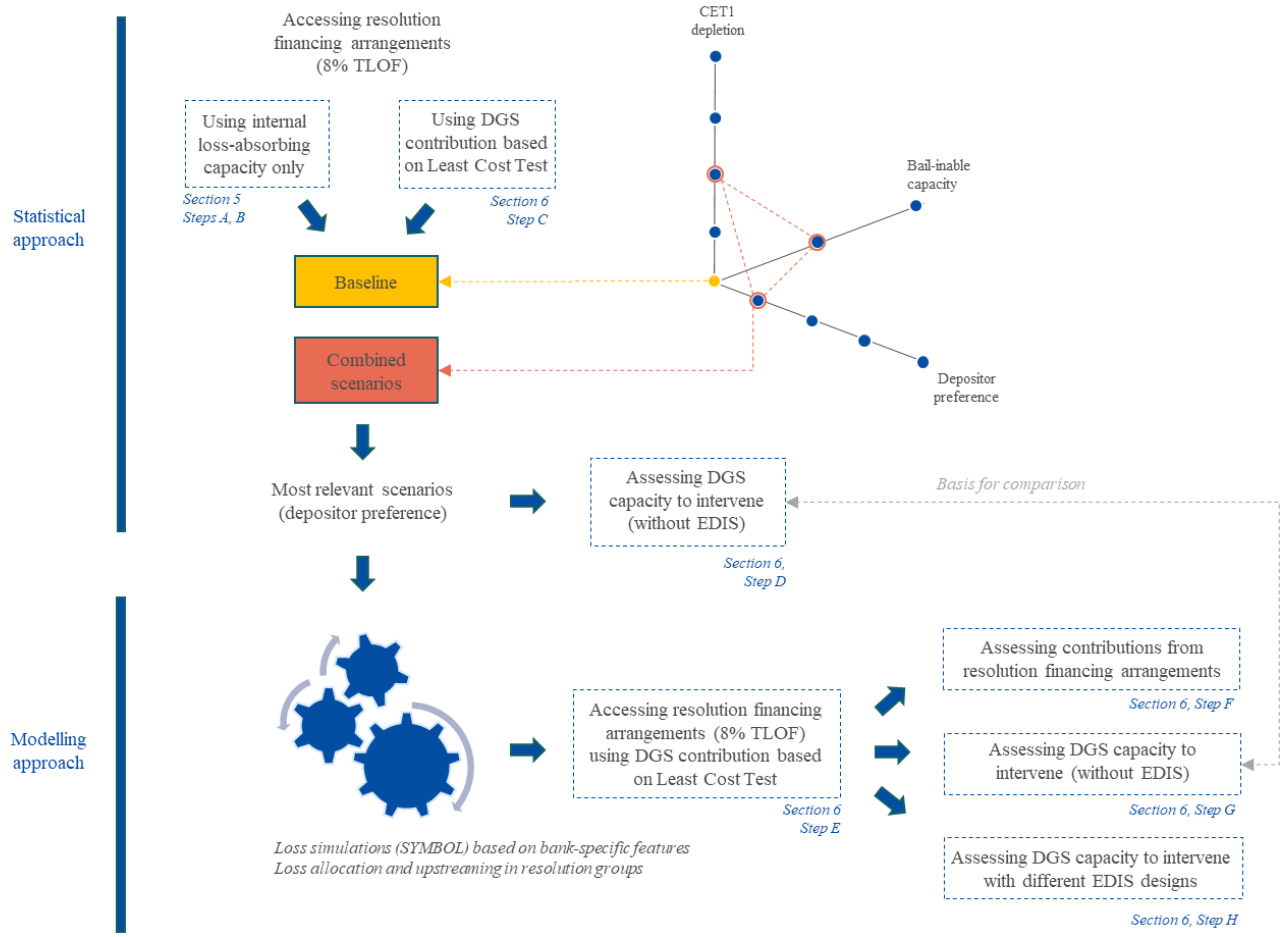
[439] The hybrid EDIS is built on the idea of coexistence of a deposit insurance fund at central level and funds remaining within the national DGSs. The central fund aims at providing liquidity to DGS in the Banking Union, once the latter have exhausted their funds. If the central fund were depleted at the time an intervention is needed, the SRB, on behalf of the central fund, would be able to borrow from national DGSs through a mandatory lending mechanism. See Annex 10 for more details on the hybrid models.

perspective, making the analysis closer to the effective implementation of the strategy defined for the resolution group. It offers a more concrete, economically consistent, opportunity to deepen the analysis and investigate credible scenarios related to the materiality and limits of DGS and resolution fund interventions.

By design and for an improved readability of the results, the model-based approach relies on a subset of assumptions that differ from the statistical approach: the analysis does not assume standard CET1 depletion scenarios, but relies on the generation of simulated losses based on bank-specific characteristics using SYMBOL, depositor preference and bail-inable scenarios are limited to the most relevant ones for the purpose of the dynamic analysis. Still, the incremental effects of each assumptions independently will have been described previously through the outcome of the static statistical approach and can therefore provide valuable insight on the possible impact of changing parameters in the modelling approach.

Based on the assumptions and scenarios detailed above, the data analysis related to the sections 3 and 4, building on the EBA CfA report, can be broken down into the following sequence of steps.

Figure 19: Key steps in the data analysis – Access to 8% TLOF and DGS interventions



Source: Commission services

Table 11: Key steps in the data analysis (details) – Access to 8% TLOF and DGS interventions

Sections	Steps	Objective	Scenarios/ assumptions	Scope	Perimeter
Section 3: Conditions to access the RF/SRF	**A**: Static - 8% TLOF (baseline)	Identify the incidence of 8% TLOF in the hierarchy of claims (impact on deposits) using the internal loss-absorbing capacity under baseline scenario.	Balance sheet as reported, depositor preference applicable in the Member State, available bail-inable capacity.	All banks	Resolution entity (solo) level
	B: Static - 8% TLOF (combined scenarios)	Identify the incidence of 8% TLOF in the hierarchy of claims (impact on deposits) using the internal loss-absorbing capacity under alternative and combined scenarios.	Four additional scenarios of CET1 depletion Four additional scenarios of depositor preference Two additional scenarios of bail-inable capacity	All banks	Resolution entity (solo) level
	The outcome of Step B serves to quantify the magnitude of the difficulty to reach 8% TLOF and is used as a benchmark for policy options addressing the issue				
Section 4: DGS interventions	**C**: Static - LCT (baseline, combined scenarios)	Continuation of Step B, assessing whether, based on the LCT, institutions would be able to reach 8% TLOF via DGS interventions under the baseline, alternative and combined scenarios.	Counterfactual: insolvency haircut 15% of assets Four additional scenarios of CET1 depletion Four additional scenarios of depositor preference Two additional scenarios of bail-inable capacity	All banks	Resolution entity (solo) level
	The outcome of Step C serves to define the most relevant scenarios (notably of depositor preference) to be used in the dynamic assessment using SYMBOL				
	D: Dynamic - LCT, DGS contributions and 8% TLOF (model)	Continuation of Step C, relying on the model-based approach using SYMBOL-generated losses.	Counterfactual: insolvency haircut 15% of assets Most relevant combined scenarios (depositor preference, bail-inable capacity) Two scenarios of loss allocation at entity level where the resolution group structure holds or breaks.	All banks where the resolution group structure can be identified	Resolution entity (solo) level Entity (solo) level when resolution group structure breaks
	E: Dynamic - Use of resolution funds (model)	Continuation of Step D assessing whether contributions from resolution funds (5% TLOF) can be used and cover all losses			
	F: Dynamic - DGS financial means (model)	Continuation of Step E assessing whether DGS financial means are sufficient to cover the maximum amount usable under the LCT.			Resolution entity (solo) level
	G: Static - DGS contributions and financial means (combined scenarios)	Continuation of Step C assessing whether DGS financial means are sufficient to cover the maximum amount usable under the LCT.	Counterfactual: insolvency haircut 15% of assets Most relevant combined scenarios (CET1 depletion, depositor preference, bail-inable capacity)	All banks	Resolution entity (solo) level
	The outcome of Step G serves as a basis for comparison with the dynamic assessment based on economic and bank-specific assumptions using SYMBOL (see Step F)				
	H: Dynamic -Hybrid EDIS (model)	Continuation of Step G assessing to what extent hybrid/EDIS models are more efficient than national DGSs to finance banks in resolution and insolvency and the scope for target level reduction.	Same as E, F and G Three scenarios of hybrid EDIS ambition		Resolution entity (solo) level

3. CONDITION TO ACCESS THE RF/SRF

The objectives of this section are to assess to what extent institutions can access, after a contribution of 8% TLOF through the bail-in of their own funds and eligible liabilities, the RF/SRF, and to analyse to what extent deposits would need to bear losses to reach a level of 8% TLOF.

As underlined previously, the assessment is based on a static statistical approach using predefined loss scenarios (see section 2.3), taking into account cross-dimensional impacts, i.e. the amendments to the creditor hierarchy with respect to depositor preference and the scenarios of bail-inable capacity. It intends to show how many institutions would be able to reach the 8% TLOF threshold, under various scenarios and assumptions.

Baseline scenario. In a first step, the assessments are based on a baseline scenario:

Baseline	Scope	Loss simulation	Loss allocation	Creditor hierarchy	Bail-inable capacity
Statistical approach	Resolution entities (irrespective of the strategy)	All CET1 available	Not relevant (simulated losses applied directly on the balance sheet of the resolution entity)	Applicable creditor hierarchy in the Member State	All bail-inable liabilities (except those with maturity below 1 month) with gradual exclusion of deposits

In a second step, the baseline scenario is further stressed by gradually amending each dimension (level of CET1 depletion, creditor hierarchy and bail-inable capacity), all other things remaining equal. These gradual changes will show the incremental impact of each adjustment against the baseline scenario and allow for explanations on the independent effects of each variable on the ability to reach the 8% TLOF threshold.

In a third step, the assessment focuses on several combined scenarios taking into account each dimension in order to test the cumulative impact of such adjustments. Combined scenarios provide a more accurate picture of the likely impact of a package of policy options, beyond the mere incremental effects tested previously. For the sake of simplification, not all possible combinations are represented in this Annex. However, the narrative attached to each section intends to describe the main impacts stemming from further modifications, more or less severe, of the combined scenarios.

All assessments include specific breakdowns, by size, strategy and funding structure aimed at providing detailed information of the impact from multiple perspectives.

3.1. Composition of the liability structure

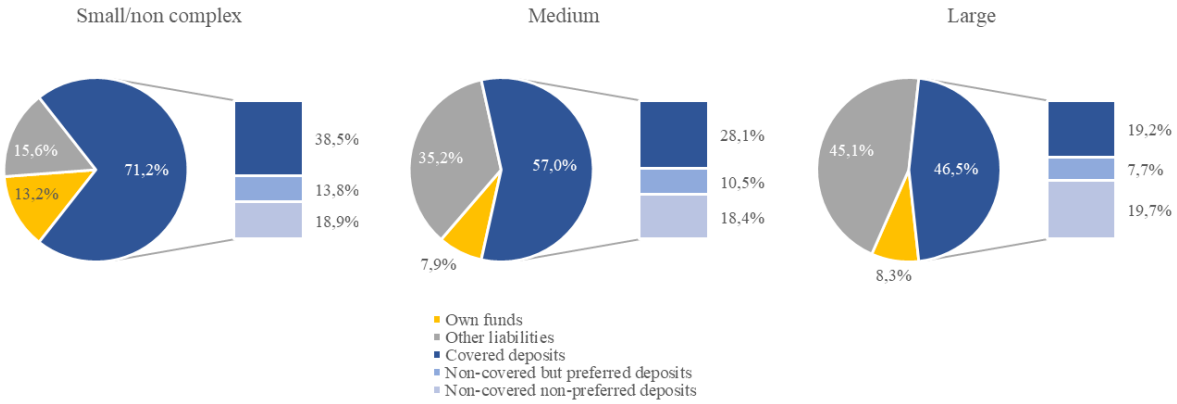
The liability structure of the institutions in the sample vary substantially, in particular depending on their size and business model. Figure 20 and Table 12 show the breakdown of the

liability structure for the resolution entities covered in the analysis. The results are based on aggregated amounts per instrument type shown as a percentage of aggregated TLOF.

The proportion of deposits represents 71.2% of the aggregated total liabilities and own funds of the small and non-complex institutions and decreases to 46.5% for the large institutions. This difference is sizeable with respect to covered and non-covered but preferred deposits, highlighting the prevalence of retail-based funding structure for the smallest banks, compared to non-preferred deposits that have a comparable share across the population of banks.

The composition of own funds also differs based on the size classification. In particular, CET1 represents 94% and 73.2% of the own funds for the small and non-complex and the large institutions respectively. The use of other own funds instruments also varies across institutions. AT1 instruments only represent a small share of the small and medium-sized institutions' total liabilities (0.2%), four times lower than that of large institutions[440]. Tier 2 instruments also appear more frequently in medium and large institutions than in small ones.

Figure 20: Share of deposits in total liabilities and own funds (% based on aggregate amounts)



Source: Commission services analysis, based on EBA CfA report and SRB data as of Q4 2019.

The composition of the liability structure also differs, although to a lesser extent, depending on whether the strategy is resolution or liquidation. On average, institutions earmarked for resolution tend to have a higher share of deposits, in particular non-covered non-preferred in their balance sheet compared to institutions earmarked for liquidation. AT1 and Tier 2 instruments also represent a higher proportion of TLOF for banks with resolution strategies.

As shown in the following sections, the funding structure has an impact on the ability to reach 8% TLOF with or without bailing in deposits, in particular for smaller institutions.

[440] Note: this is consistent with the outcome of the analysis on public issuances of own funds and eligible liabilities, see Annex 13.

Table 12: Composition of the liability structure (resolution entities, % TLOF based on aggregate amounts per category)

Type of liability (% of TLOF)	Small	Medium	Large	Resolution	Liquidation
Deposits	71.2%	57.0%	46.5%	49.9%	44.3%
- *Covered*	*38.5%*	*28.1%*	*19.2%*	*21.8%*	*19.3%*
- *Non-covered but preferred*	*13.8%*	*10.5%*	*7.7%*	*8.3%*	*9.2%*
- *Non-covered non preferred*	*18.9%*	*18.4%*	*19.7%*	*19.8%*	*15.7%*
Own funds	13.2%	7.9%	8.3%	8.4%	8.1%
- *Tier 2*	*0.6%*	*1.0%*	*1.5%*	*1.4%*	*0.9%*
- *AT1*	*0.2%*	*0.3%*	*0.8%*	*0.7%*	*0.2%*
- *CET1*	*12.4%*	*6.6%*	*6.1%*	*6.3%*	*6.9%*
Other liabilities	15.6%	35.2%	45.1%	41.7%	47.6%
Total	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Commission services analysis, based on EBA CfA report and SRB data as of Q4 2019.

3.2. Reaching 8% TLOF - Outcome of the statistical approach (Steps A and B)

3.2.1. Baseline

Table 13 shows, in aggregate, the ability of institutions to reach the 8% TLOF threshold under the baseline scenario (i.e. no CET1 depletion, assuming the applicable creditor hierarchy in each Member State and the use of the entire bail-inable capacity except liabilities with maturity shorter than one month). Since the resolution strategy (resolution *versus* liquidation) of each bank is based on past PIA decisions as of Q4 2019, and in view of the policy intention to expand the PIA to a larger number of smaller/medium-sized banks[441], the presentation of the results is covering both perimeters: the whole sample (parent level or point of entry entities[442]), irrespective of the current strategy (resolution or liquidation) and only banks with resolution strategies.

Summary assessment – Baseline

When considering no CET1 equity depletion under the baseline scenario of depositor preference (status quo), the majority of banks in the sample would be able to reach 8% TLOF in order to access the RF/SRF without imposing losses on any types of deposits. However, deposits in 96 banks (26.1%) located in 20 Member States would suffer losses when reaching the 8% TLOF threshold, up to an aggregate amount of EUR 18.3 bn. In three Member States, deposits in more than half of the banks in the sample would be affected. When only institutions with resolution strategies under the 2019 PIA decision are considered, deposits in 44 banks would be affected, up to an aggregate amount of EUR 14.2 bn in 18 Member States.

[441] See policy options on broadening the PIA in Chapter 6.

[442] The sample of institutions referred to consists of so-called "point of entry" or parent level institutions, irrespective whether they have strategy resolution or liquidation (i.e. excluding subsidiaries).

Detailed analysis

The analysis under the baseline scenario shows that overall, out of 368 banks in the sample, 272 banks (73.9%) would be able to reach 8% TLOF without impacting deposits (non-preferred, preferred and covered) when all equity is taken into account under the baseline creditor hierarchy (54.4% of these banks are small, 30.5% are medium-sized and 15.1% large). The share of banks with resolution strategies as per the 2019 PIA decisions out of the total sample is 187 (50.8%). Deposits would bear losses to reach 8% TLOF in 96 banks representing 26.1% of the sample (44 banks with resolution strategy, representing 23.5% of that sample).

In terms of geographical distribution, all banks in six Member States can reach 8% TLOF without affecting deposits, while more than half of the banks in three Member States would require the bail-in of deposits in order to reach 8% TLOF. When focusing on the size of banks, deposits would bear losses when reaching 8% TLOF in 41 medium sized banks (of which 29 with resolution strategy) and 47 small banks (of which 10 with resolution strategy). Five banks (of which two with resolution strategy) would not be able to reach the threshold at all.

In terms of materiality, approximately EUR 18.3 bn deposits would be impacted based on the entire sample (EUR 14.2 bn for banks with resolution strategies). The impacted non-preferred deposits represent EUR 14.2 bn or 1.3% TLOF for all medium-sized banks (EUR 11.6 bn or 1.3% TLOF for resolution strategies only) and EUR 0.8 bn or 1.5% TLOF for small banks (EUR 0.2 bn or 1.1% TLOF for resolution strategies only). Expressed differently, the total amount of deposits impacted when reaching 8% TLOF represent 0.7% of covered deposits for all banks, the largest impact observed for medium banks (0.6%).

Table 13: Reaching 8% TLOF – Baseline

	N.	Institutions reaching 8% TLOF without deposits	Institutions reaching 8% TLOF with non-preferred deposits and amount used		Institutions reaching 8% TLOF with preferred non-covered deposits and amount used		Institutions reaching 8% TLOF with covered deposits and amount used		Institutions not reaching 8% TLOF with deposits and additional amount required	
		Count	*Count*	*%TLOF*	*Count*	*%TLOF*	*Count*	*%TLOF*	*Count*	*%TLOF*
Small	195	148	38	1.48%	7	1.99%	1	1.06%	1	0.38%
Medium	124	83	37	1.30%	1	1.94%	1	4.45%	2	0.46%
Large	49	41	6	0.14%	0	0.00%	0	0.00%	2	0.24%
Resolution	187	143	39	0.57%	1	1.93%	2	4.35%	2	0.31%
Liquidation	181	129	42	0.98%	7	2.02%	0	0.00%	3	0.37%
Low	107	86	15	0.47%	1	1.93%	0	0.00%	5	0.34%
Mid	44	32	12	0.66%	0	0.00%	0	0.00%	0	0.00%
Mid-High	63	52	11	0.58%	0	0.00%	0	0.00%	0	0.00%
High	154	102	43	1.66%	7	1.96%	2	4.35%	0	0.00%
Total	*368*	*272*	*81*		*8*		*2*		*5*	

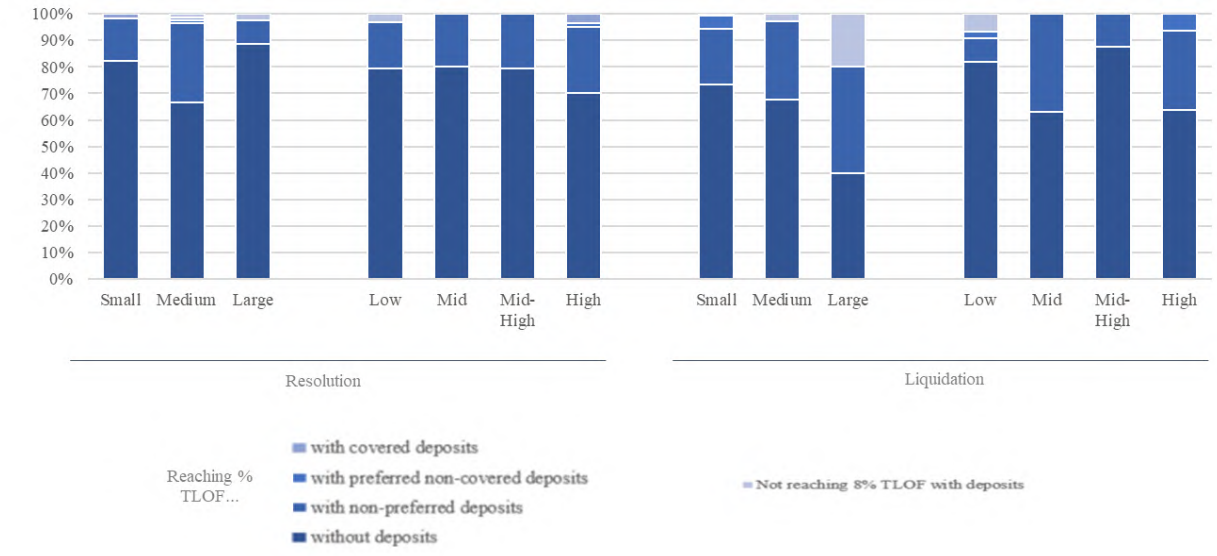
Source: Commission services analysis, based on EBA CfA report and SRB data as of Q4 2019.

Figure 21 shows the outcome of the baseline scenario when considering additional granularity. Among institutions earmarked for resolution, 82% and 67% of small and medium banks respectively would reach 8% TLOF without bailing-in deposits. This proportion rises to 98% and 97% when non-preferred deposits are affected, leaving a residual number of banks for which more senior forms of deposits would have to be bailed-in to reach the 8% TLOF threshold.

The proportions are slightly lower for small banks and stable for medium-sized banks earmarked for liquidation[443]. In particular, 5% of these small institutions would need preferred deposits to reach the threshold, and one medium-sized institution (out of 37) would not reach the level of 8% TLOF even including covered deposits. Only 40% of the few large banks earmarked for liquidation would access 8% TLOF without deposits.

In terms of funding structure, institutions going in resolution tend to have a similar proportion for accessing 8% TLOF without deposits, ranging between 79% and 80%, except for the category with the highest prevalence of deposits (i.e. deposits accounting for more than 80% of TLOF), where this proportion falls to 70%. Covered deposits would be impacted by losses in 3% of the cases with a high deposit prevalence. The proportions vary more significantly for institutions earmarked for liquidation, where 82% to 88% of the banks with a low or mid-high prevalence of deposits, compared to 63% and 64% for banks with a mid and high proportion of deposits in their balance sheet.

Figure 21: Reaching 8% TLOF – Baseline (granular), in function of depositor prevalence[444]



Source: Commission services analysis, based on EBA CfA report and SRB data as of Q4 2019.

[443] Presenting also results for banks with liquidation strategy may be relevant in case the PIA would be broadened.

[444] See section 2.3 of this Annex for details on the categories of banks in function of deposit prevalence.

3.2.2. Baseline versus more severe CET1 depletion scenarios

The ***Table 14*** shows the ability of institutions to reach the 8% TLOF threshold under various scenarios of losses in line with the CET1 depletion assumptions described in section 2.3. All other dimensions remain as per the baseline scenario.

Summary assessment – Baseline versus more severe CET1 depletion scenarios

As a general observation, increasing the severity of CET1 equity depletion, while retaining the baseline scenario of depositor preference (status quo), triggers a significant increase in the number of banks where deposits would need to be bailed-in to reach 8% TLOF and in the amounts of affected deposits.

In particular, the number of banks where deposits would be affected would increase from 96 with an aggregate EUR 18.3 bn affected deposits (44 banks with resolution strategy and an aggregate EUR 14.2 bn affected deposits) under the baseline to 246 banks with an aggregate EUR 83.1 bn affected deposits (117 banks with resolution strategy and an aggregate EUR 71.6 bn affected deposits) under the next more severe CET1 depletion scenario assuming 75% depletion of buffers. For more severe depletion scenarios, the impact is more significant.

While the bulk of affected deposits are non-preferred deposits, covered deposits would also be more affected as the severity of the equity depletion scenarios increases.

Detailed analysis

When considering all 368 banks in the sample (resolution and liquidation strategies), the proportion of banks where deposits would be bailed-in increases significantly from 96 banks (26.1%) under the baseline to 246 banks (66.8%), 282 (76.6%), 294 (79.9%) and 308 (83.7%) under the four analysed CET1 depletion scenarios respectively. When considering only banks with resolution strategies as per 2019 PIA decisions (187 banks), the share of banks where deposits would be bailed-in increases from 23.5% under the baseline to 62.6%, 71.7%, 74.3% and 80.2% under the four CET1 depletion scenarios respectively. The significant jump in the number of banks with impacted deposits under the second scenario in order of severity (depletion of 75% of buffers) compared to the baseline (full CET1 availability) is noteworthy, which demonstrates the sensitivity of the treatment of equity in these hypothetical scenarios.

In terms of materiality, when considering all 368 banks in the sample, the aggregated amount of deposits impacted increases from EUR 18.3 bn (0.7% of covered deposits) under the baseline scenario to EUR 123.7 bn (4.6% of covered deposits) under the third (middle way) CET1 depletion scenario (i.e. depletion of CET1 counting as buffers) and further to EUR 147.8 bn (5.5% of covered deposits) under the most severe scenario (i.e. depletion of CET1 except for Pillar 1). Over 90% of deposits impacted are non-preferred deposits. When considering only 187 banks with resolution strategies as per Q4 2019 PIA decisions, the aggregated amount of deposits impacted increases from a total of EUR 14.2 bn (0.5% of

covered deposits) under the baseline scenario to EUR 107.6 bn (4.0% of covered deposits) under the mid-depletion scenario to EUR 129.7 bn (4.8% of covered deposits) under the most severe scenario. Over 97% of impacted deposits are non-preferred deposits.

The breakdown by size of banks in the sample indicates that, the amount of impacted deposits for medium-sized banks increases from 0.6% of covered deposits under the baseline scenario to 2.2% of covered deposits and 2.5% of covered deposits under the third and the most severe scenario respectively.

In terms of geographical distribution, under the baseline scenario, covered deposits are impacted in two Member States, the intensity of the impact ranging between 1.1% TLOF[445] and 4.5% TLOF, while the impact on non-preferred deposits ranges between 0.2% TLOF and 3.2% TLOF. Under the third scenario, the covered deposits are impacted in six Member States with an impact ranging between 1.7% TLOF and 5.7% TLOF, while the impact on non-preferred deposits ranges between 0.8% TLOF and 4.6% TLOF (with two Member States recording values between 4-5% TLOF and eight Member States between 3-4% TLOF). Under the most severe scenario, covered deposits are impacted in eight Member States for an average ranging between 0.9% TLOF and 6.3% TLOF, while the impact on non-preferred deposits ranges between 0.9% TLOF and 5.1% TLOF with four Member States recording values above 4% TLOF and six between 3-4% TLOF.

[445] I.e. covered deposits which would bear losses when reaching the 8% TLOF threshold represent 1.1% of the TLOF of the concerned bank(s) where those deposits would be affected in that particular Member State.

Table 14: Reaching 8% TLOF – Baseline versus CET1 depletion scenarios

CET1 Depletion	N.	Institutions reaching 8% TLOF without deposits	Institutions reaching 8% TLOF with non-preferred deposits and amount used		Institutions reaching 8% TLOF with preferred non-covered deposits and amount used		Institutions reaching 8% TLOF with covered deposits and amount used		Institutions not reaching 8% TLOF with deposits and additional amount required	
		2 - Depletion 75% of buffers								
	Count	*Count*	*Count*	*%TLOF*	*Count*	*%TLOF*	*Count*	*%TLOF*	*Count*	*%TLOF*
Small	195	60	98	2.30%	32	1.82%	4	1.23%	1	0.48%
Medium	124	37	78	2.35%	4	1.72%	1	5.42%	4	0.40%
Large	49	25	22	0.75%	0	0.00%	0	0.00%	2	0.44%
Resolution	187	70	107	1.18%	5	2.27%	2	5.32%	3	0.36%
Liquidation	181	52	91	1.80%	31	1.40%	3	1.19%	4	0.48%
Low	107	62	37	0.83%	1	3.50%	0	0.00%	7	0.42%
Mid	44	14	29	1.41%	1	0.63%	0	0.00%	0	0.00%
Mid-High	63	22	40	1.72%	1	0.27%	0	0.00%	0	0.00%
High	154	24	92	2.78%	33	1.74%	5	3.48%	0	0.00%
Total	368	122	198		36		5		7	

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CET1 Depletion	N.	Institutions reaching 8% TLOF without deposits	Institutions reaching 8% TLOF with non-preferred deposits and amount used		Institutions reaching 8% TLOF with preferred non-covered deposits and amount used		Institutions reaching 8% TLOF with covered deposits and amount used		Institutions not reaching 8% TLOF with deposits and additional amount required	
		3 - Depletion of all buffers								
	Count	*Count*	*Count*	*%TLOF*	*Count*	*%TLOF*	*Count*	*%TLOF*	*Count*	*%TLOF*
Small	195	36	109	3.16%	41	2.52%	6	2.77%	4	0.55%
Medium	124	28	83	2.90%	8	1.91%	1	5.74%	4	0.44%
Large	49	22	24	1.20%	1	0.33%	0	0.00%	2	0.52%
Resolution	187	53	117	1.69%	12	1.34%	2	5.65%	3	0.41%
Liquidation	181	33	99	2.21%	38	2.20%	5	2.78%	7	0.54%
Low	107	51	45	1.16%	1	4.02%	1	1.66%	10	0.48%
Mid	44	10	32	2.00%	2	1.96%	0	0.00%	0	0.00%
Mid-High	63	12	43	2.35%	7	0.43%	1	3.53%	0	0.00%
High	154	13	96	3.60%	40	2.37%	5	4.37%	0	0.00%
Total	368	86	216		50		7		10	

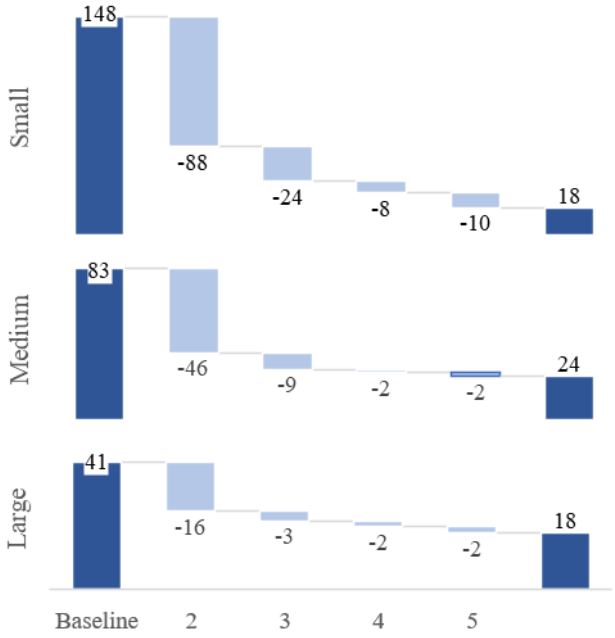
CET1 Depletion	N.	Institutions reaching 8% TLOF without deposits	Institutions reaching 8% TLOF with non-preferred deposits and amount used		Institutions reaching 8% TLOF with preferred non-covered deposits and amount used		Institutions reaching 8% TLOF with covered deposits and amount used		Institutions not reaching 8% TLOF with deposits and additional amount required	
		4 - Depletion of all buffers and 50% of P2R								
	Count	*Count*	*Count*	*%TLOF*	*Count*	*%TLOF*	*Count*	*%TLOF*	*Count*	*%TLOF*
Small	195	28	113	3.39%	44	2.41%	7	2.97%	4	0.55%
Medium	124	26	86	3.05%	7	2.10%	2	2.87%	4	0.42%
Large	49	20	26	1.31%	1	0.53%	0	0.00%	2	0.52%
Resolution	187	49	122	1.83%	11	1.57%	3	2.87%	3	0.38%
Liquidation	181	25	103	2.10%	41	2.19%	6	2.98%	7	0.55%
Low	107	48	48	1.22%	1	4.10%	2	1.69%	10	0.48%
Mid	44	10	31	2.20%	3	0.88%	0	0.00%	0	0.00%
Mid-High	63	9	46	2.56%	7	0.64%	1	3.53%	0	0.00%
High	154	7	100	3.75%	41	2.49%	6	2.91%	0	0.00%
Total	368	74	225		52		9		10	

CET1 Depletion	N.	Institutions reaching 8% TLOF without deposits	Institutions reaching 8% TLOF with non-preferred deposits and amount used		Institutions reaching 8% TLOF with preferred non-covered deposits and amount used		Institutions reaching 8% TLOF with covered deposits and amount used		Institutions not reaching 8% TLOF with deposits and additional amount required	
		5 - Depletion of all buffers and 100% of P2R								
	Count	*Count*	*Count*	*%TLOF*	*Count*	*%TLOF*	*Count*	*%TLOF*	*Count*	*%TLOF*
Small	195	18	121	3.58%	45	2.68%	6	3.22%	6	0.49%
Medium	124	24	87	3.18%	9	2.09%	2	3.42%	4	0.42%
Large	49	18	28	1.34%	1	0.73%	0	0.00%	2	0.56%
Resolution	187	39	130	1.87%	13	1.65%	3	3.42%	4	0.42%
Liquidation	181	21	106	2.22%	42	2.37%	5	3.22%	8	0.55%
Low	107	43	52	1.19%	1	4.39%	1	2.58%	12	0.49%
Mid	44	9	31	2.36%	4	0.38%	0	0.00%	0	0.00%
Mid-High	63	4	50	2.82%	9	0.80%	1	3.53%	0	0.00%
High	154	4	103	4.02%	41	2.67%	6	3.37%	0	0.00%
Total	368	60	236		55		8		12	

Source: Commission services analysis, based on EBA CfA report and SRB data as of Q4 2019

The impact of the increased severity embedded in each scenario is further highlighted in ***Figure 22***, focusing on those institutions, which can access the 8% TLOF threshold without impacting any form of deposits in each scenario of CET1 depletion. Increasing the severity of the CET1 depletion scenario has a material impact on the smaller and medium-sized banks' ability to access 8% TLOF without deposits: compared to the baseline, assuming 75% of the buffers are depleted leads to a reduction of 59% for small banks and 55% for medium banks which can access 8% TLOF without deposits.

Figure 22: Institutions able to reach 8% TLOF without deposits, comparison between each scenario of CET1 depletion)



Source: Commission services analysis, based on EBA CfA report and SRB data as of Q4 2019.

3.2.3. Baseline versus alternative depositor preferences

Table 15 shows the ability of institutions to reach the 8% TLOF threshold under various scenarios of depositor preference as described in section 2.3 and the share and amounts of deposits impacted under each scenario. All other dimensions remain as per the baseline scenario.

Summary assessment – Baseline versus alternative depositor preference scenarios

As a general observation and by design, preferring all deposits in relation to ordinary unsecured claims increases the protection of deposits by leading to a significantly higher number of banks able to achieve the 8% TLOF threshold without impacting deposits compared to the baseline hierarchy of claims. The aggregated amount of impacted deposits decreases from EUR 18.3 bn under the baseline scenario to EUR 6.4 bn under each of the four depositor hierarchy scenarios (and from EUR 14.2 bn under the baseline to EUR 4.6 bn under each of the four depositor hierarchy scenarios when considering only banks with resolution strategy under the 2019 PIA decisions).

The impact on the three categories of deposits is influenced by their relative ranking in relation to each other under the four alternative scenarios. For a complete view on the impact of each deposit type, the results from this section need to be read together with the ones under the LCT section 4.1.3.

Detailed analysis

As a general observation and by design, preferring all deposits in relation to ordinary unsecured claims increases significantly the number of banks able to achieve the 8% TLOF threshold without impacting deposits compared to the baseline hierarchy of claims. The impact on the three categories of deposits is influenced by their relative ranking in relation to each other under the four alternative scenarios.

When considering all 368 banks in the sample (resolution and liquidation strategies), the number of banks able to reach the 8% TLOF threshold without impacting deposits increases by 16.5% from 272 under the baseline hierarchy of claims to 317 under each of the four alternative scenarios of hierarchies of claims. In particular, no large banks would need deposits to access 8% TLOF under the four alternative scenarios. When considering only banks with resolution strategies as per 2019 PIA decisions (187 banks), the number of banks able to reach the 8% TLOF threshold without impacting deposits increases by a similar percentage (16.1%) from 143 under the baseline to 166 under each of the four alternative scenarios of hierarchies of claims. However, the impact on non-preferred, preferred and covered deposits varies across the four scenarios in function of when these rank *pari passu* or are preferred to each other. As shown in ***Table 15***, when comparing:

- Baseline *versus* 2nd scenario (single-tier deposit preference, all deposits *pari passu*): the number of banks with impacted non-preferred, preferred and covered deposits changes from 81, 8 and 2 respectively to 48 (when only banks with resolution strategies are considered, it changes from 39, 1 and 2 banks respectively to 20);
- Baseline *versus* 3rd scenario (three-tier deposit preference, no *pari passu*): the number of banks with impacted non-preferred decreases from 81 to 38, while the number of banks with impacted preferred and covered deposits stays the same (8 and 2 respectively) (when only banks with resolution strategies are considered the decrease in

number of banks with impacted non-preferred deposits is from 39 to 17, from 2 to 1 with preferred deposits, and always one bank with covered deposits);

- Baseline *versus* 4th scenario (two-tier deposit preference with super-preference of covered deposits, non-preferred and preferred deposits *pari passu*): the number of banks with impacted non-preferred and preferred deposits changes from 81 and 8 respectively to 46, while the number of banks with impacted covered deposits stays the same (2) (when only banks with resolution strategies are considered the number of banks with impacted non-preferred and preferred deposits changes from 39 and 1 respectively to 18);
- Baseline *versus* 5th scenario (two-tier deposit preference with preferred and covered deposits *pari passu*): the number of banks with impacted non-preferred deposits decreases from 81 to 38, while the number of banks with impacted preferred and covered deposits increase from 8 and 2 respectively to 10 (when only banks with resolution strategies are considered, the number of banks with impacted non-preferred deposits decreases from 39 to 17, while the number of banks with impacted preferred and covered deposits increase from 1 and 2 respectively to 3).

In terms of materiality, when considering all banks in the sample, the aggregated amount of impacted deposits decreases from EUR 18.3 bn under the baseline scenario to EUR 6.4 bn under each of the four depositor hierarchy scenarios. When considering only banks with resolution strategies as per Q4 2019 PIA decisions, the aggregated amount of impacted deposits decreases from EUR 14.2 bn under the baseline to EUR 4.6 bn under each of the four depositor hierarchy scenarios. This significant improvement in terms of depositor protection is enabled by the preference of deposits in relation to senior unsecured claims.

The biggest improvement in terms of protected non-preferred deposits is recorded when comparing the baseline (on aggregate EUR 17.2 bn (0.6% TLOF) impacted non-preferred deposits for 81 banks) against the single-tier depositor preference scenario (EUR 2.7 bn (0.6% TLOF) impacted non-preferred deposits for 48 banks) when reaching 8% TLOF. The aggregated amount of covered deposits, which in theory would be impacted in this simulation when reaching 8% TLOF, would increase from EUR 0.3 bn (4.4% TLOF) for two banks under the baseline to EUR 2.8 bn (0.8% TLOF) for 48 banks under the single-tier preference.

However, the impact of changing the relative ranking of covered deposits vis-à-vis other deposits by ensuring a single ranking does not affect or decrease in any way the protection of the covered deposits. As also detailed in Annex 8 and Chapter 5 (section 5.5) this is because of the following reasons: (i) covered deposits continue to be excluded from bail-in as per Article 44(2) BRRD; (ii) the protection of covered deposits is not defined by their ranking, but by being defined as eligible deposits (i.e. they are not excluded from DGS protection) up to the coverage amount whose repayment is guaranteed by the DGS (generally, EUR 100 000); (iii) the protection of cover deposits can be ensured by the DGS through alternative interventions such as contribution to resolution (to bridge the gap to 8% TLOF in order to gain access to the RF/SRF or independently from using the RF/SRF, e.g. when transferring deposits to an acquirer as part of resolution action) or to alternative measures in insolvency (e.g. when

transferring deposits of a bank with negative PIA to an acquirer as part of insolvency proceedings).

In terms of geographical distribution, in two Member States, the number of banks without impacted deposits increased by 200% when comparing the baseline with a scenario where a single-tier depositor preference is introduced and increased by more than 30% in four other Member States when all the sample was considered.

Table 15: Reaching 8% TLOF – Baseline versus depositor preference scenarios

	N.	Institutions reaching 8% TLOF without deposits	Institutions reaching 8% TLOF with non-preferred deposits and amount used		Institutions reaching 8% TLOF with preferred non-covered deposits and amount used		Institutions reaching 8% TLOF with covered deposits and amount used		Institutions not reaching 8% TLOF with deposits and additional amount required	
Hierarchy		**2 - Single-tier**								
	Count	*Count*	*Count*	*%TLOF*	*Count*	*%TLOF*	*Count*	*%TLOF*	*Count*	*%TLOF*
Small	195	166	28	0.70%	28	0.77%	28	0.92%	1	0.16%
Medium	124	102	20	0.61%	20	0.27%	20	0.82%	2	0.44%
Large	49	49	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Resolution	187	166	20	0.63%	20	0.27%	20	1.12%	1	0.41%
Liquidation	181	151	28	0.60%	28	0.42%	28	0.40%	2	0.44%
Low	107	102	2	0.98%	2	0.48%	2	2.54%	3	0.42%
Mid	44	38	6	0.27%	6	0.25%	6	1.32%	0	0.00%
Mid-High	63	60	3	1.84%	3	0.30%	3	0.56%	0	0.00%
High	154	117	37	0.51%	37	0.36%	37	0.69%	0	0.00%
Total	368	317	48		48		48		3	

	N.	Institutions reaching 8% TLOF without deposits	Institutions reaching 8% TLOF with non-preferred deposits and amount used		Institutions reaching 8% TLOF with preferred non-covered deposits and amount used		Institutions reaching 8% TLOF with covered deposits and amount used		Institutions not reaching 8% TLOF with deposits and additional amount required	
Hierarchy		**3 - Three-tier**								
	Count	*Count*	*Count*	*%TLOF*	*Count*	*%TLOF*	*Count*	*%TLOF*	*Count*	*%TLOF*
Small	195	166	20	1.80%	7	1.99%	1	1.06%	1	0.16%
Medium	124	102	18	1.16%	1	1.94%	1	4.45%	2	0.44%
Large	49	49	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Resolution	187	166	17	1.21%	1	1.93%	2	4.35%	1	0.41%
Liquidation	181	151	21	1.17%	7	2.02%	0	0.00%	2	0.44%
Low	107	102	1	1.00%	1	1.93%	0	0.00%	3	0.42%
Mid	44	38	6	1.83%	0	0.00%	0	0.00%	0	0.00%
Mid-High	63	60	3	2.54%	0	0.00%	0	0.00%	0	0.00%
High	154	117	28	1.05%	7	1.96%	2	4.35%	0	0.00%
Total	368	317	38		8		2		3	

	N.	Institutions reaching 8% TLOF without deposits	Institutions reaching 8% TLOF with non-preferred deposits and amount used		Institutions reaching 8% TLOF with preferred non-covered deposits and amount used		Institutions reaching 8% TLOF with covered deposits and amount used		Institutions not reaching 8% TLOF with deposits and additional amount required	
Hierarchy		**4 - Two-tier (covered senior to preferred)**								
	Count	*Count*	*Count*	*%TLOF*	*Count*	*%TLOF*	*Count*	*%TLOF*	*Count*	*%TLOF*
Small	195	166	27	0.95%	27	1.45%	1	1.06%	1	0.16%
Medium	124	102	19	0.83%	19	0.87%	1	4.45%	2	0.44%
Large	49	49	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Resolution	187	166	18	0.89%	18	1.05%	2	4.35%	1	0.41%
Liquidation	181	151	28	0.73%	28	0.77%	0	0.00%	2	0.44%
Low	107	102	2	0.99%	2	2.59%	0	0.00%	3	0.42%
Mid	44	38	6	0.94%	6	0.90%	0	0.00%	0	0.00%
Mid-High	63	60	3	2.03%	3	1.07%	0	0.00%	0	0.00%
High	154	117	35	0.70%	35	0.94%	2	4.35%	0	0.00%
Total	368	317	46		46		2		3	

	N.	Institutions reaching 8% TLOF without deposits	Institutions reaching 8% TLOF with non-preferred deposits and amount used		Institutions reaching 8% TLOF with preferred non-covered deposits and amount used		Institutions reaching 8% TLOF with covered deposits and amount used		Institutions not reaching 8% TLOF with deposits and additional amount required	
Hierarchy		**5 - Two-tier (covered *pari passu* with preferred)**								
	Count	*Count*	*Count*	*%TLOF*	*Count*	*%TLOF*	*Count*	*%TLOF*	*Count*	*%TLOF*
Small	195	166	20	1.80%	8	1.23%	8	0.78%	1	0.16%
Medium	124	102	18	1.16%	2	0.46%	2	2.24%	2	0.44%
Large	49	49	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Resolution	187	166	17	1.21%	3	0.46%	3	2.23%	1	0.41%
Liquidation	181	151	21	1.17%	7	1.25%	7	0.77%	2	0.44%
Low	107	102	1	1.00%	1	0.31%	1	1.62%	3	0.42%
Mid	44	38	6	1.83%	0	0.00%	0	0.00%	0	0.00%
Mid-High	63	60	3	2.54%	0	0.00%	0	0.00%	0	0.00%
High	154	117	28	1.05%	9	0.65%	9	1.90%	0	0.00%
Total	368	317	38		10		10		3	

Source: Commission services based on EBA CfA report and SRB data as of Q4 2019.

3.2.4. Baseline versus alternatives for bail-inable capacity

The results described in the previous sections assess the impacts of various scenarios when considering the bail-inable capacity of banks (with the complete or partial exclusion of deposits) as of Q4 2019. Additionally, as described in section 2.3, considering the final MREL requirement that banks need to comply with by the end of the transitional period would complement the previous results by also anticipating the ability of banks to meet 8% TLOF and the assessment of DGS interventions in the steady state. However, based on the data available, only one entity (out of 368) has a bail-inable capacity (including deposits) based on the 2019 balance sheet data that is currently lower than its estimated MREL target by the end of the transition period. Irrespective of the possible changes of the bail-inable capacity linked to the progressive path to the compliance with MREL requirements, the other analyses will therefore not rely on this additional scenario (i.e. MREL requirement when higher than the bail-inable capacity).

3.2.5. Combined scenarios

Combining the various dimensions of the statistical approach allows for a more accurate description of the impacts along a set of reasonable assumptions underpinning the analysis of the policy options.

The tables included in this section are based on three selected combined scenarios (static approach). While a larger number of combined scenarios could have been shown (25

combinations of CET1 depletion and depositor preference), this section focuses on a selection of reasonable combined scenarios in the context of the policy options. In particular, combined scenario 1 underpins the retained policy option, while the additional combined scenarios present a level of severity for CET1 depletion, which is the mid-point between the baseline and the most severe scenario and the three-tier depositor preference, which retains the super-preference of covered deposits:

<table>
<tr><th>Statistical approach</th><th>Scope</th><th>Loss allocation</th><th>Loss simulation (CET1 depletion)</th><th>Creditor hierarchy</th><th>Bail-inable capacity</th></tr>
<tr><td>Combined scenario 1</td><td rowspan="3">Resolution entities (irrespective of strategy)</td><td rowspan="3">Not relevant (simulated losses applied directly on the balance sheet of the resolution entity)</td><td>Scenario 1: No depletion</td><td rowspan="2">Scenario 2: Single-tier depositor preference</td><td rowspan="3">Scenario 1: All bail-inable liabilities (except those with maturity below 1 month) with gradual exclusion of deposits</td></tr>
<tr><td>Combined scenario 2</td><td rowspan="2">Scenario 3: CET1 depleted down to the level of Pillar 1 and Pillar 2 requirement</td></tr>
<tr><td>Combined scenario 3</td><td>Scenario 3: Three-tier depositor preference</td></tr>
</table>

Source: Commission services.

- ***Combined scenario 1*** reflects a situation without CET1 depletion, a single-tier depositor preference and all bail-inable liabilities reported as of end-2019 (except short-term liabilities) with gradual exclusion of deposits. The design of this combined scenario is relevant insofar as it allows measuring the ability to access 8% TLOF by considering all CET1 that could account for historical losses and relies on the depositor preference scenario that maximises the equal treatment of depositors (*pari passu* across all eligible categories) without lowering the level of protection and therefore creating space for DGS interventions under the LCT (see also section 4).

- ***Combined scenario 2*** reflects a situation where the CET1 level is depleted and the bank would enter resolution after all buffers absorbed losses, and assumes the same single-tier depositor preference and bail-inable capacity as above. The design of this combined scenario is relevant insofar as it allows a direct comparison with the first combined scenario to measure the effect of further CET1 depletion, featuring larger losses or a different timing for FOLF determination at the point where solvency conditions for authorisation are at risk.

- ***Combined scenario 3*** reflects the same depletion of CET1 as above, but it considers a three-tier depositor preference and applies the same bail-in capacity as the other combined scenarios. The design of this combined scenario is relevant insofar as it shows the effect, compared to the second combined scenario, of preserving more discrimination in the depositor preference and retaining the super-preference of covered deposits, which lowers the possible use of DGS via the LCT. As previous combined scenarios, it also shows, compared to the baseline, the effect of introducing a general depositor preference *vis-à-vis* ordinary unsecured liabilities.

Summary assessment – Combined scenarios

The analysis of the three combined scenarios enables a comparative view of impacts on deposits when reaching the 8% TLOF threshold when different severity of CET1 depletion would be combined with different depositor preference.

Combining various levels of CET1 depletion and depositor preference shows that the introduction of a single-tier depositor preference has an important effect on the ability of banks to reach the 8% TLOF threshold without using deposits, irrespective of the loss scenario used for the analysis. In particular, compared to the baseline scenario (where the applicable creditor hierarchy is used), an additional 45 banks would be able to reach the threshold without using deposits due to increasing the ranking of non-preferred deposits against other ordinary unsecured liabilities. Assuming CET1 depleted down to the level of Pillar 1 and Pillar 2 requirement, under a single-tier depositor preference, 45% of the banks would be able to reach the 8% TLOF threshold without deposits compared to 23% when considering a similar magnitude of CET1 depletion but no change to the depositor preference. Given that all deposits would rank *pari passu*, the number of banks for which preferred and covered deposits would be reached also increases, and may allow using DGS under the LCT (see also section 4).

Maintaining a super-preference for covered deposits would lead to an increased impact on other forms of deposits, often leaving covered deposits unaffected (which has an important impact on the LCT, see section 4), when assessing the ability to reach 8% TLOF, in particular when loss scenarios are more severe.

Detailed analysis

The following tables shows the ability of institutions to reach the 8% TLOF threshold under the three combined scenarios.

The analysis under the first combined scenario shows that, assuming no CET1 depletion and a single-tier depositor preference, a total of 317 out of 368 institutions would reach the 8% TLOF threshold without imposing losses on deposits, representing up to 89% of the sample for the banks earmarked for resolution. In particular, deposits would have to be bailed-in in 12.5% of the small and 15% of the medium-sized banks to reach the threshold, for an amount of EUR 0.21 bn and EUR 2.52 bn respectively. When considering the funding structure, banks earmarked for resolution with a high prevalence of deposits are more prone to inflict losses on deposits when reaching 8% TLOF (14 out of 60). The proportions are similar for banks earmarked for liquidation, with 84% of small and 78% of medium-sized banks able to reach 8% TLOF without deposits. The impact of the funding structure for banks with high prevalence of deposits is also comparable (76% of banks earmarked for liquidation would reach 8% TLOF without deposits against 77% for banks earmarked for resolution). In addition, deposits in 13 Member States would be protected when reaching the 8% TLOF threshold under the combined scenario 1, against seven Member States under the baseline.

The second combined scenario shows that, when considering a more severe CET1 depletion scenario, the number of institutions where deposits would be protected when reaching the 8% TLOF decreases materially, representing 54% of the banks earmarked for resolution. The effect of the prevalence of deposits in the funding structure is more important: 31 banks earmarked for resolution having a high or medium-high share of deposits out of 99 (31%) would reach 8% TLOF without deposits. This proportion falls to 18.6% when considering banks earmarked for liquidation.

In comparison, under the third combined scenario the same number of banks would not be able to reach the 8% TLOF without imposing losses on deposits, with mostly non-preferred deposits affected. Even with a three-tier depositor preference, covered deposits would be reached in 10 cases considering all banks irrespective of their strategy, mostly small institutions with high prevalence of deposits.

In terms of materiality, when considering all banks in the sample, the aggregated amount of impacted deposits decreases from EUR 18.3 bn under the baseline scenario to EUR 6.4 bn under the first combined scenario where a single-tier depositor preference is introduced, keeping all other parameters unchanged. Assuming a higher level of CET1 depletion, up to EUR 47.4 bn of deposits would be affected under a single-tier or a three-tier depositor preference (scenario 2 or 3), compared to more EUR 123.7 bn using currently applicable depositor preference. This result must however be read in conjunction with the outcome of the analysis performed in section 4.1.4, based on which the introduction of a single-tier depositor preference allows for greater interventions of DGS to protect depositors.

Table 16: Reaching 8% TLOF – Combined scenarios

		N.	Institutions reaching 8% TLOF without deposits	Institutions reaching 8% TLOF with non-preferred deposits and amount used		Institutions reaching 8% TLOF with preferred non-covered deposits and amount used		Institutions reaching 8% TLOF with covered deposits and amount used		Institutions not reaching 8% TLOF with deposits and additional amount required	
	Comb. Scenarios		**1 (No depletion, single-tier depositor preference)**								
		Count	*Count*	*Count*	*%TLOF*	*Count*	*%TLOF*	*Count*	*%TLOF*	*Count*	*%TLOF*
Resolution	Small	56	49	7	1.27%	7	0.15%	7	0.36%	0	0.00%
	Medium	87	73	13	0.61%	13	0.28%	13	1.15%	1	0.41%
	Large	44	44	0	0.00%	0	0.00%	0	0.00%	0	0.00%
	Low	63	61	1	0.99%	1	0.00%	1	0.00%	1	0.41%
	Mid	25	22	3	0.24%	3	0.24%	3	1.50%	0	0.00%
	Mid-High	39	37	2	2.71%	2	0.10%	2	0.13%	0	0.00%
	High	60	46	14	0.38%	14	0.29%	14	1.03%	0	0.00%
	Total	187	166	20		20		20		1	
Liquidation	Small	139	117	21	0.50%	21	0.98%	21	1.10%	1	0.16%
	Medium	37	29	7	0.62%	7	0.24%	7	0.25%	1	0.47%
	Large	5	5	0	0.00%	0	0.00%	0	0.00%	0	0.00%
	Low	44	41	1	0.10%	1	0.48%	1	2.54%	2	0.44%
	Mid	19	16	3	0.33%	3	0.30%	3	0.90%	0	0.00%
	Mid-High	24	23	1	0.15%	1	0.39%	1	1.37%	0	0.00%
	High	94	71	23	0.68%	23	0.45%	23	0.23%	0	0.00%
	Total	181	151	28		28		28		2	

		N.	Institutions reaching 8% TLOF without deposits	Institutions reaching 8% TLOF with non-preferred deposits and amount used		Institutions reaching 8% TLOF with preferred non-covered deposits and amount used		Institutions reaching 8% TLOF with covered deposits and amount used		Institutions not reaching 8% TLOF with deposits and additional amount required	
	Comb. Scenarios		**2 (Depletion of buffers, single-tier depositor preference)**								
		Count	*Count*	*Count*	*%TLOF*	*Count*	*%TLOF*	*Count*	*%TLOF*	*Count*	*%TLOF*
Resolution	Small	56	20	36	1.16%	36	0.49%	36	1.35%	0	0.00%
	Medium	87	45	40	1.04%	40	0.45%	40	1.71%	2	0.34%
	Large	44	36	8	0.65%	8	0.24%	8	0.65%	0	0.00%
	Low	63	55	6	3.53%	6	0.33%	6	0.57%	2	0.34%
	Mid	25	15	10	0.29%	10	0.32%	10	1.46%	0	0.00%
	Mid-High	39	19	20	0.32%	20	0.26%	20	1.23%	0	0.00%
	High	60	12	48	1.61%	48	0.71%	48	1.51%	0	0.00%
	Total	187	101	84		84		84		2	
Liquidation	Small	139	40	97	0.91%	97	0.93%	97	2.09%	2	0.32%
	Medium	37	20	15	1.45%	15	0.62%	15	1.16%	2	0.47%
	Large	5	5	0	0.00%	0	0.00%	0	0.00%	0	0.00%
	Low	44	35	5	0.60%	5	0.72%	5	2.38%	4	0.46%
	Mid	19	8	11	0.41%	11	0.33%	11	1.01%	0	0.00%
	Mid-High	24	10	14	0.51%	14	0.53%	14	1.57%	0	0.00%
	High	94	12	82	1.96%	82	1.03%	82	1.61%	0	0.00%
	Total	181	65	112		112		112		4	

		N.	Institutions reaching 8% TLOF without deposits	Institutions reaching 8% TLOF with non-preferred deposits and amount used		Institutions reaching 8% TLOF with preferred non-covered deposits and amount used		Institutions reaching 8% TLOF with covered deposits and amount used		Institutions not reaching 8% TLOF with deposits and additional amount required	
	Comb. Scenarios		**3 (Depletion of buffers, three tier depositor preference)**								
		Count	*Count*	*Count*	*%TLOF*	*Count*	*%TLOF*	*Count*	*%TLOF*	*Count*	*%TLOF*
Resolution	Small	56	20	30	2.84%	5	1.61%	1	2.61%	0	0.00%
	Medium	87	45	33	2.73%	6	1.94%	1	5.74%	2	0.34%
	Large	44	36	7	1.43%	1	0.33%	0	0.00%	0	0.00%
	Low	63	55	6	3.71%	0	0.00%	0	0.00%	2	0.34%
	Mid	25	15	10	2.07%	0	0.00%	0	0.00%	0	0.00%
	Mid-High	39	19	16	1.73%	4	0.41%	0	0.00%	0	0.00%
	High	60	12	38	3.03%	8	2.49%	2	5.65%	0	0.00%
	Total	187	101	70		12		2		2	
Liquidation	Small	139	40	56	3.02%	36	2.69%	5	2.78%	2	0.32%
	Medium	37	20	13	2.72%	2	1.84%	0	0.00%	2	0.47%
	Large	5	5	0	0.00%	0	0.00%	0	0.00%	0	0.00%
	Low	44	35	3	2.35%	1	4.02%	1	1.66%	4	0.46%
	Mid	19	8	9	1.72%	2	1.96%	0	0.00%	0	0.00%
	Mid-High	24	10	10	2.55%	3	0.74%	1	3.53%	0	0.00%
	High	94	12	47	3.42%	32	2.26%	3	2.79%	0	0.00%
	Total	181	65	69		38		5		4	

Sources: Commission services, based on EBA CfA report and SRB data as of Q4 2019.

Figure 23 shows the comparison among the combined scenarios and with the baseline on the banks' ability to reach 8% TLOF with or without deposits.

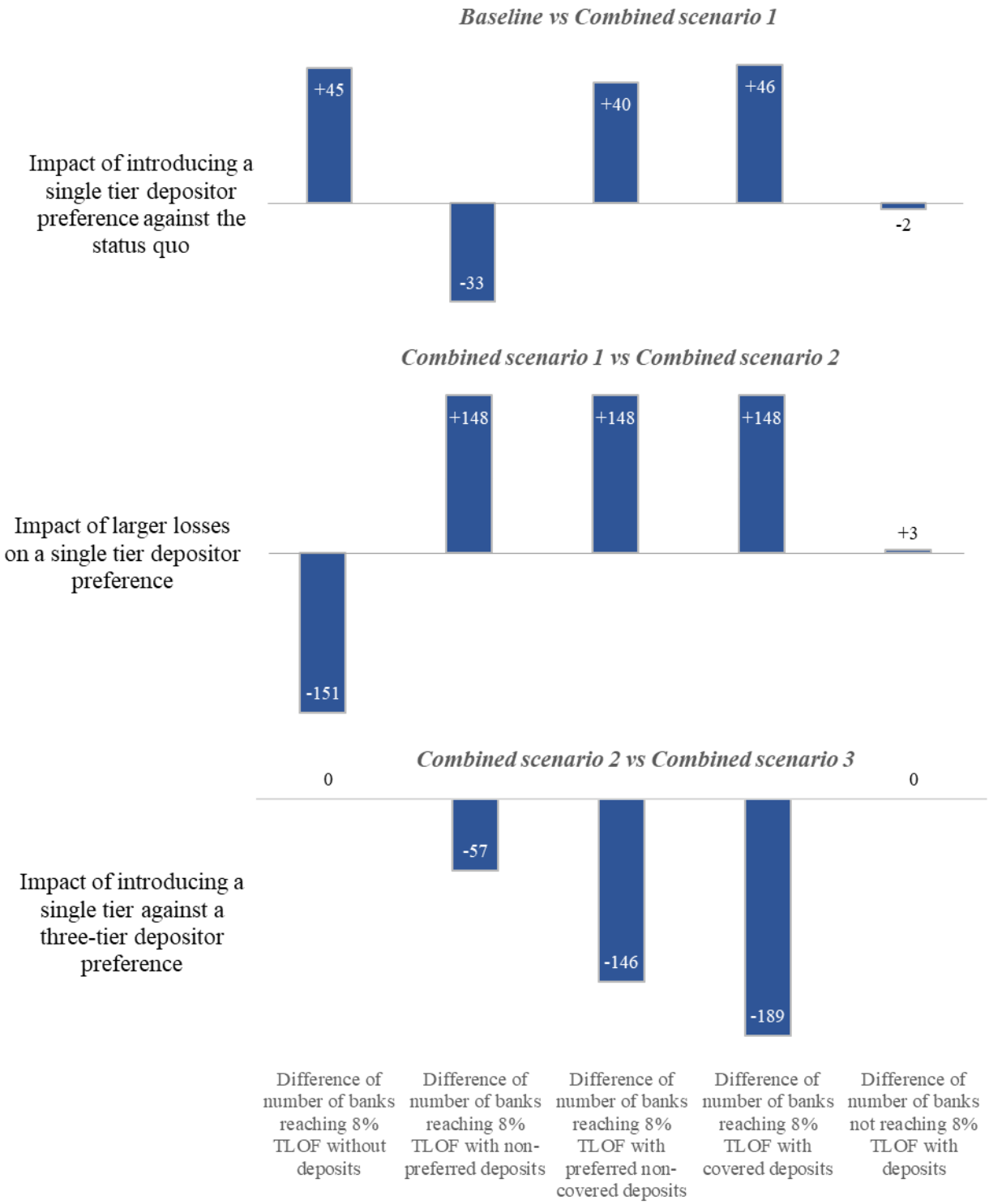
The top chart provides an overview of the impact of the introduction of a single-tier depositor preference on the ability of banks to reach the 8% TLOF threshold, by comparing the first combined scenario and the baseline. Compared to the baseline scenario (where the applicable creditor hierarchy is used), an additional 45 banks are able to reach the threshold without using deposits due to increasing the ranking of non-preferred deposits against other normal unsecured liabilities. Given that all deposits would rank *pari passu*, the number of banks for which

preferred and covered deposits would be reached also increases, and may allow using DGS under the least cost test (see section 5).

The second chart illustrates how the single-tier depositor preference would be impacted by a greater severity of loss depletion scenario, by comparing the first and the second combined scenario. Assuming a depletion of all buffers leads to a sharp decrease of the number of banks able to reach 8% TLOF without deposits under a single-tier depositor preference, commensurate to the increase of cases where deposits, all ranking *pari passu*, would be touched. Under this scenario, 45% of the banks would be able to reach the 8% TLOF threshold without deposits compared to 23% when considering a similar magnitude of CET1 depletion but no change to the depositor preference.

The third chart describes the relative impact of the introduction of a single-tier depositor preference compared to a three-tier depositor preference, by comparing the first and the second combined scenario, i.e. both relying on the same level of CET1 depletion. Compared to a single-tier system, a general three-tier depositor preference would significantly reduce the number of banks able to reach the 8% TLOF even considering covered deposits.

Figure 23: Reaching 8% TLOF – Combined scenarios



Source: Commission services, based on EBA CfA report and SRB data as of Q4 2019.

4. DGS INTERVENTIONS

The objectives of this section are to determine: (i) the ability of DGS to intervene as per the LCT under various scenarios to protect depositors and substitute possible losses born by depositors, (ii) the extent to which DGS interventions are likely to absorb losses in insolvency and, in resolution, to reach the 8% TLOF threshold after a bail-in of the eligible liabilities, and (iii) the availability of DGS funds and the likely impact of hybrid EDIS. In this quantitative analysis, the LCT amount is defined as the amount of covered deposits affected by the simulated losses under an insolvency counterfactual, which represents the maximum amount of DGS contribution to various measures.

As a first step, section 4.1 relies on the static approach, based on predefined scenarios of loss simulations (i.e. CET1 depletion), depositor preference and bail-inable capacity, applied when testing the ability to reach 8% TLOF. The focus is primarily on the scenario of depositor preference that can support a DGS intervention.

On this basis, a second step is carried out in section 4.2 based on the modelling approach described in section 2.4, whereby losses are simulated by the SYMBOL model and allocated within resolution groups, primarily assuming that the resolution group structure is maintained (i.e. losses are allocated to subsidiaries up until the level of internal loss absorbing requirements, while and any remaining losses, if any, are transferred to the parent entity)[446]. The most relevant scenarios from the static statistical analysis are used in the model-based approach, which gives a more accurate view of the impact on institutions by simulating and allocating losses according to bank-specific parameters. Results are presented for three types of crises: a crisis similar to the global financial crisis of 2008 and two other crises, one less and one more severe.

Overall, the results are very sensitive to the level of assumed recovery rate: the higher the losses on the assets in insolvency (haircut), the lower the recovery rate in a payout in insolvency and the higher the amount that the DGS could contribute to various measures, as emerging from the LCT. This means that the alternative DGS interventions allowed by the LCT are comparatively less expensive than a DGS payout in insolvency. As a result, DGS interventions may become more frequent and contribute to a larger extent to the various measures (compared to the status quo).

The recovery rate is instrumental in determining the amount of expected losses of the DGS in case of payout (i.e. the insolvency counterfactual in the LCT calculation). Lowering the recovery rate would increase the amount of expected losses in insolvency for the DGS and, consequently through the LCT, unlock more DGS funds. As mentioned in section 2.3 in this Annex, the assessments in this Annex are primarily based on an 85% recovery rate in the LCT

[446] According to the BRRD, the resolution group structure is maintained when resolution tools are applied only to the resolution entity (e.g. the parent entity), while other subsidiaries in the group which are not resolution entities themselves absorb losses by transferring them to the resolution entity through the bail-in of internal loss absorbing capacity (so-called internal MREL) which has pre-positioned *ex ante* by the parent entity on the balance sheet of the subsidiary).

insolvency counterfactual, however results for a 50% recovery rate are also briefly described (see section 4.5) in order to illustrate the sensitivity of the results to this parameter. Two main impacts could be observed by applying a recovery rate lower than 85%[447]. First, it would reduce the number of banks that cannot reach the 8% TLOF threshold as a result of an insufficient or a negative LCT. Second, as more DGS funds would be used, it would also increase the number of national DGSs unable to finance the gap to the 8% TLOF due to a liquidity shortfall. The lower the recovery rate, the stronger these two impacts[448].

Considerations on the impact of recovery rates can also be found in section 3.1.5 of the EBA CfA report.

4.1. Least cost test and DGS interventions (statistical approach) (Step C)

This section complements the analysis in section 3 and assesses the maximum level of funds unlocked by the LCT for DGS contributions in resolution or to finance an alternative measure in insolvency[449]. Additionally, for those institutions where DGS interventions would be deemed possible under the LCT, this section assesses to what extent the DGS contributions in resolution would allow reaching the threshold of 8% TLOF. The analysis also shows the number of cases where DGS interventions in resolution would not be sufficient to access external financing via the resolution fund. Statistics on cases where the 8% TLOF cannot be reached could inform the considerations of including indirect costs in the LCT calculation in the new CMDI framework.

4.1.1. Baseline

Table 17 shows, in aggregate, the number of institutions for which DGS interventions are possible (positive LCT) under the baseline scenario (no CET1 depletion, applicable creditor hierarchy in each Member State, full bail-inable capacity except liabilities with maturity shorter than one month) and, whether DGS contributions would allow reaching a level of 8% TLOF to access the RF/SRF. As for previous analyses, the results concern all entities, irrespective of their strategy.

Summary assessment – LCT Baseline

The LCT would yield a positive result for only three out of 91 banks that would require a DGS intervention to reach the 8% TLOF under the baseline scenario considering an 85% recovery rate in insolvency (out of a total sample of 368 banks). The DGS support would suffice for two out of these three banks.

[447] These impacts would be the same for all the figures in this section.

[448] Conversely, a recovery rate higher than 85% would increase the number of banks unable to reach the 8% TLOF due to an insufficient LCT and would reduce the number of DGSs facing a liquidity shortfall.

[449] Where covered deposits would bear losses under various scenarios, and therefore determine the potential cost of the payout for the DGS in an insolvency counterfactual.

Detailed analysis

Under the baseline scenario and an assumed recovery rate of 85%, the banks that cannot access the 8% TLOF threshold without imposing losses on deposits would need to unlock DGS intervention based on the LCT in order to access the RF/SRF. Out of the 91 banks (from a sample of 368 banks) that would need deposits to reach 8% TLOF, the LCT would be positive for only three banks, out of which the DGS support would be sufficient to bridge the gap until the 8% TOLF threshold in only two cases. DGS interventions would not be possible (negative LCT) for 88 banks thereby exposing deposits to losses in order to access resolution financing arrangements unless public support would be envisaged. The results are very similar irrespective of the size of the bank, the resolution strategy or its geographical location.

Table 17: LCT – Baseline

	N.	Institutions reaching 8% TLOF with deposits, requiring DGS contribution	Of which: Institutions for which DGS can intervene (positive LCT)	Of which: Institutions for which DGS interventions under the LCT are sufficient to reach 8% TLOF
		Count	*Count*	*Count*
Small	195	46	2	1
Medium	124	39	1	1
Large	49	6	0	0
Resolution	187	42	1	1
Liquidation	181	49	2	1
Low	107	16	1	0
Mid	44	12	0	0
Mid-High	63	11	0	0
High	154	52	2	2
Total	368	91	3	2

Source: Commission services, based on EBA CfA report and SRB data as of Q4 2019, assuming an 85% recovery rate.

4.1.2. Baseline versus more severe CET1 depletion scenarios

Table 18 shows the increasing risks for depositors under various scenarios of losses in line with the CET1 depletion assumptions described in section 2.3. All other dimensions remain as per the baseline scenario.

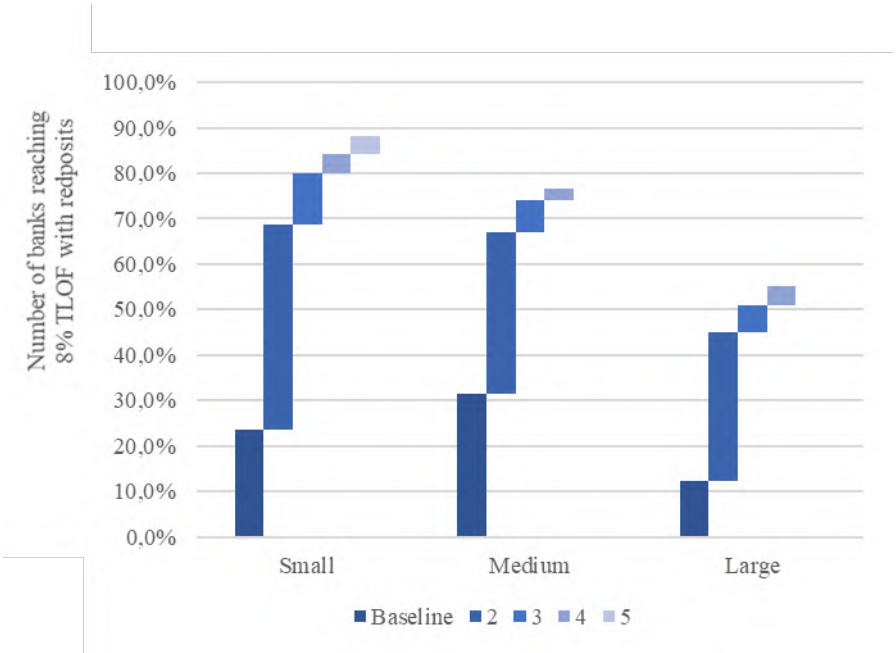
Summary assessment – Baseline versus more severe CET1 depletion scenarios

As a general observation, while the more severe CET1 depletion scenarios increase the number of institutions where deposits would need to bear losses, the effects of the scenarios remain limited with respect to the ability of DGS to intervene and contribute enough to reach the 8% TLOF threshold due to the LCT.

Detailed analysis

As highlighted in section 3.2.2, a higher severity of CET1 depletion increases the number of institutions where deposits would need to bear losses to reach the 8% TLOF threshold, irrespective of the size classification. ***Figure 24*** highlights the changes in the number of banks reaching 8% TLOF using deposits for each scenario of CET1 depletion. In aggregate, deposits in 299 banks would be impacted to access resolution financing arrangements under the most severe CET1 depletion scenario, i.e. an increase of 208 banks against the baseline scenario. In total, deposits would have to bear losses in 88% of the small banks, 79% of the medium-sized and 59% of the large banks in this most extreme CET1 depletion scenario.

Figure 24: Baseline versus depletion scenarios (number of institutions reaching 8% TLOF with deposits, per scenario of CET1 depletion)



Source: Commission services, based on EBA CfA report and SRB data as of Q4 2019.

However, irrespective of the CET1 depletion scenario, the number of institutions where the DGS can intervene under the LCT would remain limited to a maximum of six banks, of which four small and two medium-sized institutions, most of them having a high prevalence of deposits in their balance sheet. The results are identical in the three most severe CET1 depletion scenarios (i.e. as soon as buffers are depleted) showing the constraint imposed by the LCT due in part to the applicable creditor hierarchies in each Member State.

Table 18: LCT – Baseline versus CET1 depletion scenarios

CET1 Depletion	N.	Institutions reaching 8% TLOF with deposits, requiring DGS contribution	Of which: Institutions for which DGS can intervene (positive least cost test)	Of which: Institutions for which DGS interventions under the LCT are sufficient to reach 8% TLOF
		2 - Depletion 75% of buffers		
		Count	*Count*	*Count*
Small	195	134	3	1
Medium	124	83	2	1
Large	49	22	0	0
Resolution	187	114	2	1
Liquidation	181	125	3	1
Low	107	38	1	0
Mid	44	30	0	0
Mid-High	63	41	0	0
High	154	130	4	2
Total	368	239	5	2

CET1 Depletion	N.	Institutions reaching 8% TLOF with deposits, requiring DGS contribution	Of which: Institutions for which DGS can intervene (positive least cost test)	Of which: Institutions for which DGS interventions under the LCT are sufficient to reach 8% TLOF
		3 - Depletion of all buffers		
		Count	*Count*	*Count*
Small	195	156	4	1
Medium	124	92	2	2
Large	49	25	0	0
Resolution	187	131	2	2
Liquidation	181	142	4	1
Low	107	47	1	0
Mid	44	34	0	0
Mid-High	63	51	0	0
High	154	141	5	3
Total	368	273	6	3

CET1 Depletion	N.	Institutions reaching 8% TLOF with deposits, requiring DGS contribution	Of which: Institutions for which DGS can intervene (positive least cost test)	Of which: Institutions for which DGS interventions under the LCT are sufficient to reach 8% TLOF
		4 - Depletion of all buffers and 50% of P2R		
		Count	*Count*	*Count*
Small	195	164	4	1
Medium	124	95	2	1
Large	49	27	0	0
Resolution	187	136	2	1
Liquidation	181	150	4	1
Low	107	51	1	0
Mid	44	34	0	0
Mid-High	63	54	0	0
High	154	147	5	2
Total	368	286	6	2

CET1 Depletion	N.	Institutions reaching 8% TLOF with deposits, requiring DGS contribution	Of which: Institutions for which DGS can intervene (positive least cost test)	Of which: Institutions for which DGS interventions under the LCT are sufficient to reach 8% TLOF
		5 - Depletion of all buffers and 100% of P2R		
		Count	*Count*	*Count*
Small	195	172	4	1
Medium	124	98	2	1
Large	49	29	0	0
Resolution	187	146	2	1
Liquidation	181	153	4	1
Low	107	54	1	0
Mid	44	35	0	0
Mid-High	63	60	0	0
High	154	150	5	2
Total	368	299	6	2

Source: Commission services, based on EBA CfA report and SRB data as of Q4 2019, assuming an 85% recovery rate.

4.1.3. Baseline versus alternative depositor preference scenarios

This section shows when DGS interventions would be possible (positive LCT) under various scenarios of depositor preference as described in section 2.3 and whether DGS contributions would allow reaching a level of 8% TLOF. All other dimensions remain as per the baseline scenario.

Summary assessment – Baseline versus alternative depositor preference scenarios

Under a comparative analysis, the introduction of depositor preference would shield deposits from bearing losses by reducing most significantly the number of banks where non-preferred deposits would be impacted when reaching 8% TLOF.

When assuming a 85% recovery rate, the number of banks where deposits would be impacted would decrease from 91 banks in the baseline scenario to 48 under the single-tier depositor preference (out of 368 in total), reducing the EUR value of impacted deposits from EUR 18.3 bn in the baseline to EUR 6.4 bn and unlocking the most significant amount of funds for DGS contributions under the LCT (on average up to twenty times higher (EUR 0.98 bn) than under the baseline or the alternative scenarios retaining the super-preference of covered deposits (EUR 0.05 bn)). The DGS intervention under the LCT would be sufficient to bridge the gap towards 8% TLOF in 76% of cases when considering the entire sample and in 88% of cases when considering only banks with resolution strategy.

Detailed analysis

When assuming a 85% recovery rate and considering a single-tier depositor preference (scenario 2) and the entire sample, DGS can intervene under the LCT for 89% of small banks and 80% of medium banks for which deposits would be impacted when calculating the 8% TLOF threshold (reminder: under the alternative scenarios of depositor preference, no large banks would need deposits to access 8% TLOF). When considering only entities for which the strategy is resolution, DGS interventions under the LCT are possible for 80% of the banks for which deposits would be bailed-in, and would allow reaching the 8% TLOF threshold in 88% of the cases. The proportion of banks for which DGS interventions would be possible but insufficient to reach the 8% TLOF threshold is particularly concentrated in one Member State (75% of banks in that Member State for which deposits would need to be bailed-in), accounting for two-thirds of the total cases in the sample where DGS interventions under the LCT are insufficient.

Changing the creditor hierarchy but retaining the super-preference of covered deposits has no impact against the baseline. Finally, scenario 5, where covered deposits rank *pari passu* with preferred deposits is an intermediate step between the baseline and the single-tier depositor preference: under scenario 5, the LCT would enable the DGS intervention for 18 banks to protect deposits when reaching 8% TLOF (against 41 under a single-tier depositor preference), and these interventions would allow reaching a level of 8% TLOF in 13 cases (against 31 under a single-tier depositor preference).

Table 19: LCT – Baseline versus depositor preference scenarios

	N.	Institutions reaching 8% TLOF with deposits, requiring DGS contribution	Of which: Institutions for which DGS can intervene (positive least cost test)	Of which: Institutions for which DGS interventions under the LCT are sufficient to reach 8% TLOF
Hierarchy		**2 - Single-tier**		
		Count	*Count*	*Count*
Small	195	28	25	20
Medium	124	20	16	11
Large	49	0	0	0
Resolution	187	20	16	14
Liquidation	181	28	25	17
Low	107	2	1	1
Mid	44	6	5	5
Mid-High	63	3	2	2
High	154	37	33	23
Total	368	48	41	31

	N.	Institutions reaching 8% TLOF with deposits, requiring DGS contribution	Of which: Institutions for which DGS can intervene (positive least cost test)	Of which: Institutions for which DGS interventions under the LCT are sufficient to reach 8% TLOF
Hierarchy		**3 - Three-tier**		
		Count	*Count*	*Count*
Small	195	28	2	1
Medium	124	20	1	1
Large	49	0	0	0
Resolution	187	20	1	1
Liquidation	181	28	2	1
Low	107	2	1	0
Mid	44	6	0	0
Mid-High	63	3	0	0
High	154	37	2	2
Total	368	48	3	2

Hierarchy	N.	Institutions reaching 8% TLOF with deposits, requiring DGS contribution	Of which: Institutions for which DGS can intervene (positive least cost test)	Of which: Institutions for which DGS interventions under the LCT are sufficient to reach 8% TLOF
		4 - Two-tier (super-preference for covered deposits)		
		Count	*Count*	*Count*
Small	195	28	2	1
Medium	124	20	1	1
Large	49	0	0	0
Resolution	187	20	1	1
Liquidation	181	28	2	1
Low	107	2	1	0
Mid	44	6	0	0
Mid-High	63	3	0	0
High	154	37	2	2
Total	368	48	3	2

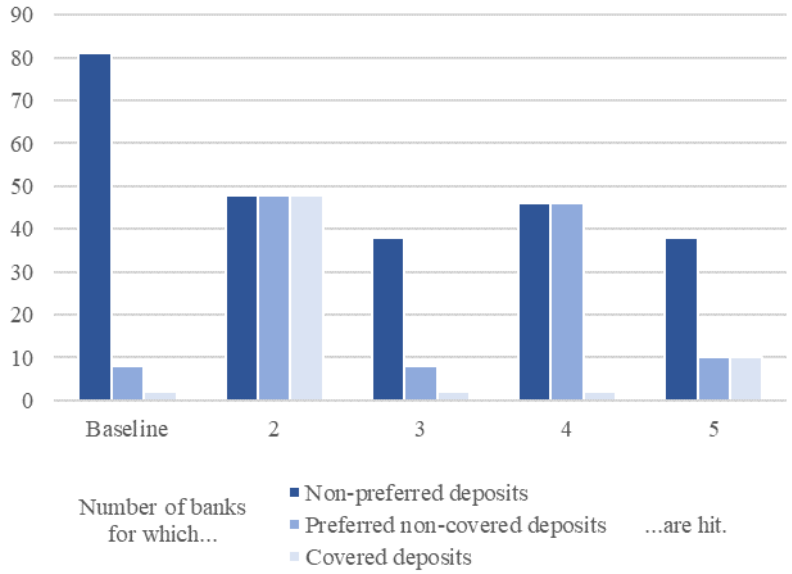
Hierarchy	N.	Institutions reaching 8% TLOF with deposits, requiring DGS contribution	Of which: Institutions for which DGS can intervene (positive least cost test)	Of which: Institutions for which DGS interventions under the LCT are sufficient to reach 8% TLOF
		5 - Two-tier (no super-preference for covered deposits)		
		Count	*Count*	*Count*
Small	195	28	12	10
Medium	124	20	6	3
Large	49	0	0	0
Resolution	187	20	4	2
Liquidation	181	28	14	11
Low	107	2	1	1
Mid	44	6	1	0
Mid-High	63	3	1	1
High	154	37	15	11
Total	368	48	18	13

Source: Commission services, based on EBA CfA report and SRB data as of Q4 2019, assuming an 85% recovery rate.

Figure 25 depicts a comparative view of the ability to reach 8% TLOF with or without deposits according to each depositor preference scenario. The shift from the baseline to

the single-tier deposit preference (scenario 2) would impact all deposits (non-preferred, preferred, covered) to the same extent, however, in a smaller number of banks. As shown in ***Figure 26***, this would improve the depositor protection and attain the objective of facilitating a greater DGS contribution to various measures (preventive, resolution, alternative measures in insolvency) under the LCT. While some other scenarios maintain the super-preference of covered deposits, they do not meet the objective of facilitating DGS funding under the LCT, which due to the very nature of the LCT, would be less costly than a payout intervention in insolvency. Please see also the explanations in section 3.2.3 on maintaining the full protection of covered deposits under a single-tier ranking preference.

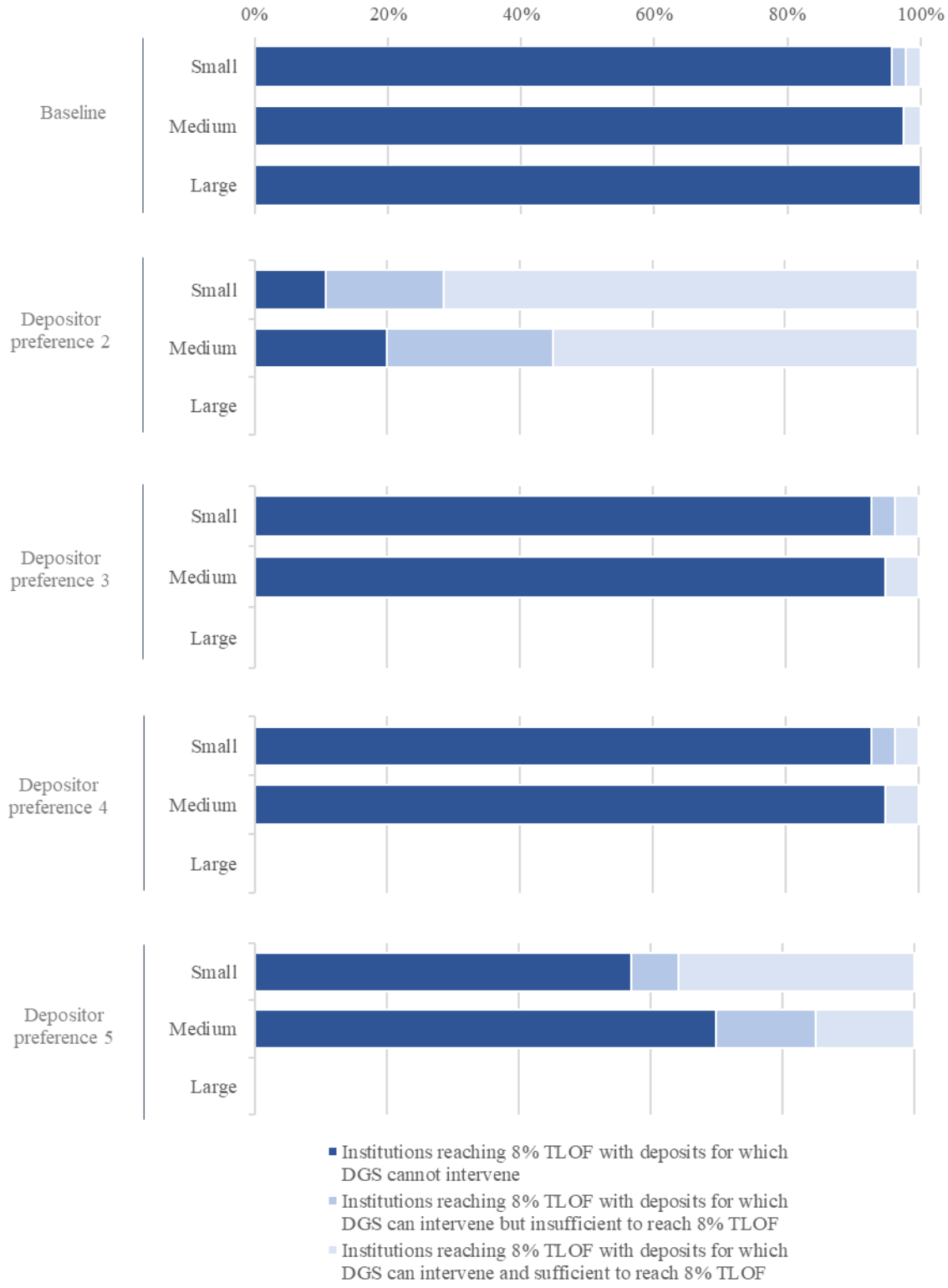
Figure 25: Reaching 8% TLOF – Baseline versus depositor preference scenarios



Source: Commission services based on EBA CfA report and SRB data as of Q4 2019.

In fact, the following ***Figure 26*** highlights the relative impact of each scenario of depositor preference against the baseline on the ability for DGS to intervene based on a positive LCT. The dark blue bars represent the percentage of banks for which deposits would need to be bailed-in to reach 8% TLOF, but where the LCT is negative, preventing a DGS intervention. The introduction of a single-tier preference would have a comparable effect across all size groups, irrespective of their strategy, with 55% to 71% of banks benefiting from DGS interventions sufficient to reach 8% TLOF, under an assumed recovery rate of 85%.

Figure 26: LCT – Baseline versus depositor preference



Source: Commission services, based on EBA CfA report and SRB data as of Q4 2019, assuming an 85% recovery rate.

The type of depositor preference also impacts the maximum amount of DGS funds allowed under the LCT in resolution or to finance alternative measures in insolvency. In particular, the single-tier depositor preference unlocks the maximum amount of funds pursuant to the LCT, on average up to twenty times higher than under the current creditor hierarchy at national level or the alternative scenarios 3 and 4. The difference is

particularly sizeable for large and mid-sized institutions. The last scenario of depositor preference (i.e. covered deposits ranking *pari passu* and preferred deposits) also allows for larger DGS contributions, however, not as significant as under the single-tier preference.

Table 20: LCT – Baseline versus depositor preference scenarios - Maximum amount of DGS interventions under the LCT (EUR bn)

	Maximum amount of DGS funds based on LCT (EUR bn)				
Hierarchy	1	2	3	4	5
	EUR	*EUR*	*EUR*	*EUR*	*EUR*
Small	0.02	0.12	0.02	0.02	0.03
Medium	0.03	0.74	0.03	0.03	0.18
Large	0.00	0.12	0.00	0.00	0.00
Resolution	0.03	0.75	0.03	0.03	0.06
Liquidation	0.02	0.23	0.02	0.02	0.16
Low	0.00	0.01	0.00	0.00	0.00
Mid	0.00	0.15	0.00	0.00	0.00
Mid-High	0.00	0.31	0.00	0.00	0.01
High	0.05	0.51	0.05	0.05	0.21
Total	0.05	0.98	0.05	0.05	0.21

Source: Commission services, based on EBA CfA report and SRB data as of Q4 2019, assuming an 85% recovery rate.

4.1.4. Combined scenarios

The same combined scenarios as described under section 3.2.5 are also assessed in this section order to determine the LCT and the extent of potential DGS contributions.

Summary assessment – Combined scenarios

The analysis of the three combined scenarios enables a comparative view of the ability of DGS to intervene and possibly reach the 8% TLOF threshold when different severity of CET1 depletion would be combined with different depositor preference scenarios, under an assumption of 85% recovery rate.

As indicated in section 3.2.5, combining various levels of CET1 depletion and depositor preference shows that the introduction of a single-tier depositor preference has an important effect on the ability of DGS to intervene and support reaching a level of 8% TLOF, irrespective of the loss scenario used for the analysis. In particular, under the baseline scenario, DGS interventions would be possible under the LCT for only 3.3% of banks for which deposits are needed to reach 8% TLOF. The introduction of a single-tier depositor preference increases this proportion to 85% of banks when considering no depletion, and 69% when assuming that all buffers have been depleted. Similarly, 76% of the DGS interventions would be sufficient to reach 8% TLOF assuming no depletion (40% assuming all buffers are depleted).

Maintaining the super-preference of covered deposits would prevent the DGS to intervene and reaching the 8% TLOF to access the RF/SRF may have a high impact on the other types of deposits, in particular under more severe loss scenarios.

Detailed analysis

Table 26 shows the number of institutions for which DGS interventions are possible (positive LCT) and, whether DGS contributions would allow reaching a level of 8% TLOF. It is complemented by ***Figure 27*** showing the comparison between the combined scenarios and the baseline with regard to DGS' ability to intervene under the LCT.

Table 21: LCT– Combined scenarios

Comb. Scenarios		N.	Institutions reaching 8% TLOF with deposits	Of which: Institutions for which DGS can intervene (positive least cost test)	Of which: Institutions for which DGS interventions under the LCT are sufficient to reach 8% TLOF	Institutions reaching 8% TLOF with deposits	Of which: Institutions for which DGS can intervene (positive least cost test)	Of which: Institutions for which DGS interventions under the LCT are sufficient to reach 8% TLOF
			1 (No depletion, single-tier preference)			**2 (Depletion of buffers, single-tier preference)**		
			Count	*Count*	*Count*	*Count*	*Count*	*Count*
Resolution	Small	56	7	6	5	36	25	10
	Medium	87	13	10	9	40	31	14
	Large	44	0	0	0	8	2	1
	Low	63	1	0	0	6	1	0
	Mid	25	3	3	3	10	7	3
	Mid-High	39	2	1	1	20	10	5
	High	60	14	12	10	48	40	17
	Total	*187*	*20*	*16*	*14*	*84*	*58*	*25*
Liquidation	Small	139	21	19	15	97	68	26
	Medium	37	7	6	2	15	10	3
	Large	5	0	0	0	0	0	0
	Low	44	1	1	1	5	1	1
	Mid	19	3	2	2	11	6	3
	Mid-High	24	1	1	1	14	7	4
	High	94	23	21	13	82	64	21
	Total	*181*	*28*	*25*	*17*	*112*	*78*	*29*

Comb. Scenarios		N.	Institutions reaching 8% TLOF with deposits	Of which: Institutions for which DGS can intervene (positive least cost test)	Of which: Institutions for which DGS interventions under the LCT are sufficient to reach 8% TLOF
			3 (Depletion of buffers, three-tier preference)		
			Count	*Count*	*Count*
Resolution	Small	56	36	0	0
	Medium	87	40	2	2
	Large	44	8	0	0
	Low	63	6	0	0
	Mid	25	10	0	0
	Mid-High	39	20	0	0
	High	60	48	2	2
	Total	*187*	*84*	*2*	*2*
Liquidation	Small	139	97	3	1
	Medium	37	15	0	0
	Large	5	0	0	0
	Low	44	5	1	0
	Mid	19	11	0	0
	Mid-High	24	14	0	0
	High	94	82	2	1
	Total	*181*	*112*	*3*	*1*

Source: Commission services, based on EBA CfA report and SRB data as of Q4 2019, assuming an 85% recovery rate.

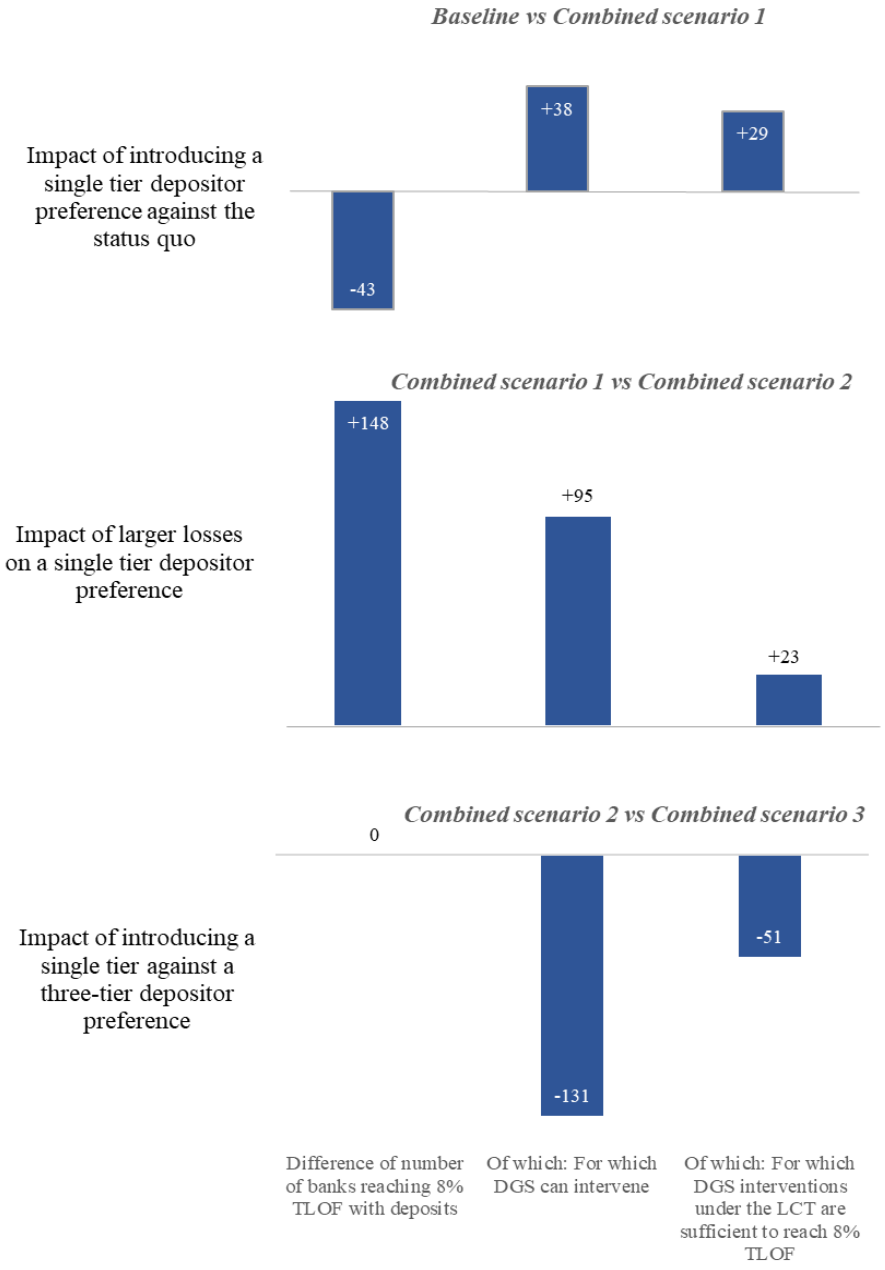
The first graph in ***Figure 27*** shows the impact of the single-tier depositor preference on the ability of DGS to intervene based on the LCT for those banks reaching the 8% TLOF threshold with deposits, by comparing the first combined scenario and the baseline, under the assumption of an 85% recovery rate. Compared to the baseline scenario (where the applicable creditor hierarchy is used), under the single-tier preference, 43 additional banks would be able to reach the threshold without using deposits due to lifting the ranking of non-preferred deposits, and the DGS could intervene for an additional 38 banks, to an extent that would enable 29 more of them to reach the 8% TLOF. Under the first combined scenario, the DGS could intervene based on a positive LCT in 85% of the cases where deposits would bear losses to reach 8% TLOF, compared to 3.3% in the baseline. In total, the LCT would be negative for seven small and medium-sized banks out of 48 that would need deposits to reach 8% TLOF. DGS interventions would be sufficient to reach 8% TLOF in all cases but two for banks earmarked for resolution.

The second graph in ***Figure 27*** illustrates how the single-tier depositor preference would be impacted by a greater severity of loss depletion scenario, by comparing the first and

the second combined scenario. Assuming a depletion of all buffers, leads to a sharp increase in the number of banks for which deposits are needed to reach 8% TLOF (+148 compared to a scenario without CET1 depletion). Even under this loss scenario, DGS interventions would remain possible under the LCT for 69% of the banks, considering the entire sample or only institutions earmarked for resolution. However, the severity of the less scenario has an impact on the proportion of banks for which the DGS interventions would be sufficient to reach 8% TLOF, decreasing from 76% in the first combined scenario to 40% in the second combined scenario. Still, in absolute amount, the number of banks for which DGS interventions would be possible and sufficient to reach the 8% TLOF is higher than in the first combined scenario, and the baseline, indicating the strong impact of the introduction of a single-tier depositor preference.

The third graph in ***Figure 27*** describes the relative impact of the introduction of a single-tier depositor preference compared to a three-tier depositor preference, by comparing the first and the second combined scenarios, i.e. both relying on the same level of CET1 depletion. As already mentioned, maintaining a super-preference of covered deposits prevents the DGS from intervening under the LCT and severely hampers the possibility to reach the 8% TLOF.

Figure 27: LCT – Combined scenarios



Source: Commission services, based on EBA CfA report and SRB data as of Q4 2019, assuming a recovery rate of 85%.

4.2. Least cost test and DGS interventions (modelling approach) (Step D)

Summary assessment – Least cost test and DGS interventions (modelling approach)

The analysis of the results using SYMBOL-generated losses allows to compare the ability of DGS interventions to reach 8% TLOF based on economically consistent and bank-specific characteristics, including considering the banking group's structures.

Overall, under a recovery rate assumption of 85%, the analysis shows that DGS interventions would allow reaching the 8% TLOF threshold on average for 7% of banks facing losses and for which DGS interventions are required under the currently applicable creditor hierarchy, assuming a stress scenario of a similar intensity as the 2008 global financial crisis. The introduction of a single-tier depositor preference increases this probability to 81%, enabling DGS interventions to bridge to 8% TLOF irrespective of the severity of the crisis scenario.

These results confirm the outcome of the statistical static analysis on the ability of a single-tier depositor preference to reduce the number of banks that need deposits to reach the 8% TLOF and at the same time unlock more possibilities for DGS to intervene based on the LCT. As set out previously, maintaining a super-preference for covered deposits may ultimately reduce the maximum amount of the LCT and thereby limit the ability of DGS interventions to reach 8% TLOF. At the same time, the magnitude of the differences compared to the current situation may limit the possibility for changes to the LCT, including indirect costs or other factors, to yield similar results.

Detailed analysis

The outcome of the previous analyses serves to define the most relevant scenarios (notably of depositor preference) for the dynamic assessment using SYMBOL-generated losses. The assessments are conducted based on the generation of a multitude of loss scenarios, from which three specific loss scenarios are extracted: a scenario with a loss intensity similar to the global financial crisis in 2008, a second less severe scenario, and a third more severe scenario. The results consider institutions that, based on the crisis scenarios, would face losses that need to be absorbed. Cases where banks would either not face losses or would face losses but not trigger the need for DGS (under the LCT) or resolution funds to intervene, are not the focus of the analysis.

As in previous sections, the analysis relies on a recovery rate in insolvency of 85% used to calculate the LCT. Using other recovery rates would impact the findings.

As set out in section 2.4, the modelling approach is based on a set of assumptions:

Baseline	Scope	Loss simulation	Loss allocation	Creditor hierarchy	Bail-inable capacity
Modelling approach	All entities (irrespective of the strategy)	Simulated losses using SYMBOL CET1 available for the purpose of 8% TLOF calculation after depletion of buffers Recapitalisation in resolution up to P1 + P2R	Simulated losses applied to resolution entities and subsidiaries under the assumption that the resolution group structure is maintained or breaks[450]	Applicable creditor hierarchy in Member States Single-tier depositor preference Three-tier depositor preference	Bail-inable liabilities (except those with maturity below 1 month) with gradual exclusion of deposits

This section provides a detailed view of the expected probabilities for DGS to intervene under the LCT and whether those interventions would allow reaching the 8% TLOF threshold in resolution under three scenarios of different crisis intensity.

Error! Reference source not found. provides the outcome of the simulation under the modelling approach, indicating the number of institutions for which DGS interventions are possible (positive LCT) and, for those institutions, whether DGS contributions would allow reaching a level of 8% TLOF. As for previous analyses, the results concern all entities, irrespective of their strategy, and assumes that the resolution group structure is maintained in resolution.

On average, considering the entire sample, DGS interventions would allow reaching the 8% TLOF threshold for 7% of banks for which a DGS intervention is required under the currently applicable creditor hierarchy and assuming a stress scenario of a similar intensity as the 2008 global financial crisis. The average number of banks where the DGS could intervene to allow bridging up the gaps to 8% TLOF is similar for small and medium-sized banks (on average 7% of banks for which DGS interventions are required), while DGS interventions would not be sufficient on average for any large bank to help it reach 8% TLOF. At the same time, banks with a high prevalence of deposits for which the LCT is positive would see the probability of DGS intervening in sufficient amounts to reach 8% TLOF in 9% of the cases, compared to generally lower levels when the prevalence of deposits is reduced.

More specifically, under the currently applicable creditor hierarchy (baseline), considering the entire sample, the probability that the DGS would need to intervene to reach the 8% TLOF for at least one bank in a crisis similar to the 2008 one is equal to

[450] The single point of entry group resolution strategy is maintained where the losses are allocated at subsidiary level up until the level of internal loss-absorbing capacity pre-positioned by the parent (resolution entity); any remaining losses impacting the subsidiary are covered by the parent. When the group resolution strategy is maintained, this system of upstreaming losses from subsidiary to the resolution entity ensures that the subsidiary absorbs losses and gets recapitalised without being placed in resolution.

100%, for an average of 19.4 banks and an average amount of EUR 3.9 bn. By size, there is a 96% or 99% probability for medium-sized or small banks respectively that DGS would intervene and reach 8% TLOF (i.e. at least one intervention is quasi certain). However, under a crisis similar to the 2008 one, the probability that the DGS funds needed are not sufficient to bridge the gap to 8% TLOF for at least one banks is equal to 100% for an average of 18 banks and an average amount of EUR 3.8 bn (either because the LCT does not unlock sufficient funds, or because the DGS cap of 0.4% of covered deposits per single use is binding).

These results change materially when assuming a single-tier depositor preference. On average, at the level of the entire sample, DGS interventions would allow reaching the 8% TLOF in 81% of the cases where the LCT is positive, i.e. an increase by 74 percentage points compared to the currently applicable creditor hierarchies. This effect is particularly important for banks with a mid to high prevalence of deposits as well as for small and medium-sized institutions where DGS interventions would allow reaching 8% in 80% and 57% of the cases where a DGS intervention is required, respectively. The three-tier depositor preference, by keeping a super-preference for covered deposits, generally leads to comparable results as the baseline.

At the same time, the introduction of a single-tier depositor preference reduces the likely number of DGS interventions: considering the entire sample, an average of 11 banks would be subject to a DGS intervention under a single-tier depositor preference, compared to an average of approximately 19 banks based on currently applicable creditor hierarchies. Similarly, the number of banks where the LCT is not enough to enable a sufficient DGS contributions towards 8% TLOF despite the need to absorb further losses[451] falls from an average of 18 under the applicable depositor preference to 10 under a three-tier preference and an average of approximately two when a single-tier preference is considered. This also applies when restricting the sample to entities with resolution strategy.

These results confirm the outcome of the statistical static analysis on the ability of a single-tier depositor preference to reduce the number of banks that need deposits to reach the 8% TLOF and at the same time unlock more possibilities for DGS to intervene based on the LCT. As set out previously, maintaining a super-preference for covered deposits may ultimately reduce the maximum amount of the LCT and thereby limit the ability of DGS interventions to reach 8% TLOF. At the same time, the magnitude of the differences compared to the current situation may limit the possibility for changes to the LCT, including indirect costs or other factors, to yield similar results.

Finally, assuming a different crisis intensity does not change the overall conclusions, as the trend keeps applying irrespective of the scenario used, but makes the DGS interventions to facilitate the access to 8% TLOF more or less likely depending on the

[451] For the purpose of the analysis, the inability to reach the 8% TLOF may be due either to an insufficient LCT or the limit set by the cap of 0.4% of covered deposits applicable for DGS interventions set out in Article 109(5) BRRD. However, the analysis suggests that the results are driven by the LCT that may often be too limited to allow reaching 8% TLOF threshold. In particular, as shown in the statistical analysis, the number of DGS interventions under the LCT is very limited as losses often do not reach covered deposits, that are taken into account for the purpose of the LCT calculations.

scenario. In particular, a less severe crisis may lead to a situation where a smaller amount of deposits may be hit, resulting in a smaller LCT that may not be sufficient to reach the 8% TLOF, threshold and conversely in case of higher losses. In each case, the difference brought by the type of depositor preference is substantial.

Table 22: Percentage of average number of banks where DGS interventions would be sufficient to reach 8% TLOF (average number of banks where the DGS intervention would be sufficient to reach 8% TLOF over average number of banks where DGS interventions are required, assuming the resolution group structure is maintained)

Depositor preference	Global financial crisis (2008)			Less severe crisis			More severe crisis		
	Baseline	Single-tier	Three-tier	Baseline	Single-tier	Three-tier	Baseline	Single-tier	Three-tier
	%	*%*	*%*	*%*	*%*	*%*	*%*	*%*	*%*
Small	7%	80%	8%	7%	77%	8%	8%	86%	10%
Medium	7%	57%	9%	7%	51%	8%	8%	65%	12%
Large	0%	13%	0%	0%	10%	0%	0%	21%	0%
Resolution	7%	74%	9%	7%	70%	8%	8%	82%	10%
Liquidation	7%	72%	8%	6%	68%	7%	8%	77%	9%
Low	6%	10%	8%	6%	9%	7%	8%	15%	14%
Mid	1%	45%	1%	0%	37%	1%	1%	59%	2%
Mid-High	2%	38%	1%	1%	33%	1%	2%	50%	2%
High	9%	80%	10%	9%	77%	9%	11%	84%	12%
All	7%	81%	9%	7%	78%	8%	8%	84%	10%

Source: Commission services, based on EBA CfA report and SRB data as of Q4 2019, assuming an 85% recovery rate.

Error! Reference source not found. shows the impact of the simulation when the resolution group structure is not maintained, i.e. simulating a break of the resolution group leaving individual subsidiaries without the possibility to pass-on losses to the resolution entity and subject to being placed in resolution themselves. In these cases, the loss allocation follows the waterfall of claims at each individual entity level until all losses are covered and no transfer of losses is taking place from subsidiaries to the resolution entities. The number of observations underlying the figures contained in this table exceeds the one in other analyses (carried out at resolution/parent entity level) because the analysis is conducted at individual level for the subsidiaries (where possible due to data availability).

Overall, the average results are slightly different from the situation where the resolution group structure is maintained. More specifically, under the currently applicable creditor hierarchy (baseline), considering the entire sample, the probability that the DGS would need to intervene to reach the 8% TLOF for at least one bank in a crisis similar to the 2008 one is equal to 100%, for an average of 36.9 banks and an average amount of EUR 7.6 bn. However, under the same type of crisis, the probability that the DGS funds needed are not sufficient to bridge the gap to 8% TLOF for at least one banks is equal to

100% for an average of 33.8 banks and an average amount of EUR 7.3 bn (either because the LCT does not unlock sufficient funds, or because the DGS cap of 0.4% of covered deposits per single use is binding).

Overall, DGS interventions would allow reaching 8% TLOF on average in 8% and 13% of the cases (i.e. at the level of the subsidiaries that would have to absorb losses individually and not pass them trough up to the resolution entity) when considering the currently applicable creditor hierarchies or the introduction of a three-tier depositor preference. On the contrary, single-tier depositor preference ensures that DGS interventions, when needed and possible under the LCT, often allow reaching the 8% TLOF threshold.

Table 23: Percentage of average number of banks where DGS interventions would be sufficient to reach 8% TLOF (average number of banks where the DGS intervention would be sufficient to reach 8% TLOF over average number of banks where DGS interventions are required, assuming the resolution group structure is not maintained)

Depositor preference	**Global financial crisis (2008)**			**Less severe crisis**			**More severe crisis**		
	Baseline	Single-tier	Three-tier	Baseline	Single-tier	Three-tier	Baseline	Single-tier	Three-tier
	%	*%*	*%*	*%*	*%*	*%*	*%*	*%*	*%*
Small	11%	85%	15%	12%	84%	15%	10%	87%	14%
Medium	5%	63%	10%	5%	59%	9%	6%	68%	11%
Large	0%	14%	0%	0%	11%	0%	0%	24%	1%
Low	3%	12%	4%	3%	10%	4%	3%	15%	7%
Mid	0%	47%	1%	0%	41%	1%	1%	62%	2%
Mid-High	1%	49%	1%	1%	43%	1%	1%	59%	1%
High	14%	84%	17%	14%	82%	17%	14%	85%	16%
All	8%	81%	13%	9%	81%	14%	8%	81%	13%

Source: Commission services, based on EBA CfA report and SRB data as of Q4 2019, assuming an 85% recovery rate.

4.3. Use of resolution funds (Step E)

Summary assessment – Use of resolution funds

The analysis of the use of resolution funds shows that, assuming a single-tier depositor preference and a stress scenario similar to the 2008 financial crisis, resolution funds would make a contribution for an average of 1.5% of the banks with resolution strategy in the sample on the basis the 8% TLOF is reached and further losses need to be absorbed. Interventions are less likely under the currently applicable creditor hierarchies or a three-tier depositor preference.

Resolution funds would also be more likely to intervene for large banks or, under a single-tier depositor preference, when the prevalence of deposits in the balance sheet structure is higher, pointing at the possible higher contribution of the bank's internal loss absorbing capacity and, in the latter case, the higher likelihood of DGS interventions based on the LCT.

Under an assumed recovery rate of 85%, the resolution funds' contributions would, on average, amount to EUR 1.5 bn when considering the currently applicable creditor hierarchy, and be reduced to EUR 1.3 bn in case of a single-tier depositor preference, under a similar crisis as 2008. When considering a more severe crisis, interventions from resolution funds could amount to EUR 3.9 bn or 3 bn, respectively.

These amounts must be considered with caution for three reasons. First, important caveats must be mentioned such as the limitation of resolution fund usage only for loss-absorption and recapitalisation (e.g. excluding liquidity measures or compensation of NCWO risks), the reliance on a sample that does not represent the entire banking sector and on specific methodological assumptions (e.g. no discretionary exclusions from bail-in). Second, the limited size of the resolution fund contribution may also be explained by the progress made in terms of risk reduction and strengthening of the banking sector as a whole, thanks to post-crisis regulatory reforms, contributing to increased robustness in terms of prudential capital, bail-inable capacity and market discipline. Third, without prejudice to the need for mutualised safety nets to promote financial stability and ensure market discipline, further analysis could be conducted in the future to explore whether and how the calibration of safety nets (RF/SRF and DGS/EDIS) may yield further cost synergies.

Detailed analysis

Building on the previous results, this section assesses to what extent the maximum contribution of the RF/SRF can absorb all the remaining losses for institutions for which DGS interventions were deemed possible under the LCT and allowed reaching a level of 8% TLOF, assuming a recovery rate of 85%. Article 44(5)(b) BRRD states that the contribution of the RF/SRF should not exceed 5% TLOF of the institution under resolution, measured at the time of resolution action. For the purpose of this analysis, the maximum contribution of RF/SRF is calculated using the reported TLOF amounts, in absence of credible forecasts of banks' balance sheets prior to resolution.

This analysis relies on the previous LCT computations and assessments of DGS interventions. It aims to show the number of cases where resolution fund contributions could absorb the simulated losses (i.e. within the cap of 5% TLOF), following DGS intervention in resolution, based on the different approaches of depositor preference.

Table 33 shows the average proportion of banks for which resolution funds would intervene under various stress scenarios and depositor preference, on the basis of the entire sample. For the purpose of this analysis, the resolution group structure is maintained in resolution. In addition, the probabilities do not take into account the factors that allowed an institution to reach the 8% TLOF threshold, i.e. through its own internal loss-absorbing capacity or via a DGS intervention based on the LCT.

Assuming a single-tier depositor preference, resolution funds would make a contribution for an average of 1.6% of the banks with resolution strategy in the sample on the basis the 8% TLOF is reached and further losses need to be absorbed. Interventions are less likely under the currently applicable creditor hierarchy or a three-tier depositor preference. Resolution funds would also be more likely to intervene for large banks or, under a single-tier depositor preference, when the prevalence of deposits in the balance sheet structure is higher, pointing at the possible higher contribution of the bank's internal loss absorbing capacity and, in the latter case, the higher likelihood of DGS interventions based on the LCT.

As described in ***Table 34*** considering a crisis of a similar intensity as the global financial crisis in 2008, there is a probability of 92% that the resolution funds would intervene for at least one bank, for an average of 4.1 banks assuming the currently applicable creditor hierarchy. The introduction a single-tier depositor preference would increase the number of interventions to an average of 5.9 banks, linked to the more frequent probability to reach 8% TLOF.

Table 24: Average proportion of banks for which resolution funds would intervene (in percentage of all banks in the sample, assuming the resolution group's structure is maintained)

Depositor preference	Global financial crisis (2008)			Less severe crisis			More severe crisis		
	Baseline	Single-tier	Three-tier	Baseline	Single-tier	Three-tier	Baseline	Single-tier	Three-tier
	%	*%*	*%*	*%*	*%*	*%*	*%*	*%*	*%*
Small	1.7%	2.2%	1.2%	1.4%	1.7%	1.0%	2.8%	3.8%	1.8%
Medium	1.2%	1.8%	1.3%	1.1%	1.5%	1.2%	1.4%	2.8%	1.7%
Large	2.4%	2.4%	2.3%	2.3%	2.4%	2.2%	2.8%	2.8%	2.5%
Resolution	1.6%	1.6%	1.0%	1.3%	1.3%	0.9%	2.4%	2.8%	1.5%
Liquidation	1.1%	2.0%	1.1%	1.0%	1.6%	0.9%	1.7%	3.5%	1.7%
Low	1.7%	1.1%	1.1%	1.5%	1.1%	1.1%	2.4%	1.3%	1.3%
Mid	2.6%	3.3%	2.6%	2.6%	3.0%	2.5%	3.0%	4.4%	2.9%
Mid-High	2.3%	3.0%	2.5%	2.2%	2.6%	2.2%	2.9%	4.5%	3.3%
High	1.5%	2.7%	1.4%	1.3%	2.2%	1.2%	2.3%	4.7%	2.1%
All	1.1%	1.6%	0.8%	0.9%	1.2%	0.7%	1.9%	3.0%	1.4%

Source: Commission services, based on EBA CfA report and SRB data as of Q4 2019.

Table 25: Average number of banks for which resolution funds would intervene

Depositor preference	Global financial crisis (2008)			Less severe crisis			More severe crisis		
	Baseline	Single-tier	Three-tier	Baseline	Single-tier	Three-tier	Baseline	Single-tier	Three-tier
All	4.12	5.89	3.01	3.30	4.53	2.47	7.14	11.07	5.24

Source: Commission services, based on EBA CfA report and SRB data as of Q4 2019.

The contribution of the resolution fund would, on average, amount to EUR 1.5 bn when considering the currently applicable creditor hierarchy, and be reduced to EUR 1.3 bn in case of a single-tier depositor preference, under a similar crisis as in 2008. When considering a more severe crisis, interventions from the resolution funds could amount to EUR 3.9 bn or 3 bn, respectively.

These results must be read with caution. First, the analysis only covers for the usage of resolution funds for loss-absorption and recapitalisation, and not interventions to provide liquidity support or compensate certain classes of creditors when mitigating NCWO risks. The analysis also considers that all bail-inable capacity excluding deposits (e.g. including derivatives and structured notes, where applicable) is used in order to reach the 8% TLOF threshold, i.e. without considering potential discretionary exclusions from bail-in pursuant to Article 44(3) BRRD. The results must also be considered taking into account that the sample used for the impact assessment represents approximately a third of the amount of covered deposits in the EU.

Second, the limited size of the resolution funds contribution may also be explained by the strengthening of balance sheets since the last financial crisis and the resulting lower impact of a similar loss scenario on more robust asset and liability structures at EU level. The progress made on risk reduction, via the reduction of non-performing loans or the build-up of capital ratios and MREL capacity may render the use of contributions from resolution funds for loss-absorption and recapitalisation purposes more limited. Without prejudice of the need for mutualised safety nets to promote financial stability and ensure market discipline, further analysis could be conducted to explore whether and how the calibration of the safety nets may be revisited at a later stage.

Table 35 shows the impact of the simulation under the assumption that the resolution group structure is not maintained. The number of observations underlying the figures contained in the table is larger than in the previous analysis because the assessment is conducted at individual level including subsidiaries.

On average, resolution funds would intervene for an average of 0.5% to 1.0% of the banks in the sample depending the depositor preference, especially for large banks or, under a single-tier depositor preference, for banks with a high prevalence of deposits in the balance sheet. Consequently, in a crisis similar to 2008, on average between seven and nine banks would need an intervention of the RF/SRF under a single-tier preference, and on average 17 banks in case of a more severe crisis. Similarly, the three-tier depositor preference lowers the probabilities for resolution funds to intervene, also compared to the baseline.

When considering the amounts, assuming the resolution group's structures break increases the amounts of the interventions to EUR 1.9 bn under the currently applicable creditor hierarchies, compared to EUR 1.9 bn or EUR 1 bn under a single-tier and three-tier depositor preference, respectively. Assuming a more severe crisis, interventions could amount up to EUR 4.3 bn under a single-tier depositor preference, i.e. allowing for a more frequent use of resolution funds.

Table 26: Average proportion of banks for which resolution funds would intervene (in percentage of all banks in the sample, assuming the resolution group's structure is not maintained)

Depositor preference	Global financial crisis (2008)			Less severe crisis			More severe crisis		
	Baseline	Single-tier	Three-tier	Baseline	Single-tier	Three-tier	Baseline	Single-tier	Three-tier
	%	%	%	%	%	%	%	%	%
Small	1.1%	1.2%	0.7%	0.9%	0.9%	0.5%	1.7%	2.2%	1.1%
Medium	0.7%	1.0%	0.6%	0.6%	0.8%	0.6%	1.0%	1.8%	1.0%
Large	2.1%	2.1%	1.9%	2.0%	2.0%	1.9%	2.4%	2.4%	2.2%
Low	1.3%	0.6%	0.6%	1.1%	0.6%	0.5%	1.9%	0.8%	0.8%
Mid	1.1%	1.4%	1.1%	1.1%	1.3%	1.0%	1.4%	1.9%	1.2%
Mid-High	0.8%	1.1%	0.8%	0.7%	0.9%	0.7%	1.1%	1.7%	1.1%
High	1.1%	2.1%	1.1%	0.9%	1.6%	0.9%	1.8%	3.7%	1.8%
All	0.8%	1.0%	0.5%	0.7%	0.8%	0.4%	1.4%	1.9%	1.0%

Source: Commission services, based on EBA CfA report and SRB data as of Q4 2019.

4.4. Availability of DGS funds and EDIS (Steps F, G and H)

The objectives of this section are to: (i) compare the DGS funding needs (in resolution and insolvency) with the DGS financial means, both under the statistical and modelling approaches in order to identify potential DGS liquidity shortfalls per Member State, (ii) assess the efficiency of EDIS models versus national DGS in providing funding.

In resolution, the DGS funds would be used to bridge the gap towards 8% TLOF for banks that cannot reach this threshold without imposing losses on deposits. The amount of DGS funds is capped by the LCT, calculated as the amount of affected covered deposits in insolvency, taking into account a recovery rate in the insolvency counterfactual of 85%. In addition, the amount of DGS funds used in resolution is also capped by a limit of 50% of the DGS available financial means per intervention, in line with the BRRD.

In insolvency, the DGS fund can contribute to alternative measures up to the limit provided by the LCT. This method has two biases: (i) an alternative measure may be less costly than the limit provided by the LCT, and (ii) payout cases are not taken into account. The same LCT calculation applies in insolvency as in resolution, however, the 50% limit on DGS funds per individual intervention does not apply.

Given the sample size limitations and to ensure comparability of results, the amounts of DGS available financial means are restated for the sample for the purpose of this analysis (i.e. 0.8% contribution rate applied to covered deposits in the sample per Member State). While it does not reflect the real amounts of DGS financial means in Member States, this

adjustment is key in avoiding overestimating the DGS financial means[452]. This method also assumes that the DGS target level is reached in all Member States.

4.4.1. Statistical analysis – Baseline versus combined scenarios

Summary assessment – Baseline versus combined scenarios

Under the baseline scenario and considering a recovery rate of 85% in the insolvency counterfactual, due to negative LCT, the DGS would not be allowed to finance the gap to the 8% TLOF threshold in almost all cases.

The combined scenario 1 has two main impacts: (i) it reduces the number of banks unable to reach the 8% TLOF threshold and; (ii) it unlocks significantly more DGS funds. However, for 35% of the banks unable to reach the 8% TLOF threshold, the LCT is still not sufficient to bridge the gap. Including indirect costs in the LCT calculation could be considered to mitigate this shortcoming. Assuming the DGS were allowed to fully finance the gap to the 8% TLOF under the LCT, three DGSs would face a liquidity shortfall.

Detailed analysis

When considering the entirety of the sample under the baseline scenario, under the baseline creditor hierarchy and assuming a recovery rate of 85%, the DGSs would not be allowed to bridge the gap to 8% TLOF in 88 cases (negative LCT) and under the LCT, DGS interventions would be allowed in only three cases. The LCT would only allow the DGS to finance EUR 0.05 bn while the gap to reach 8% TLOF would be EUR 18.3 bn. In case the DGSs would be able to finance the gap towards 8% TLOF, 6 DGSs would face a liquidity shortfall.

Under the combined scenario 1 (no CET1 depletion and single-tier depositor preference), creating one single preferred category for all deposits has the following impacts. In general, as also explained in Annex 8, it leads to a better protection of deposits and a lower protection of senior unsecured creditors. The number of banks where deposits would be impacted in order to reach 8% TLOF decrease significantly from 91 under the baseline to 48 under the single-tier deposit preference.

However, among the different categories of deposits, the non-preferred deposits would be better protected and the covered ones would become theoretically more exposed[453] than under the baseline: EUR 17.2 bn of non-preferred deposits under the baseline *versus* EUR 2.7 bn under the single-tier preference. Conversely, EUR 0.25 bn of covered deposits are affected by the 8% TLOF threshold under the baseline *versus* EUR 2.82 bn under the single-tier preference. In terms of LCT impact, the single-tier deposit preference would unlock the largest amount of DGS funds to allow for a more effective substitution of potential depositors losses by the DGS. However, even under a revised single-tier hierarchy of claims, the LCT would still not provide all the funds necessary to

[452] Otherwise, the DGS funding needs would be based on the sample of banks, while the DGS financial means would be reflecting the real banking sectors.
[453] Covered deposits are always protected.

reach the 8% TLOF in all cases. Among the 48 banks unable to reach the 8% TLOF without deposits, 17 banks would have a negative or an insufficient LCT.

Besides, in almost all cases, the cap corresponding to the maximum amount a DGS can use in resolution (i.e. 50% of the DGS financial means) does not seem binding. The LCT is the main driver explaining the inability of the DGS to finance the gap to the 8% threshold.

The combined scenarios 2 and 3 were also analysed. However, while the results of these combined scenarios are relevant for other parts of the annex, such scenarios involving significant capital depletion simultaneously for all the banks in the sample should be carefully considered in the context of assessing the DGS financial means[454].

Under the combined scenario 2, the number of banks unable to reach the 8% TLOF without affecting the deposits is quite important for the DGSs funding capacity (198 institutions). The LCT would allow 54 banks to reach the 8% but most of the DGSs would face liquidity shortfalls.

As regards combined scenario 3, the number of banks unable to reach the 8% TLOF and the amounts of DGS funds necessary to reach this threshold are similar as under combined scenario 2. However, the LCT, based on a three-tier depositor preference, would only allow three banks to reach the 8% TLOF.

When considering only the 187 banks with resolution strategies, the main conclusions of the analysis do not change. Under the baseline scenario, among the 42 banks that could not reach the 8% TLOF threshold without touching deposits, only 1 would have a sufficient LCT to allow for DGS intervention. In case the DGSs would be able to finance the gap towards 8% TLOF, 5 DGSs would face a liquidity shortfall[455]. Under the combined scenario 1, the single-tier depositor preference leads to a lower number of banks unable to reach the 8% TLOF threshold and unlock more DGS funds.

[454] The assumption of simultaneous failures for all members of a DGS is not a realistic assumption for the purpose of this analysis.

[455] When identifying the DGS shortfalls, the uses of funds both in resolution and alternative measures in insolvency are taken into account. In insolvency, it is assumed that the LCT represents the cost for the DGS.

Table 27: DGS financial means – Static statistical analysis (all sample of resolution entities)

		Baseline scenario		Combined scenario 1	
			Of which: resolution strategies		Of which: resolution strategies
Institutions unable to reach the 8% TLOF without deposits	*Count*	91	42	48	20
of which positive LCT and sufficient to reach 8% TLOF	*Count*	*2*	*1*	*31*	*14*
of which the positive LCT, but insufficient to reach 8% TLOF	*Count*	*1*	*0*	*10*	*2*
of which negative LCT	*Count*	*88*	*41*	*7*	*4*
Total amount of DGS funds needed to reach the 8% TLOF	*EUR bn*	18	14	6	5
Number of DGSs facing a liquidity shortfall, where DGSs allowed to finance all the gap to the 8% TLOF	*Count*	6	5	3	2
Maximum amount used by all the DGSs under the LCT	*EUR bn*	0	0	1	1
Total DGSs financial means *(restated to the sample)*	*EUR bn*	22	22	22	22

Source: Commission services, based on EBA CfA report, data as of Q4 2019, assuming an 85% recovery rate.

4.4.2. Modelling analysis

Summary assessment

The modelling analysis confirms the general conclusions of the static statistical analysis. In most of the cases, assuming an 85% recovery rate in the insolvency counterfactual, the current hierarchy of claims does not allow the DGSs to finance the gaps to the 8% TLOF threshold. The single-tier preference has two main impacts. It reduces the number of banks that need DGS funds, while unlocking more DGS funds to finance the remaining gaps to the 8% TLOF threshold.

The results vary substantively depending on whether the structures of the resolution groups are assumed to be maintained. Considering that the resolution structures break leads to an increase of the amount of DGS funding and consequently of the number of DGSs facing a liquidity shortfall. Indeed, the number of DGSs facing a liquidity shortfall increases significantly when assuming the break-up of resolution structures (from three to nine DGSs under a crisis as severe as in 2008).

An estimation of the probabilities and of the amounts of liquidity shortfall for the DGSs and the EDIS designs aim at assessing the relative effectiveness of EDIS in providing the funding needed. It shows that, while it is likely that the DGSs face liquidity shortfalls, EDIS would strongly mitigate this risk. However, these results should be interpreted with caution as they are subject to many assumptions and caveats that may lead to significantly underestimate the results.

Detailed analysis

Under crisis simulations as severe as in 2008, 5.28% of the banks would need DGS funds to reach the 8% TLOF threshold under the current creditor hierarchy. However, 97.11% of the funds needed to reach this threshold could not be financed by the DGSs, mainly due to an insufficient LCT. The cap of 0.4% of the covered deposits does not appear binding in most of the simulations. Changing the intensity of the crisis simulations or assuming that the resolution group structures are not maintained do not change this general conclusion[456]. However, in case the DGS would be allowed to finance the gap, between six and 15 DGSs would face a liquidity shortfall. The number DGSs facing a liquidity shortfall mainly depends on the resolution group structure holding or breaking up. When assuming that the resolution group structures are maintained, the parent entities absorb the losses of their subsidiaries. Consequently, the DGS funding needs are minimised, as is the number of DGSs facing a liquidity shortfall (between six and 10 depending on the intensity of the crisis). Conversely, when assuming that the resolution group structures are not maintained, more subsidiaries fail as the parents do not absorb their losses, leading to more DGS funding needs and a higher number of DGSs facing a liquidity shortfall (between nine and 15 depending on the intensity of the crisis).

Compared to the baseline, the single-tier preference has two main impacts. First, it reduces the number of banks where deposits would be on the line to take losses and requiring DGS funds to reach the 8% TLOF threshold, lowering the amount of DGS funding needed. In addition, it unlocks more DGS funds to finance the remaining gap, significantly increasing the number of banks that would be able to reach the threshold. Under crisis simulations as severe as in 2008, around 80% of the banks that need DGS funds would be able to reach the 8% TLOF threshold (*versus* only 7% under the baseline and 9% under the three-tier preference).

The inclusion of indirect costs in the LCT calculation may be envisaged in order to unlock more DGS funds and allow a higher percentage of banks to reach the 8% TLOF threshold. Under the single-tier preference, on average, the gap to reach the 8% TLOF represents 0.25% of covered deposits[457]. Assuming as objective covering this entire gap, indirect costs would need to be calibrated accordingly. However, this amount should be seen as a preliminary result due to the following considerations: (i) the amount of indirect costs needed to unlock sufficient DGS funds range from 0.02% to 0.70% of covered deposits among the DGSs; (ii) the LCT is based on an 85% recovery rate that may not be appropriate in all cases. For instance, assuming a lower recovery rate would unlock more DGS funds under the current LCT, potentially lowering the level of indirect costs required in the LCT calculation.

Assuming that the resolution group structures are not maintained has a significant impact on the number of DGSs facing liquidity shortfalls. Under a crisis as severe as in 2008, on

[456] For instance, under more severe crisis simulations, the share of banks that would need DGS funds would increase, as well as the amount of DGS funds needed to reach the 8% TLOF. However, the LCT would still prevent the DGSs from providing around 97% of the funds needed.

[457] The percentage does not change significantly when increasing the severity of the crisis simulations.

average the amount of DGS funds needed would increase from EUR 1.2 bn to EUR 2.73 bn and some DGSs would not be able to service their liquidity needs. The number of DGSs facing a liquidity shortfall would increase from three to nine under these assumptions.

The three-tier depositor preference would lead to similar DGS funding needs as under the single-tier preference. However, in most of the cases, the DGSs would not be able to finance the gap to the 8% TLOF threshold as a result of an insufficient LCT.

Table 33 presents the results under the assumption that all the resolution group structures are maintained, leading to minimise the amount of DGS funds needed and the number of DGSs facing a liquidity shortfall. Table 34 presents the results under the assumption that all the resolution group structures break down, leading to maximise the amount of DGS funds needed and the number of DGSs facing a liquidity shortfall.

Table 28: DGS financial means – Modelling analysis (all sample of resolution entities – resolution structures are maintained)

Resolution structure is maintained		**Global financial crisis (2008)**			**Less severe crisis**			**More severe crisis**		
		Baseline	Single-tier	Three-tier	Baseline	Single-tier	Three-tier	Baseline	Single-tier	Three-tier
Average % of banks that need DGS funds to reach the 8% TLOF threshold	*%*	5.28	3.01	3.01	4.04	2.30	2.30	9.28	5.35	5.35
Among which, average % of banks that cannot reach the 8% threshold	*%*	*92.99*	*19.18*	*91.43*	*93.21*	*21.59*	*91.77*	*92.39*	*16.15*	*90.15*
Average amount of DGS funds needed to reach the 8% TLOF threshold,	*EUR bn*	3.94	1.17	1.17	2.77	0.84	0.84	8	2.41	2.41
Among which, average % of the needed amount that cannot be provided	*%*	*97.11*	*29.88*	*94.01*	*97.11*	*34.22*	*94.30*	*96.77*	*23.86*	*92.84*
Number of DGSs facing a liquidity shortfall, if DGSs were allowed to finance all the gap to the 8% TLOF threshold	*Count*	7	3	3	6	3	3	10	4	4

Source: Commission services, based on EBA CfA report, data as of Q4 2019, assuming an 85% recovery rate.

Table 29: DGS financial means – Modelling analysis (all sample of resolution entities – resolution structures are not maintained)

Resolution structure is not maintained		Global financial crisis (2008)			Less severe crisis			More severe crisis		
		Baseline	Single-tier	Three-tier	Baseline	Single-tier	Three-tier	Baseline	Single-tier	Three-tier
Average % of banks that need DGS funds to reach the 8% TLOF threshold	*%*	4.28	2.14	2.14	3.25	1.64	1.64	7.64	3.78	3.78
Among which, average % of banks that cannot reach the 8% threshold	*%*	*91.77*	*18.83*	*86.74*	*91.47*	*19.45*	*86.27*	*92.17*	*19.06*	*87.22*
Average amount of DGS funds needed to reach the 8% threshold,	*EUR bn*	7.62	2.73	2.73	5.38	1.95	1.95	15.71	5.85	5.85
Among which, average % of the needed amount that cannot be provided	*%*	96.39	*25.16*	*92.04*	*96.22*	*24.69*	*91.71*	*96.34*	*27.25*	*92.25*
Number of DGSs facing a liquidity shortfall, if DGSs were allowed to finance all the gap to the 8% TLOF threshold	*Count*	9	9	9	8	8	8	15	11	11

Source: Commission services, based on EBA CfA report, data as of Q4 2019, assuming an 85% recovery rate.

Table 35 and ***Table 40*** compare the probabilities and the amounts of liquidity shortfalls in the Banking Union, considering in turn only the DGSs and different ways to design EDIS[458].

Under a high-ambition hybrid EDIS, a target level of 0.6% of covered deposits is considered, where 75% of the funds are in the central fund and 25% remaining in the national DGSs. A medium-ambition hybrid EDIS considers a target level of 0.7% of covered deposits, where 50% of the funds are in the central fund and 50% remaining in the national DGSs. A low-ambition hybrid EDIS considers a 0.8% covered deposits target level with 25% of the funds in the central fund and 75% in the national DGSs.

The results show an important probability that at least one DGS faces a liquidity shortfall in the Banking Union in case of financial crisis. For instance, under a financial crisis as severe as in 2008 and considering a single-tier depositor preference, there is 30.78% probability that at least one DGS faces a liquidity shortfall. On average, the amount of the liquidity shortfall would amount to EUR 0.3 bn. Assuming that the resolution group structures break down has a significant impact on the results. The probability of DGS

[458] See Annex 10 for more details on the hybrid model designs.

liquidity shortfall would raise from 30.78% to 74.78% and the amount of liquidity shortfall would increase on average from EUR 0.3 bn to EUR 0.8 bn. In addition, increasing the severity of the crisis simulations would have a significant impact on the probability of shortfall (58.17% if the resolution group structure is maintained and 91.34% if the resolution group structure is not maintained).

The hybrid EDIS models would significantly mitigate the risk of liquidity shortfall. The high-ambition hybrid EDIS would reduce the probability of liquidity shortfall to a negligible level in all situations. The low-ambition hybrid EDIS would also reduce the probability of liquidity shortfall. In case the resolution group structures are maintained, the probability of liquidity shortfall is negligible, but it raises to 6.68% in the worst case scenario including crisis simulations more severe than in 2008 and considering a break-up of the resolution group. The shortfall amount would be limited.

These results should be interpreted with great caution, as the probabilities and the amounts of liquidity shortfalls are may be significantly underestimated:

- First, the results do not include payout cases, which are much more cash consuming. Including them would significantly increase the funding needs of the DGSs and hybrid EDIS models, leading to higher probabilities and amounts of liquidity shortfalls both for the DGSs and the hybrid EDIS models.
- Second, the analysis is based on an 85% recovery rate. Assuming a lower recovery rate would unlock more funds, leading to higher probabilities and amounts of shortfalls for the DGSs and the hybrid EDIS models.
- Third, the results are based on restated amounts of DGS and hybrid EDIS financial means that may not be fully representative for all Member States[459]. In addition, a larger sample of banks would automatically increase the probabilities and the amounts of liquidity shortfall.

[459] Given that the analysed sample only covers a share of the EU banks, the size of the DGS funds and hybrid EDIS funds have been restated for comparability reasons.

Table 30: Performances of the DGSs and the hybrid EDIS in providing funding in resolution (Resolution structure is maintained)

Resolution structure is maintained			Global financial crisis (2008)		Less severe crisis	More severe crisis
			Single-tier		Single-tier	Single-tier
DGSs only	Probability of liquidity shortfall	%	30.78		22.06	58.17
	Amount of liquidity shortfall	*EUR bn*	0.3		0.3	0.5
High ambition hybrid EDIS	Probability of liquidity shortfall	%	0		0	0
	Amount of liquidity shortfall	*EUR bn*	0		0	0
Medium ambition hybrid EDIS	Probability of liquidity shortfall	%	0		0	0
	Amount of liquidity shortfall	*EUR bn*	0		0	0
Low ambition hybrid EDIS	Probability of liquidity shortfall	%	0.05		0	0.25
	Amount of liquidity shortfall	*EUR bn*	0		0	0

Source: Commission services, based on EBA CfA report, data as of Q4 2019, assuming an 85% recovery rate.

Table 31: Performances of the DGSs and the hybrid EDIS in providing funding in resolution (Resolution structure is not maintained)

Resolution structure is not maintained			Global financial crisis (2008)		Less severe crisis	More severe crisis
			Single-tier		Single-tier	Single-tier
DGSs only	Probability of liquidity shortfall	%	74.28		63.02	91.34
	Amount of liquidity shortfall	*EUR bn*	0.8		0.6	1.4
High ambition hybrid EDIS	Probability of liquidity shortfall	%	0.1		0.05	0.5
	Amount of liquidity shortfall	*EUR bn*	0		0	0.01
Medium ambition hybrid EDIS	Probability of liquidity shortfall	%	0.5		0.25	2.48
	Amount of liquidity shortfall	*EUR bn*	0.02		0.01	0.07
Low ambition hybrid EDIS	Probability of liquidity shortfall	%	1.74		0.99	6.68
	Amount of liquidity shortfall	*EUR bn*	0.08		0.05	0.28

Source: Commission services, based on EBA CfA report, data as of Q4 2019, assuming an 85% recovery rate.

4.5. Sensitivity analysis of the impact of the recovery rates in insolvency

The recovery rates in insolvency are extremely heterogeneous across banks and Member States and are impacted by many factors, such as the bank's individual characteristics (asset quality, other financial fundamentals), the market situation, the national insolvency laws and national judicial regimes as well as the severity of the crisis.

In this context, the results of the analyses are very sensitive to the value of the haircuts and corresponding recovery rates applied to the assets in insolvency that serves as a basis for the calculation of the LCT. Lower recovery rates (i.e. higher haircuts) lead to comparatively larger losses in insolvency due to the inability to recover all proceeds from the liquidation of the assets, and would result in a higher probability to reach covered deposits in the hierarchy of claims in the insolvency counterfactual. As a consequence, more banks may face a positive LCT on the basis of low recovery rates on assets.

These results affect the magnitude of the different options tested in the quantitative analysis, but do not alter the conclusions related to the banks' ability to reach 8% TLOF without DGS interventions nor to the comparison between the various scenarios of depositor preference.

In fact, changing the level of haircuts does not affect the liability structure and, as a result, the capacity of institutions to access the 8% TLOF without deposits, or to what extent certain forms of deposits would have to bear losses in order to reach that threshold. However, higher haircuts impact the frequency with which DGS could intervene under the LCT as well as the ability of the DGS's intervention to help reaching 8% TLOF. The number of banks with a positive LCT and the maximum amount of DGS funds unlocked by the LCT increases significantly with a recovery rate of 50% compared to the primary assumption of 85%.

More specifically, assuming a 50% recovery rate, the currently applicable creditor hierarchies and no CET1 depletion, 232 institutions would have a positive LCT irrespective of their ability to reach the 8% TLOF threshold, against eight when considering an 85% recovery rate. In this case, 63% of the small banks, 76% of the medium-sized and 64% of the large banks would have a positive LCT. At least 90% of the banks in the sample would have a positive LCT in eight Member States.

Under a single-tier depositor preference, the number of banks with a positive LCT would increase from 150 assuming a recovery rate of 85% to 300 with a recovery rate of 50% (out of a total sample of 343 institutions). Under this scenario, 84% of the small banks, 92% of the medium-sized and 86% of the large banks would have a positive LCT. When considering the funding structure, 98% of the banks in the sample with a prevalence of deposits higher than 70% of TLOF would have a positive LCT. Similarly, at least 90% of the banks in the sample would have a positive LCT in 14 Member States.

In terms of amounts of DGS funds unlocked under the LCT, lowering the recovery rate increases the maximum amount for DGS intervention to EUR 15.8 bn assuming a 50% recovery rate, the currently applicable creditor hierarchies and no CET1 depletion, compared to EUR 0.23 bn with a recovery rate of 85%. Results are similar for scenarios 3 and 4 of depositor preference. This amount increases from EUR 1.15 bn to EUR 20.8 bn when considering a single-tier creditor hierarchy, and from EUR 0.40 bn to EUR 18.7 bn under scenario 5 of depositor preference. While the magnitude of the increase is higher for all other scenarios, the single-tier depositor preference remains the option under which the maximum amounts of DGS funds can be mobilised under the LCT, even assuming a 50% recovery rate, while being the most protective of depositors given the number of banks able to reach the 8% TLOF without deposits, as shown in section 3.2.3.

5. CAVEATS AND DISCLAIMERS

Overview of main caveats and disclaimers

Caveat/disclaimer	Description	Mitigating factor(s)
Representativeness of the sample	The sample of banks underpinning all analyses in this Annex is based on the data collected by the EBA as part of their annual exercise whereby national resolution authorities report banks' liability data and MREL decisions to the EBA. The sample include 368 banks when considering parent-level entities and 862 banks when counting also subsidiaries. A number of entities have been eliminated from the sample due to data quality issues. The banks in the sample represent approximately 52% (when also considering third country assets) to 73% (when only considering domestic assets) of the total banking asset in the EU. The covered deposits of the banks in the sample represent 38.3% of the covered deposits reported for the entire EU as of Q4 2019.	The sample represents 73% of the total EU domestic banking assets, excluding third country assets. For the purpose of assessing the DGS intervention against the DGS financial means, the level of DGS financial means has been recalibrated to match the banks in the sample.
Expansion of the PIA as per policy options in Chapters 5 and 6 could not be quantified.	The number of additional banks that would go in resolution under the policy options cannot be estimated upfront, as the PIA remains a case-by-case assessment by resolution authorities, retaining elements of discretion and highly dependent on the financial condition of the bank at the moment of failure. Moreover, the strategy set out for a bank at the planning stage (resolution vs liquidation) is a presumptive path based on backward looking information, which allows deviations to take account of the specific situation at the time of failure.	The calculations and analyses carried out in this Annex illustrate the results on two perimeters: - the entire sample of banks (parent level) irrespective of their resolution strategy (resolution or liquidation). This would show the impacts assuming all banks would be placed in resolution; and - only banks with strategy resolution as per 2019 data.

Insolvency haircut (loss) assumption of 15% of total assets (corresponding to a recovery rate of 85%) in the context of calculating the LCT.	The recovery rates and therefore, the losses in insolvency, range widely across Member States as they are impacted by national insolvency laws and judicial regimes. Moreover, recovery rates are also highly case-dependant. For the purpose of the analyses carried out in, one primary assumption has been used (15% haircut in insolvency corresponding to a recovery rate of 85%), however results corresponding to a 50% haircut and recovery rate have also been presented.	To mitigate the uncertainties deriving from these limitations, qualitative clarifications are provided in order to show how the results would be impacted if higher or lower recovery rates were considered.
The impact of using different insolvency haircuts or corresponding recovery rates on the results cannot be clearly attributed to a single factor – such as the need to harmonise insolvency laws.	The recovery rates which are extremely heterogeneous across banks and Member States are impacted by many factors, such as: the bank's individual characteristics (asset quality, other financial fundamentals), the market situation, the national insolvency laws and national judicial regimes as well as the severity of the crisis. While one may argue that further harmonisation of insolvency laws may reduce the heterogeneity in recovery rates, this may not be necessarily the case, as a direct relationship cannot be established between these two elements. The impact of insolvency laws on recovery rates cannot be disentangled from the impact of other relevant factors.	Transparency is ensured in the reading of the results throughout this Annex, with respect to the impact of various recovery rates on the results. However, the variation in results cannot be clearly attributed to one particular cause.
Creditor hierarchy applicable in each Member State	Each national creditor hierarchy has been adjusted to follow a common list of insolvency ranking based on a simpler standard structure to perform the analysis in sections 3 and 4. Individual liabilities reported in the dataset have been mapped accordingly.	The ranks under the national hierarchies have been mapped to a standard ladder keeping the relative seniority between the main categories of liabilities, in particular deposits, and taking into account the most frequent rank reported for each form of liabilities to cater for cases where contractual features affect the rank of a given liability.

The analyses reflect the balance sheet data as of Q4 2019 when banks were still in transitional period to comply with their MREL requirements.	Modelling or estimating potential changes in balance sheets as of 2024 when most banks are expected to reach compliance with their MREL requirements was not attempted in this analysis due to the complexity of such a task and the additional required assumptions that would require extrapolation across the sample.	A scenario was added assessing the impact of reaching 8% TLOF and allowing for DGS intervention by considering MREL requirements (assuming all banks will comply with their requirements by 2024) rather than the bail-inable capacity as of Q4 2019. However, this scenario was not relevant as for almost all banks (except one), the bail-inable capacity as of Q4 2019 exceeded their MREL requirement.
The results of the model-based approach are based on three scenarios of crises: one similar to the 2008 global financial crisis and two other crises, one less severe and one more severe.	A multitude of crises with different intensities have been simulated using the SYMBOL model. However, for reasons related to complexity, readability and relevance, not all results are presented in this analysis.	The results are presented for three selected simulated crises, to which the reader can easily relate. The CMDI framework was enacted in the wake of the 2008 global financial crisis, therefore presenting simulations of a crisis similar to that particular crisis, as well as less and more severe crises is a sensible approach.
Impact of COVID-19 crisis on presented results	The figures presented in this Annex reflect the situation as of Q4 2019, prior to the set-up of the COVID-19 crisis.	As shown by the report monitoring risk reduction indicators as of May and November 2021 by the Commission, the ECB and the SRB, the consequences of the COVID-19 pandemic have not led to a material deterioration of Banking Union institutions' solvency or liquidity position. This is in part due to the extraordinary policy measures taken in response to the COVID-19 pandemic including in particular the introduction of loan moratoria and public guarantee schemes. The borrower relief and liquidity support measures have mitigated the impact of the pandemic on bank balance sheets, and as these measures have or are being phased out, banks remained resilient. See also the analysis of the evolution of balance sheets changes in section 6 'Other methodological considerations'.

6. OTHER METHODOLOGICAL CONSIDERATIONS

General information on data

The analysis in this annex is based on resolution data reported under Commission Implementing Regulation (EU) 2018/1624 of 23 October 2018 (ITS on resolution reporting) by institutions included in the scope of the BRRD and submitted to the EBA. The analysis is complemented with data on formally adopted MREL decision that were reported to the EBA for the reference date 31 December 2019. Where formally adopted MREL decision were not yet available at the point of reporting, indicative decisions are considered. Where neither formal nor indicative MREL decisions were included, an MREL proxy was considered, as explained in the assumptions and scenarios section 2.3.

General information on the sample and data quality checks

The sample of covered institutions includes 368 entities when counting all parent-level institutions and 862 entities when also including the subsidiaries. The composition of the sample and the exclusion of certain entities is driven by number of institutions participating in the data collection exercise and data quality criteria[460].

General information on the reference date for data analysis

The quantitative assessments included in this annex are based on data as of 31 December 2019, in line with the analysis published in the EBA's CfA report on 22 October 2021.

The recent evolution of key indicators of banks' balance sheets shows that the conclusions drawn in this annex would not change if they were based on the latest available data points (e.g. end-2022).

- Evolution of the liability structure

In the EU, banks' total liabilities increased by 8.7% between end-2019 and end-2022[461]. This evolution is partly driven by an increase in deposits and other MREL eligible liabilities.

At the level of the EU, covered deposits increased by 14.3% between end-2019 and end-2021[462]. However, despite this nominal increase, the share of deposits from households and non-financial corporations as percentage of the total liabilities remained stable (on average, 47.6% of total liabilities as of end-2022, compared to 44.9% as of end 2019), suggesting the absence of material changes in banks' liability structure[463].

[460] EBA (22 October 2021), *Call for advice regarding funding in resolution and insolvency*. As shown by the EBA CfA report, the loss simulation requires a minimum set of three variables (total assets, total risk exposure amount (TREA) and CET1 capital) to be reported by each entity to be included in the analysis. Entities, for which this information is missing are excluded from the analysis. Prior to excluding entities without reported total assets, reported TLOF is used as a proxy for non-systemic and smaller institutions (< EUR 50 bn TLOF).

[461] EBA risk dashboards

[462] EBA Deposit Guarantee Schemes data

[463] EBA risk dashboards

In fact, based on data covering the Banking Union, the aggregated amount of MREL eligible liabilities held by banks within the SRB remit increased by 14.8% between end-2019 and Q3-2022. The stock of eligible liabilities in percentage of TREA (i.e. considering the risk profile of the banks) increased in most Member States during that period[464]. In the EU, and with a focus on smaller banks, data shows that the share of MREL resources, in percentage of TREA, generally increased for domestically systemic banks (by 1.6% for the larger ones, and approximately 4% for systemic banks with less than EUR 10 billion balance sheet) as well as for other smaller lenders (by approximately 6% for non-systemic banks with less than EUR 5 billion balance sheet). These groups of banks often rely on deposits to comply with MREL requirements, representing up to 5-6% TREA for the smaller banks[465].

As a result, the impact on banks' ability to reach 8% TLOF without deposits would remain neutral because of these two conflicting trends: the increase of loss-absorbing capacity improves banks' resilience using internal resources, which are often ranking lower than deposits in the hierarchy of claims, reducing the need to rely on deposits to reach 8% TLOF; at the same time, part of the increase of these MREL eligible instruments takes the form of deposits.

In addition, the amount of assets, which is used to estimate the losses in SYMBOL, has increased in the same proportion as the liabilities, in particular the amount of loss-absorbing capacity. Higher potential losses stemming from the increased asset base are therefore commensurate to an observed higher amount of loss-absorbing capacity, maintaining the conclusion as regards the ability to reach the 8% TLOF without deposits. The absence of a relative shift in the share of deposits in banks' balance sheets also supports the assumption that the evolution of the liability composition is not likely to fundamentally affect the analysis of banks' ability to access resolution funding arrangements.

Similarly, these evolutions are not expected to materially impact DGS's ability to intervene based on the least cost test to support the access to resolution funding arrangement. In fact, two independent effects can be drawn from the evolution of banks' liability structure. On one hand, the least cost test may lead to a higher amount of possible support due to the increased volumes of covered deposits that would have to be paid out in insolvency. This may facilitate the bridge to the 8% TLOF threshold. On the other hand, the stable proportion of deposits in banks' total liabilities, compared to other loss-absorbing resources, would not materially affect the triggers based on which DGS can intervene (i.e. when loss absorption needs reach deposits). As a result, the possible higher volume of DGS support would not necessarily be accompanied by a more frequent ability of DGS to intervene compared to the situation as of end 2019.

[464] SRB MREL Dashboard, Q3 2022

[465] EBA quantitative MREL reports 2019 (27 May 2021) and 2020 (22 April 2022).

- Evolution of the asset quality and prudential requirements

In addition, data shows that the quality of the assets have not materially changed, nor deteriorated over the last years despite the impact of the COVID pandemic, which had led to an expectation of credit risk deteriorations. Importantly, banks keep fulfilling prudential requirements.

Banks risk-weighted assets slightly increased between end-2019 and end-2022, with an increase of 6.4% mainly since end-2021, driven by credit risk[466]. In this context, the gross non-performing loans (NPL) ratios continued to decrease between 2020 and 2022 for the majority of Member States while remaining largely stable for the remaining Member States and closed at 1.8% in Q4 2022 respectively. The feared negative impact of the Covid-pandemic did not materialize. The gross and net NPL ratios continued to decrease in 2021 and 2022, in almost all Member States, highlighting the absence of significant negative shift in asset quality. These evolutions could be explained by the effectiveness of the various policy measures introduced to cushion the impact of the COVID-19 pandemic. Since the start of the pandemic, all Member States, with the support of SURE and Next Generation EU, implemented various forms of support for households (furlough) and non-financial corporations including some form of moratorium on payments of credit obligations[467].

At the same time, prudential ratios, both on solvency and liquidity, remained high, showing a resilience of the banking sector despite the economic environment. Compliance with MREL requirements also improved over the period[468].

In this context, the crisis scenarios simulated by the SYMBOL model would apply to a population of banks, which is essentially unchanged, in particular not riskier and displaying a resilience level comparable to the evidence as of end-2019. Since the impact of the recent evolution of banks' balance sheet did not lead to major shift in terms of liability structure or general riskiness, one may assume that the models used in this assessment would lead to comparable results even if fed with more recent data.

These elements provide comfort that the conclusions of the assessment performed on the ability to access the resolution fund and the possible use of DGS would not be materially affected by adding more recent data. In fact, banks' balance sheets have not changed fundamentally over the recent years and the risks remain contained.

- Evolution of DGS available financial means

Finally, recent trends in banks' balance sheets would not affect the robustness of the safety nets tested in this analysis either, in particular on the ability of DGS to provide the necessary funding. Data shows that the DGS available financial means in the EU increased by 33.4% between end-2019 and end-2021. As of end-2021, available financial means stood at 0.75% of covered deposits, in aggregated terms (0.64% as of end-2019),

[466] EBA risk dashboards
[467] Monitoring reports on risk reduction indicators (Commission, ECB, SRB), May 2021, November 2021
[468] Idem.

remaining high despite the significant increase of covered deposits observed during the period. However, there are still important differences among Member States and deposit guarantee schemes (even within some jurisdictions when they have several deposit guarantee schemes)[469].

Noteworthy, the analysis performed in this annex assumes that target levels are reached (the deadline foreseen in DGSD is July 2024). As a result, the evolution of the DGS available financial means does not change the assumptions nor the outcome of the simulations.

Other considerations

The analyses in this annex are based on the solo balance sheet data of the entities included in the sample. This is to reflect that resolution action such as bail-in of eligible liabilities in order to access resolution financing arrangements (if needed) is applied to the parent entity, assuming that the resolution group structure holds.

Statistics in this annex show results covering the entire perimeter of the sample at parent entity level as well as the sub-sets of banks with resolution and liquidation strategies reflecting the PIA decisions as of Q4 2019. Offering results for the entire perimeter caters for a potential expansion of the PIA to more banks. Still, results displayed in the various sections provides for a breakdown per type of resolution strategy.

In the tables in section 3 of this annex, the figures expressed as percentage of TLOF have as denominator the total TLOF of the banks where each type of deposits would be impacted (non-preferred, preferred, covered deposits), broken down by the perimeter of banks concerned (e.g. by size, funding profile, strategy, etc.).

[469] EBA Deposit Guarantee Schemes data

ANNEX 8: IMPACT ASSESSMENT OF TECHNICAL TOPICS THAT WERE NOT EXHAUSTIVELY COVERED IN THE MAIN BODY OF THE IMPACT ASSESSMENT

1. EXPERIENCES WITH BAILING-IN DEPOSITORS

The liability structure of banks shows substantial differences across the European banking sector. In this regard, recent experiences demonstrated that bailing-in[470] certain liabilities - such as uncovered deposits - could entail a certain risk of depositor runs thereby putting the overall financial stability at risk. In some instances, a bank run occurred although a harmonised depositor protection was already in place[471]. In particular, during and after the global financial crisis, Cyprus, Greece and Iceland adopted several types of administrative measures to stop financial instability and contagion. In Italy precautionary measures were required to maintain depositor confidence. Conversely, the resolution of a small Danish bank in 2016 apparently did not influence depositor confidence although uncovered depositors were bailed-in.

Non-exhaustive list of observed depositor runs/outflow in the context of bail-in

The case of **Northern Rock**[472] in **England** in 2007 represents one of the emblematic examples of bank runs. Throughout that summer, serious concerns emerged about the viability of Northern Rock's business model (heavy reliance on wholesale market funding leading to considerable liquidity risk), which were compounded by the developments in the US sub-prime mortgage market. Both elements combined led Northern Rock seeking assistance from the Bank of England in September 2007, which sparked a dramatic bank run with GBP 3 bn of deposits withdrawn in the span of three days[473].

In 2008 in **Iceland**, a loss of market access caused three systemic cross-border banks to default on their foreign liabilities and led to a widespread financial distress resulting in

[470] From January 1, 2015, all EU Member States were required to transpose the BRRD into their national law. A key element of the new powers is the bail-in tool (as of January 1, 2016), requiring banks to absorb losses and recapitalise thanks to own resources. Some Member States had already similar tools available in their national laws.

[471] The original DGS Directive of 1994 only required a minimum level of harmonisation between domestic deposit guarantee schemes in the EU. It proved disruptive for financial stability and the internal market, especially during the financial crisis of 2007-2009. An amending Directive in 2009 required EU countries to increase their protection of deposits firstly to a minimum of EUR 50,000, and then to a uniform level of EUR 100,000 by the end of 2010. In 2014, the EU adopted Directive 2014/49/EU (DGSD). It requires EU countries to introduce laws setting up at least one DGS that all banks must join and to ensure a harmonised level of protection for depositors on the basis of protected types of deposits.

[472] Reference research gate (2009), *The Northern Rock Crisis: a multi-dimensional problem*.

[473] In February 2008, Northern Rock was nationalised. By using emergency legislation to pass the Banking (Special Provisions) Act, which enabled HM Treasury to carry out direct transfers of securities, liabilities and property. Two years later, the bank was eventually split into two to facilitate its return to the private sector and Virgin Money, in 2012, completed their purchase of NR, costing approximately GBP 1 bn (see: (PDF) The Northern Rock Crisis: a multi-dimensional problem in previous footnote.

intense deposits outflows, accompanied by a currency depreciation. The banking crisis in Iceland[474] was unprecedented in certain aspects, as the three banks Kaupthing, Landsbanki and Glitnir (over 80% of the Icelandic financial system) collapsed within a few days. The main causes of the collapse were multidimensional[475]. In September 2008, Glitnir Bank was the first amongst the three to request Emergency Liquidity Assistance (ELA) from the Central Bank of Iceland as it had exhausted its market options. The request was declined by the Central Bank of Iceland and suggestions about a partial nationalisation were raised instead. The announcement of the latter caused credit default swap spreads to jump, leading to funding problems for several other banks. This was coupled with an important deposit withdrawal by retail depositors that brought the entire Icelandic banking system on the brink of collapse by October 2008. As the crisis erupted, several measures were taken in relation to deposits, starting with the government's announcement of a blanket guarantee for all domestic deposits. The aim of the announcement was to stop the run on the banks. It was limited to covered deposits in domestic banks in Iceland, given the limited resources of the Deposit Guarantee Fund and the Ministry of Finance's inability to provide a credible backstop. Further, it was required to introduce a depositor preference in the creditor hierarchy via the Emergency Act (regardless whether they were collected through domestic or foreign branches). Until then, deposits were general claims and were therefore more likely to bear losses. The change in the creditor hierarchy was expected to reduce losses to depositors, both in branches and subsidiaries in Iceland and abroad[476]. A government bailout could not be realised as the State's resources unmatched the size of the problem. Furthermore, the Central Bank of Iceland was unable to act as a lender of last resort in foreign currency given that its foreign credit lines and FX reserves could not cope with the banks' needs. Therefore, each bank was resolved through the transfer of domestic activities to a new bank and the economic and financial assistance of the IMF programme was provided where capital controls and the restructuring of private debt were introduced.

In 2013 in **Cyprus**, depositors suffered losses in two systemic banks (following the bail-in of retail investors), which undermined the short-term confidence leading to significant outflows of deposits, especially from the affected banks. The Cypriot banking sector was

[474] Financial Stability Institute (FSI) (2020), FSI crisis management series No.1, *The banking crisis in Iceland*.

[475] First, the Icelandic banking system grew at a significant pace in the years prior to the crisis, which subsequently led to liquidity and funding concerns as the three banks increasingly relied on funding abroad. Second, there were undetected asset quality issues, where the prudential rules on large exposures could often be circumvented, enabling banks to build up important concentration risk. Finally, Iceland was particularly vulnerable to the global financial crisis due to its own imbalances. A high proportion of the banks' assets and liabilities were denominated in foreign currency and larger banks were even interconnected through credit links. Reference: FSI crisis management series papers, see link in previous footnote.

[476] Several other emergency measures introduced were directed towards deposits: (i) domestic branches transferred their guaranteed deposits to new banks and remained unaffected by the crisis, (ii) payment systems continued to be operational throughout the resolution process and all bank branches remained open, (iii) in 2011, a new separated guarantee fund within the deposit guarantee fund was established. The resources in the new fund are devoted to cover deposits in the new Icelandic banks, without the risk of being claimed by the depositors in the old banks. Besides other features the 0.15% limit on banks' contributions was abolished. Reference: FSI crisis management series papers, the banking crisis in Iceland, see link in previous footnote.

increasingly cut off from international market funding and major financial institutions recorded substantial capital shortfalls against the backdrop of the exposure to the Greek economy and deteriorating loan quality in Cyprus[477]. Research confirms that concerns about the safety and soundness of the banking system are very likely to result in a reallocation of deposit holdings towards cash. As part of the agreement for the Economic Adjustment Program for Cyprus (the Cypriot Program), in March 2013[478], Cyprus implemented an estimated EUR 7 bn bail-in solution[479] to recapitalise the largest systemic bank (**Bank of Cyprus, BoC**). The second largest bank (**Cyprus Popular Bank, Laiki**) was subject to the sale-of-business tool merging it with BoC. For the first time in the euro area, unsecured depositors were called upon to recapitalise their banks raising the risk of a system wide run. As a result, capital controls and certain other administrative measures (like bank holidays, limits on cash withdrawals and domestic transfers) were imposed[480]. By the time the final agreement on the Cypriot program was reached[481], the two banks had experienced deposit outflows of about EUR 10-17 bn. Through the intense outflows, fewer deposits remained available for the bail-in and exacerbated the loop between bank and sovereign balance sheets (including cross-border in Greece). To ring-fence exposure of Cyprus to Greek risks[482], all Greek-related assets (loans and fixed assets) and customer deposits of all Cypriot banks in Greece (including of the third largest, Hellenic Bank) were sold to Piraeus Bank at a net asset value estimated using an adverse valuation scenario (around EUR 3.2 bn)[483].

[477] European Commission (2013), *The economic adjustment programme for Cyprus*, Occasional Papers, 149.

[478] In March 2013, the Eurogroup reached a political agreement with the Cypriot authorities on the key elements necessary for a future macroeconomic adjustment programme. The European Commission, the European Central Bank (ECB) and the International Monetary Fund (IMF) agreed an economic adjustment programme with the Cypriot authorities on 2 April 2013. The programme covered the period 2013-16 and the financial package covered up to EUR 10 bn with the ESM providing up to EUR 9 bn, and the IMF contributing around EUR 1 bn.

[479] World Bank Group, *Bank resolution and "bail-in" in the EU: selected case studies pre and post BRRD*. On March 22 2013, the Parliament urgently approved a new law enabling the Central Bank of Cyprus to resolve insolvent institutions (Cyprus Resolution Law (2013)). A new bail-out plan was announced on March 25 2013, which did not require further parliamentary approval. The new bank resolution law now provided a legal basis to implement change: Laiki was resolved immediately with full contribution from shareholders, bondholders and uninsured depositors. Selected Laiki assets and EUR 9 bn of ELA were folded into the BoC with uninsured depositors converted to shareholders (at a rate determined after a detailed asset valuation by the summer of 2013 but expected at the time to be between 40-50%).

[480] IMF publication (2020), *Managing systemic bank crises, new lessons and lessons relearned*.

[481] The Cypriot authorities requested financial assistance from the EU and the IMF on 25 June 2012, while a political agreement on the key elements necessary for the Cypriot program was reached between the Eurogroup and the Cypriot authorities on 16 March 2013.

[482] European Commission (2013), *The economic adjustment programme for Cyprus*, Occasional Papers, 149. Concerning their Greek exposure, Cypriot banks were vulnerable on two fronts. First, they considerably expanded their loan operations in Greece from 2005 onwards. The second channel of exposure consisted of investments in Greek government bonds. With respect to loan quality in Cyprus, impaired credits for real estate projects in particular were behind the deterioration linked to the high indebtedness of the private sector and the worsening macroeconomic environment. As a consequence, confidence in the banking sector waned and liquidity pressures mounted.

[483] World Bank, *Bank resolution and "bail-in" in the EU: selected case studies pre and post BRRD*.

In 2018, **Cyprus Cooperative Bank (CCB)** – by then the second largest credit institution in Cyprus – witnessed intense liquidity outflows[484] as press rumours spread suggesting a possible depositor haircut[485], which echoed the 2013 events and led to a depletion of EUR 3 bn (with EUR 300 m in a few days only) out of around EUR 11 bn of deposits[486]. The bank was entirely funded through deposits and it did not have any senior or subordinated debt. In 2018, the bank was split into a good and a bad bank, with the operating bank network sold to Hellenic Bank[487]. As the restructuring of CCB started on the basis of the national resolution law before the EU rules entered into force (namely the BRRD/SRMR), the process remained governed by Cypriot national law and managed by national authorities (see also Annex 9)[488].

The bail-in of depositors in Cyprus triggered certain cross-border spill-overs effects. For instance, in **Romania** the **branch of BoC** experienced intense liquidity outflows following the resolution measures implemented by the Cypriot authorities, which included, as aforementioned, a bail-in depositors of BoC and Laiki. Indeed, initially, it was envisaged to also bail-in the depositors of that branch, but the plan could not be implemented. The branch ran out of liquidity and eligible collateral for the refinancing operations with the Romanian National Bank which led to the temporary closure of the branch. The Romanian authorities tried to avoid any negative financial stability impact and hence, to bail-in depositors. After almost four weeks of closure and intense cooperation between the Romanian and Cypriot bank supervisors, the branch was successfully integrated into Marfin Bank, the Romanian subsidiary of Laiki Bank. The transfer concerned all local deposits, cash, liquid assets and a sufficient amount of loans. This solution satisfied all involved parties and proved to be a good example of cross border home-host supervisory cooperation in a crisis situation. Albeit, the percentage of total assets of Cypriot banks, in the Romanian banking sector were rather low, there was also a risk of contagion to the Greek banks. The Romanian subsidiaries of the Greek banks were confronted with deposit outflows since the start of the Greek crisis and although their situation stabilised in the second half of 2012, their deposit base remained highly sensitive to any adverse developments in the euro area.

In **Greece**, successive rounds of deposit outflows took place throughout the period 2010-2012 due to a collapse in depositor confidence, caused by economic and political turmoil, coupled with speculations about a disorderly default, an exit from the Eurozone and a forcible currency redenomination. Overall, during the period mid-January 2010 to June

[484] According to the press (2009), *Cyprus co-operative bank*.

[485] European Commission (2018), *Post-Programme Surveillance Report- Spring 2018*, institutional papers, p.83. This coincided with the final steps in the restructuring process of the CCB, which was initiated by the Cypriot authorities in February 2014 and modified in December 2015. Contrary to initial expectations, the CCB was unable to return to viability: it failed to recover much money from its very significant portfolio of non-performing loans (NPLs), partly because of the CCB's own governance failures and partly because of obstacles created by the Cypriot legal framework to work out NPLs.

[486] According to the press (2009), *Cyprus co-operative bank*.

[487] According to the press, the operating bank network sold to Hellenic Bank: EUR 9.7 bn in deposits, performing loans of EUR 4 bn, Cyprus government bonds of EUR 4bn and EUR 1bn in cash. Most of the non-performing assets (EUR 8.3 bn) were handed over to Kedipes (the Cyprus Asset Management Company).

[488] European Commission (2018), *State Aid SA.35334 (2018/N-2)*; OJ C 406, 9.11.2018, p. 1–12.

2012, private sector deposits plummeted by 37%, as Greek households and businesses withdrew domestic deposits of roughly EUR 87 bn. Deposits stabilised only after the parliamentary elections of June 2012 as the new coalition government declared its intention to implement the terms of the economic adjustment programme agreement. However, the January 2015 elections triggered a new wave of "Grexit" fears and a deposit run. The liquidity pressures created by the deposit flight amplified, as during December 2014 to June 2015, households and businesses withdrew EUR 43 bn from banks (nearly a quarter of the total deposits). In February 2015, the ECB withdrew the waiver on eligibility of Greek government bonds as acceptable collateral for the Eurosystem refinancing operations leading to the reliance of Greek banks on the more costly ELA mechanism. Nevertheless, again banks runs were triggered when the ECB Governing Council decided on 28 June 2015 not to increase the amount of ELA available to Greek banks because of the uncertainty created by the Greek government's surprise decision to call a snap referendum. As almost all banks ran out of cash, the Greek government imposed sweeping capital controls on 28 June 2015 and introduced a bank holiday period to stem deposit outflows. On 18 July 2015, a new legislative act was passed, with which the bank holiday period ended and banks re-opened. However, certain restrictions on cash withdrawals and transfers of funds remained. Capital controls were gradually relaxed in line with a conditions-based roadmap, but were fully lifted only on 1 September 2019.

In November 2015 in **Italy**, the resolution of four small banks[489] (combined market share of around only 1%), raised concerns how to maintain depositor confidence. The bank of Italy[490] put the four banks under special administration with the aim to apply the just transposed resolution tools introduced by the BRRD. However, the bail-in tool was only available as of 1 January 2016. Four temporary bridge banks were set up that took over the respective banks' good assets and liabilities, while preserving their regular business and employment. In line with the applicable State aid rules[491], part of the losses incurred were borne by the banks' shareholders and subordinated bondholders (including retail investors)[492]. Since some of the bailed-in retail investors were also depositors, it was required to limit the risk of deposit outflows and to stabilise the deposit base of the newly created bridge banks. Therefore, on 22 November 2015, Italy decided to set up a solidarity fund to compensate losses and restore investor confidence[493]. The solidarity fund was endowed with EUR 100 m funded by contributions of Italian banks and managed by the Italian Deposit Guarantee Fund (FITD)[494]. In addition, an arbitration mechanism was set up to deal with the damages claimed by retail subordinated

[489] Banca delle Marche, Banca Popolare dell'Etruria e del Lazio, Cassa di Risparmio della Provincia di Chieti, Cassa di Risparmio di Ferrara.

[490] Bank of Italy (2015), *Information on resolution*.

[491] European Commission (2016), *Commission decision of 29.04.2016 on the State Aid SA.39543 (2015/N), SA.41134 (2015/N), SA.41925 (2015/N), SA.43547 (2015/N) implemented by Italy Amendment to the resolution of Banca Marche, Banca Etruria, Carife and Carichieti*.

[492] According to the press (2015), *Who paid for saving the four Italian banks*.

[493] Bank of Italy (2016), *Speech by the Governor of the Bank of Italy Ignazio Visco*.

[494] Italian Deposit Guarantee Fund (FITD), *Solidarity Fund* and Official Journal of the Italian Republic (2016), *Law Decree 59, 3 May 2016*.

bondholders from banks that may have violated rules on consumer protection in investment services.

In 2016, the **Danish** case of **Andelskassen JAK Slagelse**[495] was one of the first BRRD bail-in cases including the write-down of unsecured depositors and contributions of the DGS, while ensuring uninterrupted access to the bank's deposits and critical functions and hence without observed loss of depositor confidence.

Recently, cases in **Spain** demonstrated that political events have the potential to cause bank runs. In particular, the cases of CaixaBank and Banco Sabadell have underlined the occasional political nature of bank runs. The Catalan crisis significantly impacted the financial sector in the area, with clients boycotting the independence movement and removing their savings from Catalan banks. It further prompted a general fear that, in the event of independence, clients would not be able to access their savings and that banks would not have access to the ECB refinancing operations. According to the information provided by both entities[496], Caixabank experienced an outflow of EUR 7 bn of deposits and Sabadell of EUR 4.6 bn. Overall, more than 1300 companies – including CaixaBank and Banco Sabadell – decided to transfer their legal headquarters out of Catalonia as result of the ongoing uncertainty.

2. DEPOSITOR RANKING IN THE HIERARCHY OF CLAIMS

Existing CMDI framework

In terms of terminology, the existing framework distinguishes among four main types of deposits:

(1) covered deposits (eligible deposits[497] whose amounts are protected by DGS funds up to the coverage level set out by the DGSD (EUR 100 000)),
(2) non-covered preferred deposits (eligible deposits from natural persons and SMEs exceeding the DGSD coverage level),
(3) non-covered non-preferred deposits (large corporate deposits (non-SME) exceeding the DGSD coverage level), and
(4) non-eligible deposits excluded from repayment by the DGS pursuant to Article 5(1) DGSD, which currently include deposits held by public authorities, financial sector entities and pension funds. In the hierarchy of claims, non-eligible deposits rank the same as non-preferred non-covered deposits.

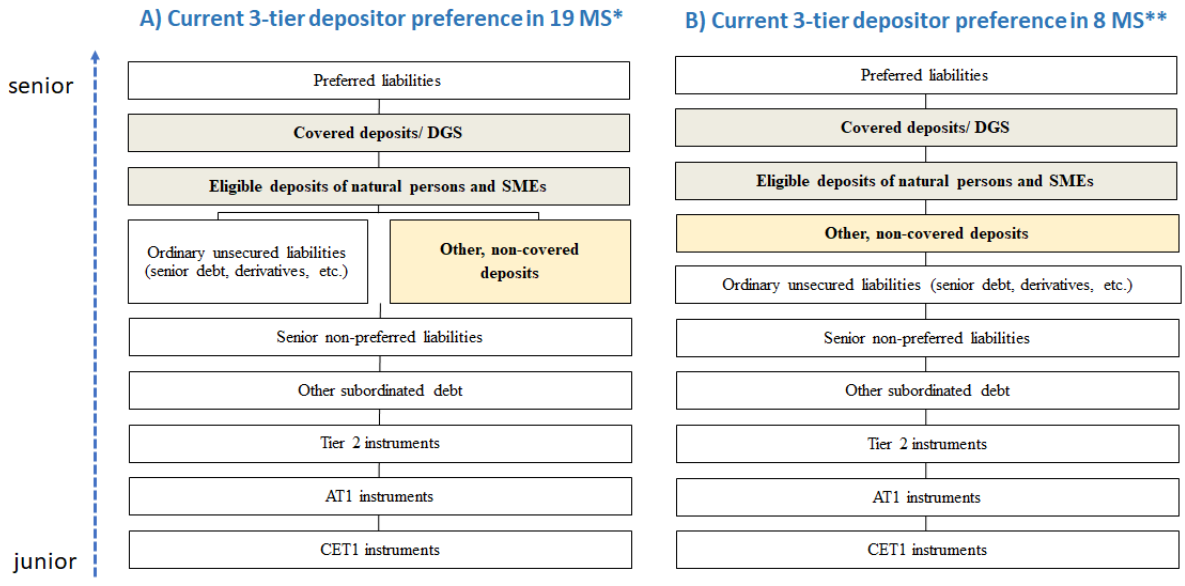
Under the existing CMDI framework, Article 108(1) BRRD creates a **three-tier depositor preference** in the hierarchy of claims. It provides that covered deposits and the claims of DGSs in insolvency (subrogating to the right and obligations of covered deposits following a payout) must rank above non-covered preferred deposits ((deposits

[495] Finansiel Stabilitet Group, a public limited company owned by the Danish State through the Ministry of Business and Growth (2016), *Annual Report 2016*. The lack of effective corporate governance coupled with prior careless lending led to numerous Danish banks, notably small and medium-sized financial institutions, to significant distress. By December 2016, the portfolio of financial assets of Andelskassen amounted to DKK 275 mn in comparison to DKK 1.3 bn in 2015.
[496] According to the press (2020), *El Pais article*.
[497] An 'eligible deposit' is a deposit that is eligible to be protected by a DGS.

by natural persons and SMEs exceeding EUR 100 000). In turn, the latter must rank above the claims of ordinary unsecured creditors (senior debt). Therefore, the DGS has the same ranking as covered deposits, which is preferred relative to all other types of non-covered deposits.

There are, however, two types of deposits whose ranking is not contemplated in Article 108(1) BRRD: the non-covered non preferred deposits (e.g. corporate non-SME deposits exceeding the coverage level of EUR 100 000) and the non-eligible deposits excluded from repayment by the DGS. While Article 108(1) BRRD does not allow these deposits to rank alongside the preferred deposits mentioned therein, thus setting out a three-tier approach to the ranking of deposits, the directive is otherwise silent on what level of the insolvency creditor hierarchy they should be placed, leaving that choice to the national legislator. In most Member States, the deposits not covered by Article 108(1) BRRD rank in insolvency alongside ordinary unsecured claims, including senior debt instruments eligible for MREL (section A of below figure), while in a minority of Member States, they already rank above ordinary unsecured claims (section B of below figure).

Figure 28: Stylised view of the three-tier depositor preference in the current creditor hierarchies in insolvency laws (baseline)



** AT, BE, CZ, DE, DK, EE, ES, FI, FR, IE, LV, LT, LU, MT, NL, PL, RO, SE, SK*
*** BG, CY, EL, HR, HU, IT, PT, SI*
Note: this illustration is stylized and simplified. In reality, the hierarchies of claims across Member States are unharmonized, in particular with regard to the senior layers and may include additional sub-categories of liabilities.

Source: Commission services

Nevertheless, in recent years, an increasing number of Member States have granted a legal preference in insolvency to those deposits under their national laws[498]. In compliance with the three-tier approach required by Article 108(1), in those Member States, the deposits of large corporates and the excluded deposits rank below covered

[498] Other Member States may be considering similar amendments in their national insolvency legislation.

deposits, DGS claims and eligible deposits of natural persons and SMEs, but above ordinary unsecured claims.

Table 32: Forms of depositor preference in the EU under the existing hierarchies of claims

Form of depositor preference	Member States
Depositor preference compared to senior unsecured claims, under a three-tier approach	8 Member States (BG, CY, EL, HR, HU, IT, PT, SI)
No depositor preference, where non-preferred non-covered deposits rank *pari passu* with other senior unsecured claims	19 Member States (AT, BE, CZ, DE, DK, EE, ES, FI, FR, IE, LV, LT, LU, MT, NL, PL, RO, SE, SK)

Source: Commission services

These relevant differences in the creditor hierarchy in insolvency among Member States lead to a divergent treatment of deposits across the EU and pose complications when calculating the relevant insolvency counterfactual for the purposes of the NCWO assessment and the least cost test.

The impact of DGS ranking in the hierarchy of claims on the least cost test (LCT)

The super-preference of the DGS in the current framework, i.e. the fact that it ranks above other deposits, and its impact on the least cost test (LCT), is the main reason why the DGS funds can almost never be used outside a payout event of covered deposits in insolvency.

The objective of the LCT safeguard is to ensure that any DGS intervention other than paying out of covered deposits would not expose the DGS to losses greater than the ones it would incur in a payout of covered depositors in an insolvency counterfactual. The DGS can only provide an amount up to the losses it would bear in case of a hypothetical payout in insolvency. These losses are given by the difference between the amount disbursed by the DGS in case of a payout and the proceeds the DGS would recover from the liquidation/sale of the bank's assets in insolvency. Given the super-preferred ranking of the DGS in the hierarchy of claims, the DGS has the hypothetical possibility to recover most or all of its expenditure in insolvency. Importantly, with such a super-preference, the DGS would benefit from these recovered amounts before other creditors, including eligible uncovered depositors (preferred and non-preferred). However, in some Member States, the recovery rate can be low, mostly depending on the efficiency and performance of judicial systems, the quality of assets to be liquidated, the time required to conduct the insolvency proceedings and other factors[499].

Under the existing framework, the DGS can almost never be used for measures other than the payout of covered deposits in insolvency, such as use in resolution provided under Article 109 BRRD. The high ranking of the DGS and consequently high likelihood to get its claims paid from the insolvency estate, before other creditors, make the counterfactual of a payout in insolvency appear artificially less costly, despite the fact that a DGS contribution to resolution or an alternative measure could be more cost efficient (involve a lower need for cash disbursement from the DGS to support a sale of

[499] Given the heterogeneity in recovery rates, Annex 7, which is based on the EBA's reply to the call for advice, takes a conservative assumption for an 85% recovery rate. It also shows how a higher or lower recovery rate would impact the LCT.

business strategy, compared to a full payout of all covered deposits), better preserve depositors' confidence and facilitate a more efficient crisis management. On one hand, paying out covered deposits in insolvency is likely to require a very significant upfront cash disbursement by the DGS (especially in cases of predominantly deposit-funded mid-sized banks with significant amounts of covered deposits) (see reference to ECB paper below). On the other hand, an intervention in resolution to support the transfer of a failing bank to a buyer may require only a portion of those DGS financial means. Transfer transactions can unfold in many ways, depending on the quality of assets and the funding/liabilities to match these, as well as the appetite of the buyer and the offered price. Considering the likely need to plug a gap between the value of assets and deposits to be transferred to a buyer, the DGS/resolution fund contribution to support such transfer may be much lower than the total value of covered deposits that would need to be paid out in insolvency. Under the current set-up, the DGS super-priority ends up protecting the financial means of the DGS and of the banking industry from possible replenishment burden by hindering any DGS intervention, without bringing a better protection for covered deposits. The protection of covered deposits does not depend on their ranking in the hierarchy of claims; rather, it is insured through the obligation to be paid out under the DGSD when accounts become unavailable and the mandatory exclusion from bearing any losses in resolution.

To overcome these limitations, certain Member States include indirect costs in the LCT in order to facilitate the use of DGS and counteract at least to some extent the super-preference of the DGS. Other Member States are concerned about including indirect costs as some of them may be difficult to quantify and have the potential to weaken the LCT safeguard.

Regarding the argument of cost-efficiency associated with the use of DGS funds in resolution or alternative measures *versus* the cost of a payout of covered deposits in insolvency, an ECB paper on DGS alternative measures[500] shows that 261 banks, banking groups or hosted subsidiaries in the Banking Union could individually deplete their fully-filled DGSs with a single payout of covered deposits in insolvency. While 129 of these banks are significant institutions likely to involve resolution rather than a depositor payout in insolvency, the remaining 132 are less significant institutions, which also have covered deposits exceeding the target level of their DGSs and are spread across all Banking Union Member States. We can conclude for this reason that, it is appropriate to allow for cheaper, more cost-efficient alternative uses of the DGS in resolution, to support a transfer of assets and liabilities (deposits) followed by market exit.

Relevant policy options analysed in the context of the CMDI reform

Withdrawing the super-preference of the DGS and envisaging a more harmonised depositor preference when compared to the current situation is instrumental in providing adequate funding in resolution and making resolution effective for smaller and medium-sized banks that would involve the transfer of the business and market exit of the failed bank. The main reasoning behind this proposal relies on the notion that the super-preference of covered deposits and DGS claims subrogating to covered deposits in the

[500]ECB (October 2022) *Protecting depositors and saving money - why DGS in the EU should be able to support transfers of assets and liabilities when a bank fails*.

current framework significantly reduces the likelihood that a DGS would be exposed to losses in a hypothetical insolvency considered as the counterfactual for DGS interventions other than payout. As a result, the capacity of a DGS to contribute to the alternative measures or in resolution is limited or null.

Two changes to the BRRD rules on the ranking of deposits are key across all the option packages considered in Chapter 6 of this impact assessment (except the baseline), to make the framework function in practice and make the access to funding in resolution truly credible.

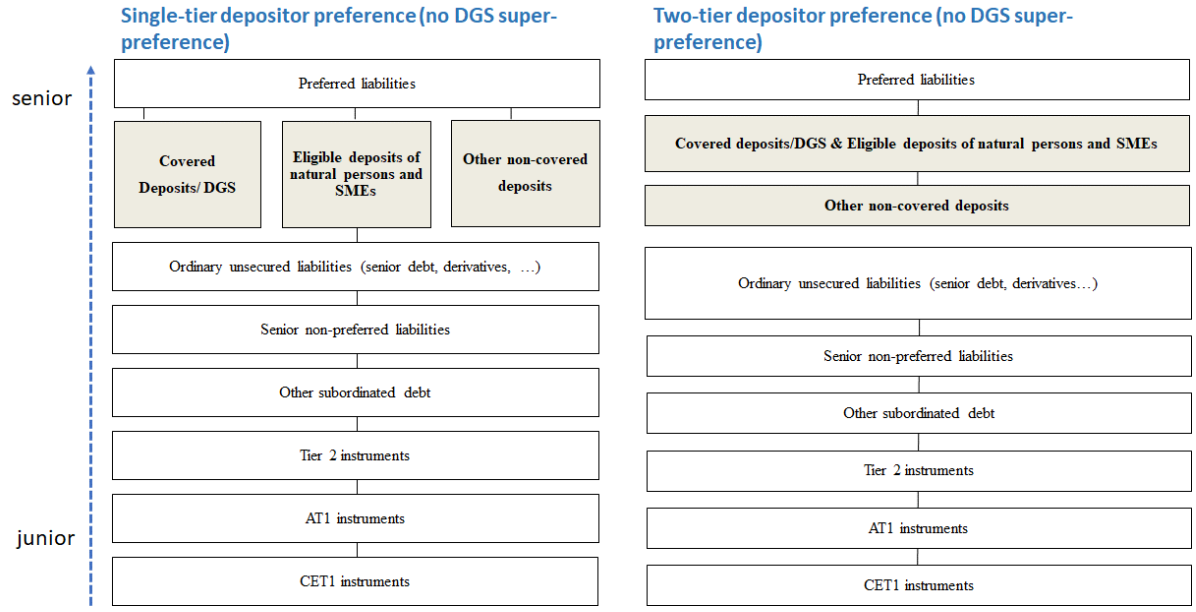
First, the legal preference at EU level would be extended to include all deposits (general depositor preference). This entails that all deposits, including eligible deposits of large corporates and excluded deposits[501], would rank above senior unsecured claims.

Second, the different rankings of deposits (i.e. the three-tier approach) would be removed and replaced either with a two-tier depositor preference (option 2), whereby covered and preferred deposits rank *pari passu* and above non-preferred non-covered deposits or with a single ranking (options 3 and 4), whereby all deposits rank at the same level amongst themselves (single-tier depositor preference). The EBA's reply to the call for advice and Annex 7 further describe the different depositor preference scenarios assessed (five scenarios)[502], varying in scope and relative ranking among deposits and concluded that only those without the super-preference of the DGS are worth considering for the CMDI review (see also Box 3 in Chapter 6). They also describe the reasons why the general depositor preference with a single-tier ranking best addresses the objective of the framework, largely because it: (i) protects deposits by reducing the amount of deposits that would be otherwise bailed-in to reach 8% TLOF and access the RF/SRF and (ii) it unlocks the largest amounts of funds that the DGS could contribute to measures other than payout under the least cost test, which is critical for facilitating the use of DGS funds as proposed by the packages of options.

[501] As mentioned, under the policy option described in Annex 6, the deposits of public authorities would no longer be deemed as excluded deposits.

[502] The five possible scenarios of harmonising the depositor preference in the hierarchy of claims have been tested by the EBA in its reply to the call for advice: (i) baseline or current framework (three-tier depositor preference with super-preference for DGS and covered deposits); (ii) single-tier depositor preference (all types of deposits rank *pari passu* among themselves and above ordinary unsecured claims); (iii)a three-tier depositor preference (covered deposits rank above preferred deposits in all Member States, which rank above non-preferred deposits, the latter also ranking above ordinary unsecured claims); (iv) two-tier depositor preference (covered deposits and DGS are super-preferred to preferred deposits, which rank *pari passu* with non-preferred deposits, the latter ranking above ordinary unsecured claims) and (v) two-tier depositor preference (covered deposits rank *pari passu* with preferred deposits, all of which rank above non-preferred deposits, the latter ranking above ordinary unsecured claims).

Figure 29: Stylised view of creditor hierarchy in insolvency with a single-tier and two-tier depositor preference without super-preference of DGS/covered deposits:



Source: Commission services

Impacts of generalising depositor preference versus ordinary unsecured claims

Granting a stronger preference to all deposits[503], compared to ordinary unsecured claims, would be beneficial for their protection in resolution and be equally warranted from an insolvency policy perspective. It would facilitate the bail-in of ordinary unsecured claims, which could contribute to market discipline and potentially decrease the likelihood of inflicting losses on deposits. By preferring all deposits versus the ordinary unsecured category of claims, the repayment that the remaining senior creditors would be expected to receive in insolvency decreases, which in turn would mitigate the NCWO risks arising from their bail-in. This would significantly contribute to enhancing the credibility and implementation of the bail-in tool in resolution, as the bail-in of senior debt becomes more effective and credible. By mitigating the NCWO impediments to the bail-in of senior debt, the general depositor preference leads to an increase in the total amount of claims, other than deposits, that can contribute to loss absorption and recapitalisation of the institution under resolution. The consequences of a cleaner category of ordinary unsecured claims on the resolvability of institutions are twofold: the ability to comply with minimum bail-in of 8% TLOF rule to access the RF/SRF increases[504], and the need for contributions from the RF/SRF (or the amount of funding needed from the RF/SRF) decreases. At the same time, such a change would improve the transparency and legal certainty of the resolution framework. It moreover results in an alignment with past experiences of handling banks' failures, where State aid was granted

[503] In the US, the hierarchy of claims also foresees a general depositor preference where all deposits, whether insured or not, rank *pari passu*. This facilitates the contributions of the deposit insurance fund to resolution action.

[504] As shown in Annex 7.

inter alia with the aim of protecting depositors and where the use of those public funds did not require the burden sharing of any depositor[505].

A move towards general preference for all depositors would also be beneficial from a cross-border and level playing field perspective. A more harmonised insolvency ranking across the EU would facilitate the resolution of cross-border groups, in particular when carrying out the NCWO assessment. Disparities in the treatment of depositors across the EU can be problematic, particularly where they lead to the perception that depositors that rank *pari passu* with unsecured creditors are more likely to be bailed-in.

At the same time, the granting of a stronger preference to all deposits would be equally warranted from an insolvency policy perspective. An enhanced protection is aligned with the central role deposits play in the real economy, being the primary tool for savings and for payments, as well as in the banking activity, where they represent an important source of funding and are the main pillar for the confidence that supports the banking system, which becomes of particular relevance in times of market stress.

Impacts of a single-tier depositor preference without super-preference of DGS

As shown in the EBA call for advice and Annex 7 section 4, placing all deposits in the same ranking in insolvency increases significantly the likelihood of a DGS being able to participate in resolution under the LCT, or to fund alternative measures in insolvency, as well as the amount of funds it can provide.

It should be highlighted that such a change would not translate into a worse treatment for covered deposits as, in reality, their protection comes from the payout by the DGS up to the EUR 100 000 level and not from their preferred ranking in insolvency (covered deposits are paid within seven days from the moment their accounts become unavailable and they never rely on their ranking in the hierarchy of claims to receive proceeds from the insolvency estate). Their mandatory exclusion from bail-in is likewise not affected in the options envisaged in this impact assessment. The single-tier ranking would have the merit of ensuring that the banking industry does not receive better protection in insolvency than depositors, even non-covered ones. Replacing the super-priority of DGS claims with a single-tier ranking for all deposits would enable the use of DGS funds under the LCT in resolution to resolve smaller and mid-sized banks via transfer strategies with market exit, without imposing losses on depositors. Such reform would contribute to reinforcing depositor confidence and safeguarding financial stability by preventing the risk of bank runs.

The general depositor preference with a single-tier ranking would best address the objective of the revised framework, because it would: (i) protect deposits in resolution by reducing the amount that would be otherwise bailed-in[506] to reach 8% TLOF and allow access to the RF/SRF; (ii) maintain intact the protection enjoyed by covered deposits which does not depend on their ranking and (iii) unlock the largest amounts of funds that the DGS could contribute to measures other than the payout of covered deposits under

[505] Paragraph 42 of the 2013 Banking Communication explicitly sets out that contribution from deposits is not required as a mandatory component of burden sharing under State aid rules.
[506] For non-covered deposits because covered deposits are already excluded from bail-in.

the least cost test, which is critical for facilitating more cost-efficient interventions by the DGS.

While it may expose the DGS industry-funded safety nets to more frequent contributions by the banks, it would reduce the likelihood and extent of recourse to taxpayer money, improve financial stability and depositor protection and safeguard the financial means of the DGS to a greater extent than a payout of covered deposits in insolvency. This is especially important for cases of a more systemic nature, i.e. going beyond the failure of a single institution. Under the current set-up there is a much higher risk that in a systemic crisis a single failure could deplete the available means of a DGS through the payout of covered deposits, and it would not be possible to replenish it in good time before it needs to payout again in a subsequent bank failure. This, in turn, increases the risk of the sovereign having to step in and provide necessary funds to the DGS to preserve its payout function. Our proposed changes would allow the DGS to act in a cheaper, more cost-efficient way in resolution, thereby better preserving its financial means and liquidity position and possibly allowing it to be used in more than one case during a crisis of more systemic nature.

Impact of a two-tier depositor preference without super-preference for DGS

The implementation of a two-tier depositor preference without the super-preference of DGS and covered deposits would entail that covered and preferred deposits rank *pari passu* and above non-preferred non-covered deposits.

The removal of the DGS super-preference would increase to a relative extent, compared to the baseline, the amount of funds the DGS could contribute for measures other than payout under the LCT. However, because the DGS would still be a preferred creditor in relation to non-covered non-preferred deposits, the increase in DGS funds unlocked under the least cost test for these measures would be significantly lower than under a single-tier depositor preference where all deposits would rank *pari passu* in the hierarchy of claims (see Box 3 in Chapter 6). Based on the sample analysed in Annex 7, section 4.1.3, the funding unlocked through the least cost test under a single-tier depositor preference would be 20 times higher than under the current framework, while it would be five times higher than under a two-tier depositor preference. Such a change in the hierarchy of claims would not deliver on all objectives of the CMDI reform, which would remain very close to the status quo (alternative measures including bail-outs would continue to be used for small and mid-sized banks).

Stakeholder views

In what concerns the **general depositor preference**, consultations with stakeholders revealed that the bail-in of any deposits is deemed to carry a significant contagion risk to the financial system and to entail political sensitivities (see also point 1 of Annex 8), so much so that, despite only covered deposits being in the list of mandatory exclusions from bail-in in Article 44(2) BRRD, resolution authorities generally expect to have to exclude other deposits on a discretionary basis from bearing losses in resolution under Article 44(3) BRRD. When some of those deposits rank *pari passu* with senior bail-inable liabilities, their exclusion has the potential to create NCWO problems, particularly considering that they tend to represent a significant percentage of the total senior class.

The stakeholders against the general depositor preference mostly said that there was a lack of rationale for differentiating the treatment of non-covered deposits from large corporates and from financial institutions from the treatment given to other types of senior claims, particularly for those instruments which are legally considered deposits but are very similar to bonds or other securities. It should be noted, however, that this differentiation already exists in the current framework, considering that deposits from large enterprises are covered by the protection granted by a DGS. It was also argued that such a change could have an impact on the funding costs of institutions, although it should be kept in mind that a more favourable ranking of these deposit claims under normal insolvency proceedings would become a more accurate indicator of their associated risk of losses in resolution and, therefore, could lead to a more accurate pricing, thus offsetting increases in the cost of funding of senior debt. Similarly, the pricing of senior debt would also become more indicative of the associated risk of losses in resolution, which would increase transparency and legal certainty for creditors. The alleged marginally higher issuance costs for ordinary unsecured debt (and by extent to marginally higher funding costs for banks) raised by some banks is not supported by empirical evidence[507]. Moreover, any potential marginal cost impact must be weighed against the added benefits that depositor preference brings in terms of enforcing market discipline on financial investors to monitor banks' risks more closely, once their expectation that they will be bailed-in (instead of being bailed-out under a less effective CMDI framework) becomes more credible.

Finally, some stakeholders claims that general depositor preference would leave resolution authorities without flexibility in determining the scope of the bail-in tool. In this respect, it is important to note that it is not being proposed to mandatorily exclude non-covered deposits from bail-in, which means that resolution authorities still maintain the possibility to impose losses on those deposits if and when deemed necessary and appropriate.

Regarding views on the **single-tier depositor preference**, some stakeholders (including a few Member States and banks) argue that preserving a super-priority for DGS in the hierarchy of claims is instrumental in ensuring the recovery of funds used to payout covered deposits in insolvency, even if the creditor payout in insolvency can take many years (depending on the judicial system in each Member State and the approach to liquidate assets[508]). These stakeholders claim that a single-tier depositor preference in the creditor hierarchy would increase the costs and liquidity needs of the DGS and would deviate from the minimisation moral hazard and from the guiding resolution principle of ensuring that losses are borne by shareholders and creditors. Other Member States are fully supportive of removing the super-preference of the DGS from the hierarchy of

[507] See for example, the IMF Working Paper 13/172 (July 2013), *Bank Resolution Costs, Depositor Preference, and Asset Encumbrance*, from a review of previous studies it concludes that introducing a single-tier depositor preference in the US had "little "systemic effect" on overall bank funding costs.

[508] In some Member States and in specific cases, the approach to liquidate assets in insolvency is to sell those assets to buyers which may take several years to complete. In other cases, depending on the bank's business, a solvent wind-down of assets may be pursued, meaning that proceeds are recovered by respecting the reimbursement schedule of assets, which for certain loan portfolios such as mortgages can take tens of years.

claims as they see this as the only credible alternative to make funding in resolution available when needed.

Importantly, the amount of cash the DGS must disburse in a payout in insolvency corresponds to the total amount of covered deposits in the bank (plus other direct costs) and, as shown in the evaluation (sections 7.1.4.4. and 7.2.2.6 in Annex 5 of the IA), it is likely to be significantly higher than the amount the DGS would need to contribute to fund the gap between assets and liabilities for facilitating a transfer strategy in resolution or in the context of an alternative measure. Additionally, by facilitating transfer strategies in resolution, the franchise value of the failing bank's assets is preserved as opposed to insolvency[509] and so is the client relationship, which is transferred to a new bank rather than being interrupted, avoiding thus potential contagion effects, risks of bank runs and impacts on financial stability. Therefore, the difference in costs for the DGS between pursuing more resolution *versus* insolvency lies in the more efficient usage of funds, facilitated by removing the super-preference of DGS in the hierarchy of claims. Facilitating the use of DGS funds through changes to the depositor ranking positively contributes to financial stability and depositor confidence, while also better preserving the DGSs' available financial means in case other crises occur. The rationale for allowing a broader scope of DGS interventions is further explained in Annex 10.

It should be highlighted that such a change would not translate into a worse treatment for covered deposits as, in reality, their protection comes from the payout by the DGS and not from their preferred ranking in insolvency. Their mandatory exclusion from bail-in is likewise not affected in the options envisaged in this impact assessment. The super-priority ends up protecting the financial means of the DGS and the banking industry, who are called to replenish those funds through contributions. The single-tier ranking would have the merit of ensuring that the banking industry does not receive better protection in insolvency than depositors, even non-covered ones. Replacing the super-priority of DGS claims with a single-tier ranking for all deposits would contribute to reinforcing depositor confidence and safeguarding financial stability by preventing the risk of bank runs.

3. MANDATORY EXCLUSIONS FROM BAIL-IN

Another aspect regarding the harmonisation of the hierarchy of claims relates to the priority ranking under national insolvency laws of liabilities which are mandatorily excluded from bail-in under Article 44(2) BRRD (see ***Table 33*** for a listing of excluded liabilities). The ranking of these liabilities diverges significantly across Member States, in line with national specificities pertaining to areas such as taxation, employee protection, social security or civil law. In some Member States, some of these excluded liabilities rank above deposits, in others, some rank below or among deposits.

The possibility to give a legal preference to these exclusions in the hierarchy of claims, combined with requiring that those preferred claims excluded from bail-in rank above the claims of the DGS subrogating to covered deposits, so as to reduce the risk of NCWO

[509] According to the valuation methodology, the haircut imposed on assets in a transfer transaction is lower than the haircut that could be imposed in some situations in insolvency. This may not be the case in a wind-down liquidation which may take a very long time to complete.

when applying the bail-in tool was discussed with Member States. However, the large majority of Member States did not favour the introduction of such changes in the national creditor rankings, as this would unduly interfere with other areas of their national laws and legal traditions that are not harmonised at EU level. Member States noted that liabilities excluded from bail-in do not form a homogenous group and that the reasons justifying their protection in a resolution scenario where the bank is to remain in going concern, generally linked with the need to ensure the continuity of critical functions and to reduce the risk of systemic contagion, may not be present in a liquidation scenario, particularly in those Member States where the activity of the bank does not continue in insolvency. Concerns were also raised regarding the compatibility with constitutional principles of providing the same types of creditors with a different treatment in insolvency depending on who the debtor is (i.e., a bank or a non-financial entity) and the operational difficulties in implementing these legal preferences.

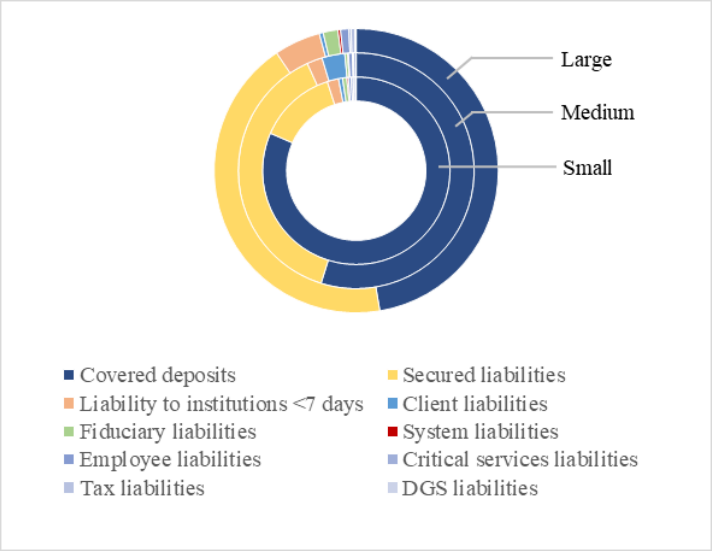
In order to judge the relative importance of each type of excluded liability, ***Table 33*** shows the share of each type of mandatorily excluded liabilities out of the total of mandatory exclusions, depending on the size classification and strategy. For smaller banks, covered deposits represent the bulk of excluded liabilities (80%), while for medium sized banks this share decreases (57.8%) and for large banks it is almost on a par (47.4%) with secured liabilities (43.5%) which are more material.

Table 33: Share of each type of mandatory exclusions out of total excluded liabilities (resolution entities, %)

(% of mandatory exclusions)	Small	Medium	Large	Resolution	Liquidation
Covered deposits	81.5%	54.8%	47.3%	50.1%	50.6%
Secured liabilities	13.4%	38.4%	43.2%	41.0%	43.6%
Liability to institutions <7 days	2.0%	2.1%	5.3%	4.5%	2.5%
Client liabilities	0.7%	3.1%	0.4%	1.1%	1.9%
Fiduciary liabilities	0.7%	0.4%	1.7%	1.4%	0.1%
System liabilities	0.3%	0.1%	0.3%	0.3%	0.2%
Employee liabilities	0.5%	0.5%	0.9%	0.8%	0.6%
Critical services liabilities	0.3%	0.1%	0.2%	0.2%	0.2%
Tax liabilities	0.4%	0.3%	0.5%	0.4%	0.3%
DGS liabilities	0.1%	0.0%	0.1%	0.1%	0.0%

Source: Commission services, based on EBA CfA report, data as of Q4 2019

Figure 30: Share of each type of mandatory exclusions out of total excluded liabilities (resolution entities, %)



Source: Commission services, based on EBA CfA report, data as of Q4 2019

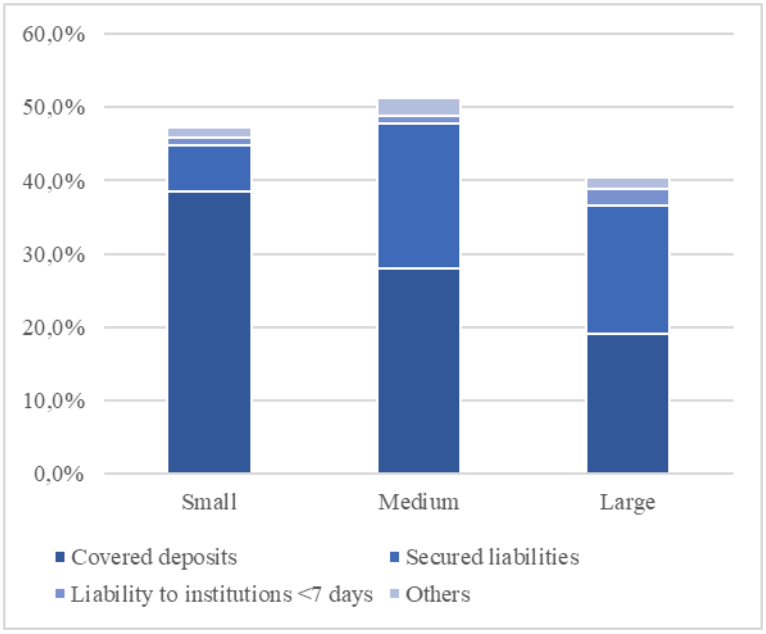
Table 34 shows the amount of liabilities mandatorily excluded from bail-in, expressed in % TLOF per size category and strategy, at the level of the entire sample. Institutions' liability structure is composed of significant amounts of liabilities statutorily excluded from bail-in. On average, these represent 47.2% of TLOF for small and non-complex banks, 51.2% for medium and 40.5% for large institutions. Covered deposits represent the highest share of excluded liabilities, followed by secured liabilities, significantly less prominent for the smallest institutions, and to a lesser extent liabilities to institutions below 7 days. Other forms of excluded liabilities represent much lower amounts, across all types of institutions. The differences are not material when breaking down the population by strategy.

Table 34: Largest types of mandatory exclusions from bail-in (%TLOF)

(%TLOF)	Small	Medium	Large	Resolution	Liquidation
Mandatory exclusions	47.2%	51.2%	40.5%	43.5%	38.2%
Of which: covered deposits	*38.5%*	*28.1%*	*19.2%*	*21.8%*	*19.3%*
Of which: secured liabilities	*6.3%*	*19.7%*	*17.5%*	*17.8%*	*16.7%*
Of which: liability to institutions <7 days	*0.9%*	*1.1%*	*2.1%*	*2.0%*	*1.0%*

Source: Commission services, based on EBA CfA report, data as of Q4 2019

Figure 31: Largest types of mandatory exclusions from bail-in (% TLOF)



Source: Commission services, based on EBA CfA report, data as of Q4 2019

On average for all entities in the sample, mandatory exclusions account for up to 50% of the TLOF at national level in eight Member States, and up to 70% in 14 additional Member States.

Table 35: Mandatory exclusions from bail-in (%TLOF), Member State level

(%TLOF)	Count	Member States*
Below 30%	2	IE, LU
Between 30 and 50%	8	AT, BE, DE, EE, FI, FR, NL, SE
Between 50 and 70%	13	BG, CY, ES, EL, HR, IT, LT, LV, MT, PL, PT, RO, SI
Above 70%	3	CZ, DK, SK

** Figures for HU not available.*

Source: Commission services, based on EBA CfA report, data as of Q4 2019

Despite the large amounts of mandatory exclusions, the analysis shows that the proportion of exclusions over their respective ranking in the applicable creditor hierarchy is moderate. For the purpose of this analysis, the simplified creditor hierarchy used in Annex 7 has been used to ensure comparability. ***Table 36*** shows the amount of mandatory exclusions ranking senior to senior non-preferred and junior to non-preferred deposits (or preferred deposits in jurisdictions with a general depositor preference) in percentage of the concerned ranks in insolvency pursuant to the applicable hierarchy in each Member State[510]. This perspective does not consider excluded liabilities ranking at the high end of the hierarchy of claims and focuses on those ranks that are likely to be impacted by the bail-in.

[510] With one exception covering liabilities *pari passu* with senior non-preferred due to the presence of excluded liabilities at this level of the hierarchy of claims.

Table 36: Mandatory exclusions from bail-in (exclusions ranking between senior non-preferred and non-preferred or preferred deposits depending on the applicable depositor preference, % of liabilities with similar ranking)

(% ordinary unsecured - hypothetical)	Small	Medium	Large	Resolution	Liquidation
Mandatory exclusions (average)	5.2%	4.4%	5.8%	5.7%	4.1%
Mandatory exclusions (first quartile)	0.1%	0.5%	1.6%	0.7%	0.0%
Mandatory exclusions (third quartile)	4.0%	6.2%	8.2%	6.5%	4.0%

Source: Commission services, based on EBA CfA report, data as of Q4 2019

On average, those mandatory exclusions represent less than 6% of the respective liability classes, with a widely spread distribution around the average, as 25% of the resolution entities (first quartile) have a portion of excluded liabilities at most equal to 0.1% or 1.6% for small and large institutions, respectively.

These results are not indicative of actual NCWO risks, which remain a case-by-case assessment based on each bank's liability structure. They provide, however, an overview of the magnitude of the exclusions in those layers more prone to generate NCWO risks.

Having in mind the legal and operational difficulties presented above and the arguments put forward by Member States during the consultation stage, together with the limited impact on the reduction of NCWO risks, the possibility of introducing a legal preference for all liabilities mandatorily excluded from bail-in and ranking them above the claims of DGSs subrogating to covered deposits was discarded and was therefore not considered in any of the options described in this impact assessment.

4. EARLY INTERVENTIONS MEASURES

The purpose of early intervention measures is to allow interventions by competent authorities at an earlier stage of financial deterioration of a bank with a view to limit or avoid its impact. However, these measures have been rarely applied so far. The EBA indicated that, in most situations where the EIM triggers were met, competent authorities preferred to address the situation through other supervisory powers[511].

The early intervention powers conferred on competent authorities on the basis of national laws implementing the BRRD overlap to an extent with the supervisory powers, provided in the CRD (and also mirrored in the SSMR)[512]. This overlap creates legal uncertainty and procedural challenges for competent authorities and could explain to some extent their scarce application. Also, in the Banking Union, the provisions on early intervention powers contained in the BRRD are not replicated in a uniform and directly applicable legal basis, meaning that their application by competent authorities, including the ECB, may hinge on potentially diverging national transposition measures.

[511] See EBA (27 May 2021), *Report on the application of EIMs in the EU in accordance with Articles 27-29 BRRD*, EBA/REP/2021/12, p 17-19.

[512] More specifically, some of the early intervention measures listed in Article 27(1) BRRD partially or fully overlap with other supervisory powers in Article 104(1) CRD and Article 16(2) SSMR.

The EIMs available to competent authorities should be revised to improve legal clarity and eliminate the overlaps with supervisory measures provided in CRD and SSMR[513]. A single legal basis for their direct application in the Banking Union (i.e. a regulation) would also reduce the difficulties caused by diverging transpositions of the current BRRD provisions in national laws. Moreover, the need for sufficiently early coordination between resolution and competent authorities should also be ensured in the EIM process.

Based on the observation that, so far, EIMs have been used rarely[514], the Commission would not consider the possibility of simply preserving the status quo as appropriate. Instead, two options were considered:

- removing these measures entirely from the BRRD and allowing their use as supervisory powers according to SSMR and CRD;
- amending the provisions in BRRD only to the extent necessary to address the overlap between the EIMs and supervisory measures, and providing a single legal basis for their application by the ECB in SRMR.

The first option would substantially increase the margin of manoeuvre and discretion of supervisors in applying EIMs. In particular, subsuming these measures under supervisory powers would entail that, rather than having to meet specific triggers (as is the case now) to be able to use EIMs, supervisors would be able to use them based on their general discretion and proportionality considerations, as it happens for all supervisory measures.

This option, however, has several substantial drawbacks. First, it appears disproportionate to the objectives pursued. The complete elimination of all EIMs from BRRD is not necessary to address the issue of overlaps, particularly considering that the overlap is only partial[515]. Also, the transfer of all the EIMs into supervisory legislation entails the amendment of the relevant provisions in CRD and SSMR so as to include powers currently not provided therein. This would be an additional complication, particularly considering that the legal basis for changes to SSMR requires unanimity of Member States to implement legislative changes. Also, the first option would move EIMs entirely under the remit of the supervisory framework, which is regulated by the general principle of proportionality[516], leaving supervisors with substantial discretion when choosing whether to apply supervisory powers and which one. In particular, the supervisory framework does not provide specific triggers to assess whether the conditions to apply the powers overlapping with EIM are met. Also, it does not provide any "escalation ladder" between less invasive and more invasive powers. As a result, this approach appears disproportionate also with respect to the impact of the different measures. While it may be not be appropriate to establish a strict escalation ladder with specific hard triggers for each measure, at least some distinction between those which

[513] See Annex 5 (Evaluation).

[514] See EBA (27 May 2021), *Report on the application of early intervention measures in the European Union in accordance with Articles 27-29 of the BRRD*, EBA/REP/2021/12, p 17 to 19.

[515] In particular, an overlap exists between the measures in Article 27(1)(b), (d), (f) and (g) BRRD and articles 104 CRD and article 16 SSMR.

[516] Connected to an actual or likely breach of the requirements in CRD or CRR.

may have a limited impact on the bank and those which may be more disruptive seems desirable.

This is in turn relevant to ensure coordination between supervisors and resolution authorities. In the absence of a clear demarcation between the more and less invasive measures available to the supervisor, the only options in this respect would be to either require the supervisor to coordinate with the resolution authority anytime it applies any supervisory measures (including less relevant supervisory powers which do not indicate a risk of important deterioration of the bank's financial situation and have no clear link with the initiation of resolution), or eliminate the need for coordination. Notwithstanding the practical arrangements that may already exist between the relevant competent and resolution authorities, BRRD and SRMR should ensure that cooperation between those authorities takes place in an appropriate and timely way, to ensure sufficient preparation for resolution and even a timely trigger of FOLF.

Finally, for completeness, it should be clarified that, from the perspective of market reputation, and specifically when it comes to the application of the Market Abuse Regulation[517], there is no difference between the use of supervisory powers or early intervention measures. In particular, this regulation qualifies as 'insider information' any information which, if disclosed, "*would be likely to have a significant effect on the prices of those financial instruments*"[518]. Such qualification would lead to the application of a set of obligations and safeguards contained in the Market Abuse Regulation. However, for the purposes of its application, there is no difference between the application of a supervisory measure or an EIM. In both cases, the information that such a measure has been applied may be qualified as insider information depending on the specific circumstances of the case. From this perspective, therefore, there is no reason to prefer one of the mentioned approaches to the other.

On this basis, the second and more targeted approach has been retained. In particular, it is sufficient to amend BRRD provisions only to the extent necessary to address issues with the EIMs, which directly overlap with supervisory measures. In this respect, there can be scope for further amendments on the requirements to activate these measures in BRRD with a view to ease their application and the internal sequencing between EIMs. The reform could anyway maintain some form of a distinction between measures considered less invasive and those considered more invasive[519].

Moreover, a single and directly applicable legal basis for the use of EIMs should be introduced in SRMR to ensure an effective and consistent application by the ECB (without having to rely on potentially diverging transpositions of the BRRD provisions). Finally, the reform should ensure efficient and swift coordination between supervisors and resolution authorities in the context of EIMs. The proposed approach would also be

[517] Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC (OJ L 173, 12.6.2014, p. 1–61).

[518] Article 7 of the Market Abuse Regulation.

[519] Several of the elements which form part of this option were discussed and supported by most Members in the context of the Commission expert group (EGBPI).

consistent with the F4F Platform recommendations for eliminating the overlap between EIMs and supervisory powers[520].

5. TRIGGERING OF FOLF

The timing of the FOLF determination is crucial with respect to the amount of private resources left in the bank to execute the resolution strategy. The earlier FOLF is triggered, the more liquidity, capital and other bail-inable resources are available in the bank. Conversely, a tardive FOLF determination, which is likely to be related to the important implications of the decision (including in terms of legal risk), combined with the discretion granted to the supervisors in this respect, often leads to a more severe depletion of equity, liquidity and potentially other instruments than under a timelier FOLF determination[521], which as a result may endanger the effective application of the most appropriate resolution strategy. Since the FOLF assessment is under the discretion of the competent authority[522], it is crucial to ensure a timely assessment of FOLF through adequate governance, cooperation and timely exchange of information between competent and resolution authorities, so as to support a smooth continuum between going and gone concern.

Supervisory discretion is important to ensure that all the elements of a specific case are properly taken into account, in particular by considering the likely evolution of the financial distress as well as potential alternatives (i.e. such as the presence of available private buyers). Moreover, the discretion is needed to account for the potential implications in terms of market and reputational impact, which are naturally associated with the determination of a bank's failure.

The Commission examined three options in view of addressing the identified problem:

- first, preserving full supervisory discretion, to ensure that the specific circumstances of each case are always considered with the maximum flexibility (status quo);
- second, imposing stricter quantitative triggers for FOLF; and
- third, providing for framed supervisory discretion with focus on the degree of the bank's financial deterioration.

The first approach was discarded because it would not address the problems of insufficient legal certainty and would not contribute to the objective of activating crisis measures earlier. This in turn affects the available financial resources in resolution (or insolvency) and subsequently the capacity to access additional funding sources. In particular, while there is merit in considering full flexibility in the run up to a bank's failure, the risk of considerable losses and/or liquidity runs, which would need to be

[520] See Annex 2.

[521] As the situation of the bank deteriorates further, short-term funding providers may refrain from rolling over their commitments and depositors may potentially run on the bank.

[522] Although the resolution framework also allows the resolution authority to initiate FOLF. In the Banking Union, all FOLF determinations of banks under the SRB's direct remit were launched by the ECB and the timing of the relevant assessments varied depending on individual circumstances in each case.

covered in resolution/insolvency proceedings in the event that a prospective buyer or any other private solution does not materialise, cannot be disregarded.

A second possibility would be to provide for stricter triggers for the authorities to determine a bank as being FOLF. In particular, the current provisions in Article 32 BRRD do not contain any hard triggers to be used by supervisors (and, eventually, by resolution authorities) for this purpose. The requirement is rather to consider whether the conditions which would justify a withdrawal of the bank's license (as per the applicable supervisory framework) are met or are likely to be met in the near future. Similarly, the supervisor is required to consider if a situation of illiquidity of the bank (i.e. the bank cannot repay its obligations when due) or balance sheet insolvency (i.e., the assets of the bank are less than its liabilities) has occurred or is likely to occur in the near future. These rather general conditions could be articulated in a more specific and quantifiable manner within the legislative text.

This second approach would improve the clarity and certainty of the supervisor's decisions and would in turn improve legal certainty and predictability for banks and for the markets. Also, if correctly set up, it would ensure that the bank's failure is declared at a time when sufficient liquidity and loss absorption resources are retained, to be used for an effective restructuring of the bank in the event of resolution, and ensuring that more resources are available to repay creditors if the bank is instead put into national insolvency. At the same time, however, this approach creates a substantial risk of arbitrary decisions, which may end up damaging banks and the markets. Considering the complexity of a bank's business and the many circumstances, which may contribute to create a situation of failure or likely failure, it seems difficult for the legislator to set up strict hard triggers which can sufficiently encompass the various circumstances occurring at the time of the bank's financial deterioration. This creates, for example, a risk of forcing supervisors to take decisions on banks which may actually still be sold to a buyer or managed through other tools than insolvency or resolution, or inversely the risk of not being able to declare FOLF sufficiently early because the strict legal conditions are not yet met. This option is therefore deemed too rigid and it would not allow sufficient margin for supervisors to assess important elements at the time of a bank's financial deterioration, creating a substantial risk of incorrect (too early or too late) decisions, which may end up damaging banks, their customers and the markets.

Against these considerations, the retained approach (third option) would be to instead frame the discretion of the supervisor, so as to ensure a better balance between clarity and predictability of their decisions and the need to account for flexible action.

In particular, the reform should ensure that the current rules on the FOLF determination, while leaving room to still take into account the existence of private solutions to address the failure of the bank, do not risk excessively delaying the process for the preparation of a potential resolution or insolvency. To achieve this, the supervisor should be required to notify sufficiently early the resolution authority as soon as it considers that there is a material risk that an institution or entity meets the conditions for being assessed as failing or likely to fail. On this basis, the resolution authority should be empowered to assess, in close cooperation with the competent authority, what it considers to be a reasonable timeframe for the purposes of looking for solutions, of private or administrative nature,

able to prevent the failure. The supervisor should maintain its discretion to explore the possibility of private solutions, as they may prevent the bank's failure.. Should it be concluded that the deterioration of the bank's financial conditions has reached such a stage that its resolvability would be endangered, authorities should take this element into due account in their decision to declare the FOLF and in setting a timeline to take action. Where the competent authority concludes that the institution or entity is failing or likely to fail, it should formally communicate this to the resolution authority. The resolution authority should then determine whether the conditions for resolution are met.

This option, which is common across all packages of policy options presented in Chapter 6, would improve legal certainty and in turn, foster the use of crisis measures at a sufficiently early time to ensure adequate financing resources and therefore the likelihood of meeting the requirements to access the resolution fund.

6. INTERACTION BETWEEN FOLF TRIGGERS AND INSOLVENCY

National insolvency proceedings are very heterogeneous across EU Member States. One difference concerns the trigger to initiate such proceedings. Only few Member States aligned the triggers for commencing national insolvency proceedings with the FOLF triggers in the BRRD. In general, the trigger to initiate insolvency is only met later than FOLF triggers, when the bank reaches a state of financial insolvency (which generally entails the bank's inability to repay its debts). This may give rise to a situation where a failing bank for which there is no public interest in using resolution, can also not be placed in insolvency because the trigger to initiate the proceedings is not met. This can happen, for example, when a bank is declared FOLF based on a likelihood of breach of capital requirements, without the bank being in actual breach or insolvent yet.

To address this potential "limbo" situation, the 2019 Banking Package introduced Article 32b BRRD, requiring Member States to ensure the orderly winding up in accordance with the applicable national law of failing banks, which cannot be resolved due to negative PIA. However, the implementation of this article in the national legal framework in the current form seems insufficient to address all residual risks of standstill situations. In particular, there is still uncertainty as to what the concept of "winding up in accordance with national law" entails, and whether it requires the exit of the bank from the market and within which timeframe. Due to the variety of actions that can be taken under national rules, the winding up of banks across the EU may lead to a long period of restructuring during which the bank continues operating. There is, therefore, inconsistency and uncertainty across Member States regarding managing banks that are not resolved.

BRRD II partly addressed this issue by introducing a provision (Article 32b) which requires that, in the event of FOLF with no public interest, a bank must be wound down according to the procedure available under national laws. This provision still leaves a margin of uncertainty as to which procedure should apply in these cases, and particularly whether only insolvency laws (or at least and namely procedures labelled as "national insolvency proceedings" under BRRD) should apply – or all the national procedures available are acceptable – and what the wording "winding up" exactly entails. At the same time, it should be observed that the choice to use the open language contained in

the provision was the result of a specific decision in the course of the negotiation between co-legislators, to avoid excessively limiting the avenues available at national level and avoid a harmonisation of the existing procedures.

Three options were considered:

- the baseline option i.e. keeping the current legislative provision allowing for substantial margin for available solutions at national level;
- Establishing an automatic correspondence in the law between the conditions which can justify a FOLF determination and the triggers for insolvency in national law;
- Providing further framing to the existing provisions, and particularly to Article 32b, while maintaining a degree of diversification in the procedures available at national level.

A first available solution would be to retain the legislative text in its current form, leaving substantial margin for available solutions at national level. This would avoid a risk of unwanted limitations, and would in particular allow solutions at national level, which can be beneficial in preserving the bank's value (e.g. through restructuring or sale measures), as well as avoid a disorderly liquidation procedure, which may cause disruptions in the market or loss of value. At the same time, this avenue would do little in improving clarity and would still maintain uncertainty as to the outcome of such procedures. For example, it cannot be excluded that, in some cases, it would lead to very long periods of restructuring, which do not necessarily improve the viability of the bank, before a decision is taken on forcing a bank's exit from the market. This option was therefore discarded.

A second possibility would be to establish in the law an automatic correspondence between FOLF triggers and insolvency triggers. This would ensure complete clarity and predictability and would guarantee that if, resolution does not follow a FOLF declaration, an insolvency proceeding according to national laws would instead take place and the bank would exit the market. However, this option has the disadvantage of limiting substantially the available measures under national law. A number of viable procedures are not qualified as insolvency in the narrow sense, as they do not entail the immediate closure of the bank's business and its liquidation or sale, but allow other intermediate steps to be taken, for example a period of restructuring to avoid insolvency or to look for potential buyers. Also, this option would require some relevant changes to national insolvency laws, particularly with respect to the triggers to initiate the insolvency procedures. This is challenging in practice and in some cases not possible under national laws, as it would require the competent insolvency authority (in many cases a court) to act on the basis of prospective assessments of the bank's situation carried out by a supervisor. This is not legally or constitutionally feasible in many Member States. The non-desirability of this solution was also confirmed in the context of the discussion in the CWP under the German Presidency[523]. As such, this option was discarded.

[523] European Council (November 2020), *German Presidency progress report on strengthening the Banking Union*.

The third and retained option[524] in this respect is to provide further framing and clarifications as to the functioning and consequences of Article 32b BRRD. This would entail, in particular, a set of clarifications and additional elements on the concept of "winding up under the applicable national law" contained in this provision. The objective of these clarifications is to ensure that such procedures lead to the market exit of the bank. It is acceptable to leave a margin at national level as to how this market exit should occur (i.e., whether through a sale or otherwise). However, clarity on the need to produce this outcome, and possibly a clearer reference to a time frame for the exit, would improve clarity and certainty and reduce the possibility of standstill situations. In this context, it is also appropriate to further enhance the role of the withdrawal of the bank's license when FOLF is declared and no resolution ensues. Further clarity on the interactions between the FOLF determination and the withdrawal of the license by the supervisor, and, to the extent possible, a better framing of how this power should be exercised, would improve the functioning of the framework in this respect. It is important, in particular, to ensure that the supervisor can withdraw the license in all cases in which a bank has been declared FOLF.

7. DGS BRIDGE TO 8% TOLF FOR TRANSFER STRATEGIES

The policy options described in Chapter 6 of the impact assessment allow the DGS to facilitate the transfer of deposits, including by providing a bridge to meet the access conditions for the RF/SRF. ***Figure 32*** illustrates different stylised scenarios[525] to visualise who would pay and who would be protected. The limit to the amount of the intervention of the DGS and the conditions for the SRF to cover depositors vary depending on the option in the IA.

Under scenario 1, the bank's internal loss absorption capacity would suffice to reach the 8% TLOF threshold and access the RF/SRF. In this case, the SRF is available and the DGS may also be potentially available.

Scenarios 2-5 show different cases, where the internal loss absorption capacity of the bank is not sufficient to reach the 8% TLOF threshold. In those scenarios, depositors may need to suffer losses in order to access financing by the RF/SRF under the current rules. This could be avoided by allowing the DGS to shield depositors (not only covered) from such losses.

Under scenario 2, the LCT would allow the DGS to contribute exactly the amount sufficient to reach the access conditions for the SRF. Once the DGS has contributed such an amount, the SRF intervenes in addition to the DGS, given that the DGS contribution alone is still not sufficient to cover all the losses accumulated.

Under scenario 3, DGS would only cover part of the gap between the assets and the deposits transferred, as the LCT would not allow for more. The other part of the gap would have to be covered by the resolution fund.

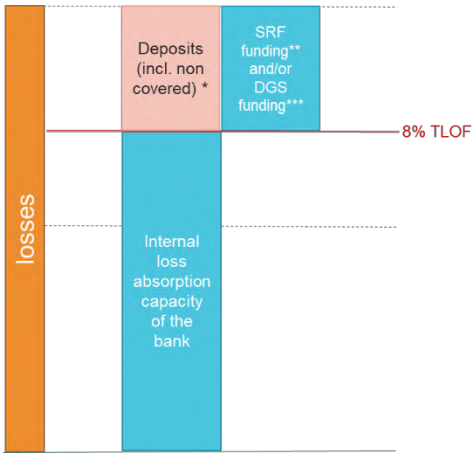
[524] This option was supported by the majority of member in the Commission expert group (EGBPI).
[525] A variety of other scenarios are possible.

Under scenario 4, the amount provided by the DGS would be lower than what the LCT would allow for, however this would be sufficient to reach 8% TLOF.

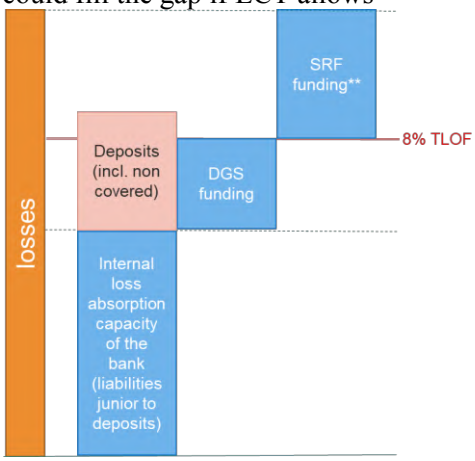
Under scenario 5, to protect deposits from bearing losses, the DGS would intervene but with an amount lower than the one allowed under a positive LCT (no need to get as high as 8% TLOF and access the fund).

Figure 32: Visual on who pays and who is protected

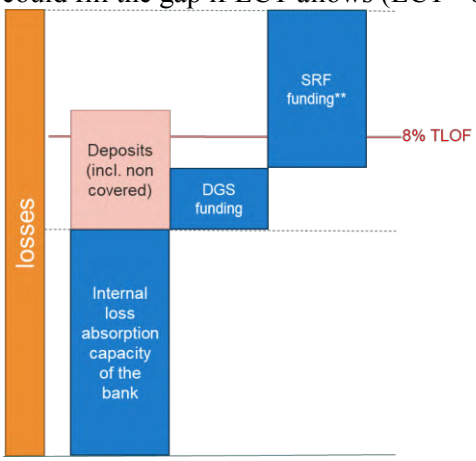
Scenario 1: SRF funding only accessible when loss absorbing capacity reaches 8% TLOF



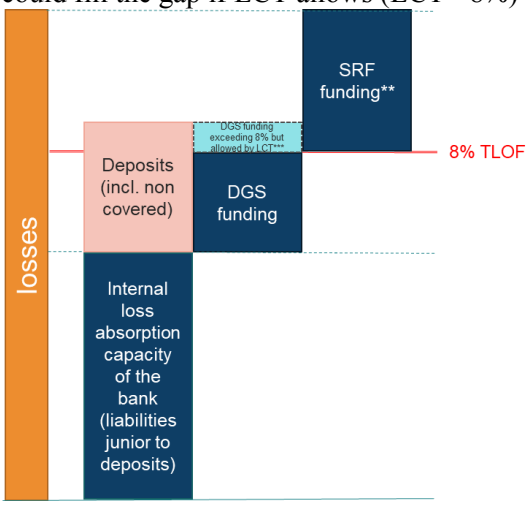
Scenario 2: If losses exceed 8% TLOF and loss absorbing capacity is below 8% TLOF, DGS could fill the gap if LCT allows



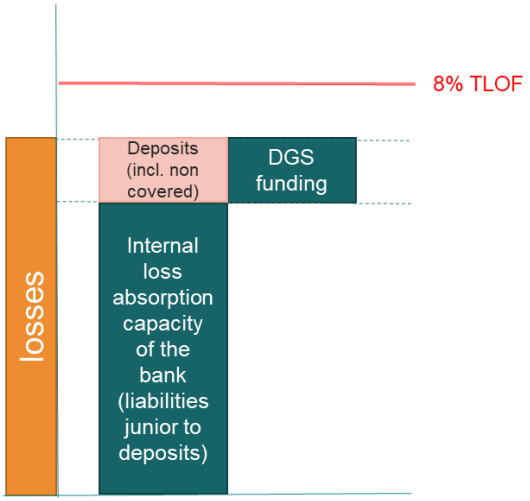
Scenario 3: If losses exceed 8% TLOF and loss absorbing capacity is below 8% TLOF, DGS could fill the gap if LCT allows (LCT <8%)



Scenario 4: If losses exceed 8% TLOF and loss absorbing capacity is below 8% TLOF, DGS could fill the gap if LCT allows (LCT >8%)



Scenario 5: If losses are below 8% TLOF and loss absorbing capacity is below 8% TLOF, DGS could fill the gap to loss coverage if LCT allows. No SRF intervention needed.



*Notes: * The amount of deposits which may be exposed to losses to reach 8% TLOF depends on the specific situation at hand, and particularly on the amount of assets that are transferred to a buyer; **In scenario 4, SRF is used to shield deposits from losses only if they meet specific requirements; *** The amount of DGS funding depends on the scenario. In scenario 2 the whole amount given by the LCT is used (even beyond 8%), in scenario 4 the lower between the LCT and 8%.*
Source: Commission Services

8. TREATMENT OF LIQUIDATION ENTITIES IN THE MREL FRAMEWORK

Under the MREL framework, resolution authorities are required to adopt a MREL decision for all banks under their remit, regardless of the strategy chosen during resolution planning in case of their failure[526]. This includes the banks likely to be wound up under normal insolvency proceedings or other equivalent national procedures according to the resolution plan (the so-called "liquidation entities"). As a rule, the

[526] See the reply to question 38 in Commission Notice relating to the interpretation of certain legal provisions of the revised bank resolution framework in reply to questions raised by Member States' authorities (2020/C 321/01).

MREL set for liquidation entities does not exceed the loss absorption amount as determined by the applicable minimum capital requirements. There is no additional requirement in terms of the liquidation entities' liability structure nor any increased loss absorption capacity in comparison to the prudential requirements.

While there is no publicly available data on the number of liquidation entities in each Member State in the Banking Union, it can be reasonably expected that a majority of institutions that are not in the direct remit of the SRB would be liquidation entities – even more so in domestic markets characterised by a large number of institutions (often relatively smaller)[527].

This represents a non-negligible administrative burden not just for resolution authorities, who have to issue MREL decisions at least on an annual basis, but also for the affected liquidation entities. While the latter are already excluded from the MREL reporting provided under Article 45i BRRD, they are still expected to monitor compliance with the MREL decision. In terms of distribution of impact, the requirement to adopt MREL decisions and communicate them to banks under liquidation strategies impacts the administrative burden on banks and resolution authorities asymmetrically across Member States, i.e. to a greater extent in Member States with less concentrated banking markets than in Member States with few banks under liquidation strategies. The existence of such a decision also means that liquidation entities are required to obtain prior permission from resolution authorities before calling, redeeming, repaying or repurchasing their eligible liabilities[528] and, if they are part of a daisy chain, their own funds and eligible liabilities held by other entities in that daisy chain need to be deducted[529].

Based on the above considerations, the Commission considered the following options:

- Maintaining the status quo;
- Waiving the obligation to adopt a MREL decision in relation to liquidation entities whose MREL would not exceed the loss absorption amount;
- Continue to require the adoption of a MREL decision for these liquidation entities but waiving the need to update them on an annual basis.

The first option was discarded as the current MREL framework for liquidation entities does not add value from a resolvability perspective. The third option would alleviate the administrative burden for resolution authorities but only marginally, but not for the institutions themselves, which would still be captured by the rules concerning prior permission and daisy chain deductions and was therefore also discarded.

Ultimately, the second option was retained, as it was the one most conducive to reducing the regulatory burden for both the concerned entities and the resolution authorities, without affecting the prudential soundness of the framework or the resolvability of the entities or groups. It is also in line with existing provisions of the MREL framework,

[527] According to the SRB's 2020 Annual Report, the five Member States in the Banking Union with the highest number of LSIs expected to be covered by resolution planning as of 1 January 2020 were: Germany (1 336), Austria (413), Italy (128), France (71) and Spain (55).
[528] As per Article 78a CRR.
[529] See the Commission's 'quick-fix' legislative proposal addressing the operationalisation of the indirect issuance of internal MREL instruments within a resolution group (the so-called 'daisy chain' deductions).

namely the exclusion of liquidation entities from the MREL reporting and from the obligation to include contractual clauses recognising the effects of the bail-in powers in contracts governed by third country laws.

The obligation on resolution authorities to adopt a decision for those liquidation entities whose MREL exceeds the loss absorption amount is not affected, nor is the requirement to draw up and review resolution plans for all liquidation entities.

Finally, targeted adjustments are implemented in MREL reporting, introducing a statutory simplified reporting regime for those liquidation entities for whom MREL exceeds the loss absorption amount. This obligation on the concerned liquidation entities is necessary to ensure that resolution authorities are able to monitor compliance with MREL. It is also understood that resolution authorities already envisage ad hoc reporting requests in these situations. Therefore, this change will not represent much additional burden on the sector, also considering that only a few liquidation entities actually have MREL set at a level above the loss absorption amount, while at the same time ensuring a harmonised and coherent treatment of liquidation entities across the EU.

9. OTHER POTENTIAL TOPICS TO BE ADDRESSED IN THE REVIEW

In the following, some additional amendments of technical nature which are expected to require a reflection as part of the potential changes in the CMDI reform are briefly presented.

Precautionary measures under BRRD

BRRD provides for a set of precautionary measures (in the form of recapitalisation or guarantees/liquidity) which can be granted to solvent banks to address issues identified in a stress test or equivalent exercise. BRRD provides for strict conditions and safeguards to grant support in this form, to ensure that the support does not benefit a bank that is too close to failure and to avoid (for precautionary recapitalisation) that the support is used to cover losses that were already incurred by the bank or are likely to be incurred.

Past practice in the application of these measures has provided the opportunity for the Commission to identify issues which may require an interpretive effort and to clarify them as part of its practice[530]. In order to ensure further clarity of the legislative text and improve the legislation, there is scope to integrate some of the lessons learnt in the relevant provisions.

Potential clarifications in this respect can include considerations on the concept of solvency, as well as the determination of the amount of support allowed, particularly with respect to the distinction between incurred, likely and unlikely losses. Furthermore, the legislative text could benefit from additional clarity as to the use of precautionary recapitalisation to support impaired asset measures (such as the transfer of impaired assets to an Asset Management Company). This possibility was already confirmed by the

[530] See also Chapter 2, section 2.1.1 for a problem analysis.

Commission, subject to strict conditions, in the AMC blueprint[531] but a specific reference in the legislative text could provide further certainty in this respect.

Access condition to RF/SRF for liquidity provision

The framework is currently ambiguous regarding the condition to access the RF/SRF for providing liquidity to a bank in resolution, creating legal uncertainty. The current legal interpretation stemming from past cases is that the RF/SRF could be tapped for liquidity provision without the 8% TLOF minimum bail-in condition. The current initiative aims to clarify that in the legal text, which would improve the legal certainty of the framework.

Treatment of contingent liabilities in bail-in

In general terms, liabilities are considered as contingent when they are recorded against an event which is not certain and may occur at some point in the future. There can be several instances which generate a contingent liability, ranging from guarantees (only activated if the underlying event occurs) to liabilities connected to potential legal claims (which come into existence and are quantified only once a judgement confirms an underlying obligation).

From a resolution perspective, contingent liabilities become relevant when it comes to their bail-inability. The BRRD currently does not provide specific rules to address contingent liabilities in this context. This circumstance had the potential of creating uncertainty as the treatment of such liabilities, which in turn may affect consideration on other related issues, such as resolvability and the implementation of a resolution strategy.

In light of this, it is appropriate to consider this issue as part of the review and reflect on whether there is scope to further clarify the legislative provisions in BRRD to address some of the identified uncertainties.

Operationalisation of transfer strategies

Transfer strategies, such as the sale of (all or part of the) business to an acquirer, the use of bridge bank and transferring bad assets to an asset management vehicle, are provided in the current framework, alongside the open-bank bail-in strategy (absorption of losses and recapitalisation of the bank through conversion of creditors into new shareholders). However, so far open bank bail-in strategies have been predominant in resolution plans as standalone tool.

On this basis, there is scope to consider, as part of the reform, potential avenues to further clarify the legislative text to provide additional incentives for resolution authorities to consider transfer strategies in their resolution planning, for instance by ensuring a more proportionate calibration of MREL requirements.

[531] See Commission Staff Working Document (March 2018), *AMC Blueprint*, SWD(2018)72 final, p.35.

10. BUSINESS MODEL SPECIFICITIES OF SMALL AND MEDIUM-SIZED BANKS

This section aims to provide additional information on the business model of smaller and medium-sized banks, also called less significant institutions (LSIs) which are at the centre of the CMDI reform. More specifically, it looks at the types of depositors served by small and medium-sized banks across the EU, considering the policy options described in Chapter 6 aiming to shield more depositors from bearing losses by making more use of industry-funded safety nets, such as the DGS funds and/or and RF/SRF.

According to the ECB's 2019 report on LSIs[532], the LSI sector represents a relevant share of the wider European banking industry, representing roughly 19% of total banking assets in the euro area. The geographical distribution of LSIs varies. In certain Member States (Luxembourg, Germany, Austria, Ireland), the importance of LSIs is particularly high, as they account for one third of the domestic banking sector. In contrast, the LSI sector is relatively small in Member States where the banking sector is more concentrated (France, Spain, Greece). In absolute value, the LSI sector in Germany is by far the largest, hosting over 1,400 institutions which together represented 55% of the LSI assets at EU level as of 2019[533].

Most smaller and medium-sized banks still follow the traditional business model (i.e. collection of deposits and granting of loans) and are predominantly financed by equity and deposits. The LSI sector is dominated by retail banks and diversified banks (the latter have a higher percentage of exposures to corporate clients, including SMEs). These LSIs belong mainly to the cooperative and savings bank sectors. They are typically active locally, being fully anchored in the "local economic fabric" of their home regions and service local customers. In terms of balance sheet structure, on the liability side, customer deposits represent by far the largest source of funding, while the issuance of debt securities as well as the trading of derivatives remains only of minor importance for these banks. Overall, retail deposits remain a main source of funding of LSIs, making up for 67.7% of total funding on average, against 36.9% for significant institutions.

This information is very relevant in view of certain stakeholder views that only covered deposits as well as retail and SME deposits (above the coverage level) should be protected from losses, while "wholesale" deposits held by corporates or more sophisticated counterparties should not benefit from additional protection from losses, especially by using DGS funds. These stakeholders argue that shielding all deposits from losses by making more use of safety nets in resolution or alternative measures in insolvency could lead to moral hazard. However, data as quoted above shows that the overwhelming majority of deposits held by smaller and medium-sized banks are retail or corporate/SME deposits held by local clients. Typically, these deposits tend to be sticky in a crisis, meaning they tend to be left with the bank until its failure, while deposits made by large firms or more sophisticated investors tend to run at first signs of distress. Given the preponderance of such sticky deposits in smaller and medium-sized banks, it is important to have the tools and the funding to enable a deposit book transfer as part of a

[532] ECB (2019), *Risk report on less significant institutions*.
[533] See part 1.1 of the ECB's 2019 Risk report on LSIs.

sale of business transaction in case of failure (in or outside resolution). The alternative is to handle the failure of such banks by making recourse to public support or inflicting losses on retail and SME deposits in resolution in order to reach the 8% access condition to the resolution fund.

11. HIGHLIGHTS OF THE US FRAMEWORK (FDIC APPROACH)

Since its creation in 1933 in the aftermath of the Great Depression, the Federal Deposit Insurance Corporation (FDIC) has developed a crisis management framework for most deposit-taking institutions combining resolution, liquidation and deposit insurance (as well as supervisory) functions in a single federal authority based on a single legal framework. This enables the FDIC to act decisively and apply the most fitting (and least costly) solution in each particular crisis case. In contrast, in the EU, those competencies are split across different authorities and legal frameworks at European and national level.

In the US, the distinction between "resolution" and "insolvency" does not exist, unlike in the EU: the failure of banks is handled by the FDIC using the tools and powers at its disposal. In case of failure, the FDIC is appointed as a receiver (i.e. liquidator) of the failed institution. The preferred tool of the FDIC is the purchase and assumption (P&A) transaction, whereby the FDIC transfers assets and deposits (and possibly other liabilities) of the failed bank to a purchaser, or even sells the whole bank. It may also organise a bridge bank to continue the operations of the failed bank until it is sold or liquidated. Although the FDIC does not have a statutory bail-in tool (one of the four tools in the EU framework), the FDIC powers can achieve a comparable outcome as part of a liquidation process of the residual failed bank.

The FDIC has to select the least costly way forward for dealing with any bank, encouraging interested purchasers to bid for the failing bank. Based on its experience, transfer strategies proved to be less costly than pay-out in most cases. The FDIC may also payout insured depositors (up to USD 250 000) when this is less costly than a P&A transaction. There are no hard limits for support from the Deposit Insurance Fund, financed by the industry, as long as the 'least cost principle' is respected – in particular, there are no minimum bail-in conditions to access that Fund, unlike in the EU.

In terms of creditor hierarchy, the US system includes a single-tier depositor preference where all deposits (including insured ones) rank *pari passu* and which greatly facilitates the use of the Deposit Insurance Fund to support such transfer transactions under the least cost test.

The FDIC may use their fund for many purposes other than payout: support a merger with another bank, support transfers of assets and liabilities, fund a bridge bank and provide liquidity in resolution. The US framework also provides for an exception to the least cost requirement when a "systemic risk determination" is made to the effect that compliance with that requirement would have serious adverse effects on economic

conditions or financial stability, and the provision of assistance would avoid or mitigate such adverse effects[534].

Between 2000 and 2020, 95% of the FDIC's interventions to preserve access to deposits in a failed bank were P&As (US equivalent of a transfer tool) with deposit insurance fund support, and only 5% were payouts of covered deposits. The FDIC estimates that between 2008 and 2013, the use of transfer tools saved USD 42 billion, or 43%, compared with the estimated cost of using payouts.

Similarly, the Deposit Insurance Corporation of Japan (DICJ) notes that "The pay-out method should [therefore] be avoided as far as possible." (DICJ, 2005)" [535].

For these reasons (no distinction between resolution and insolvency, one centralised authority for dealing with failing banks, one centralised fund, one approach to assessing the least cost principle and extensive experience with marketing/sale of failing banks), the US regime is often, also in the EU discussions, raised as an example to follow.

The extensive experience and excellent track record of the US FDIC, spanning over many decades, where failing smaller and mid-sized banks are routinely restructured/transferred to a buyer with the support of a common fund financed by the contributions of the industry, can reveal how some features of the CMDI framework could be improved.

[534] Financial Stability Institute, (July 2022), *Counting the cost of payout: constraints for deposit insurers in funding bank failure management*. See Table 3 on p. 15 and p.19.
[535] ECB (October 2022) *Protecting depositors and saving money - why DGS in the EU should be able to support transfers of assets and liabilities when a bank fails*

ANNEX 9: SELECTED CASES OF APPLICATION OF THE CMDI FRAMEWORK SINCE 2015

This annex provides an overview of selected cases when the CMDI framework was applied since 2015. The cut-off date is 18 November 2022.

1. PREVENTIVE PRIVATE OR MARKET-CONFORM PUBLIC MEASURES[536]

Bank	Balance sheet size at time of intervention	Home jurisdiction	Date measure taken	Description of measure taken	Amount / Source of assistance (if applicable)	Current status of bank
NORD/LB[537]	EUR 146.9 bn (2019)	DE	December 2019	Received public support, for strengthening capital and restructuring, which the Commission has assessed as market-conform.	EUR 2.8 bn investment, EUR 0.8 bn capital relief (of which EUR 0.8 bn provided by the IPS and EUR 2.8 bn was a public market conform measure)	In operation
Banca Carige(*)[538]	EUR 23 bn (Jan 2020)	IT	December 2019	The voluntary arm of the IT DGS (private measure) and, in accordance with Article 11(3) DGSD, the IT DGS (private measure in accordance with Tercas case law) provided contributed to the capital increase of the bank.	EUR 318.2 m and EUR 301 m	Acquired
Banca Carige	EUR 23 bn (Jan 2020)	IT	April 2022	The IT DGS (private measure in accordance with Tercas case law) provided a further capital contribution of EUR 530 m to facilitate the sale of the bank to BPER.	EUR 530 m	Acquired

[536] In the market-conform public measures the State invested in a market-conform manner together with the DGS.
[537] Case SA.49094 (2019/N)
[538] Cases marked with (*): no (individual) SA decision exists.

Bank	Balance sheet size at time of intervention	Home jurisdiction	Date measure taken	Description of measure taken	Amount / Source of assistance (if applicable)	Current status of bank
Banca Popolare di Bari (*)	EUR 13.6 bn (Jun 2019)	IT	May 2020	The voluntary arm of the IT DGS provided capital (private measure).	EUR 1.2 bn	In operation

2. PRECAUTIONARY PUBLIC MEASURES

Bank	Balance sheet size at time of intervention	Home jurisdiction	Date measure taken	Description of measure taken	Amount / Source of assistance (if applicable)	Current status of bank
Banca Monte dei Paschi di Siena[539]	EUR 143.5 bn (2017)	IT	December 2016; July 2017	Received precautionary liquidity support (state guarantee) and recapitalisation.	EUR 15 bn (liquidity guarantee), EUR 5.4 bn (recapitalisation)	In operation, restructuring
Banca Carige[540]	EUR 22 bn (2018)	IT	January 2019	Received precautionary liquidity support in the form of remunerated guarantees that are restricted to solvent banks.	Up to EUR 3 bn	In operation, restructuring
Banca Popolare di Vicenza[541]	EUR 34.4 bn (2016)	IT	January, April 2017	Received precautionary liquidity support in the form of guarantees.	EUR 3 bn, EUR 2.2 bn	Acquired
Veneto Banca[542]	EUR 28 bn (2016)	IT	January, April 2017	Received precautionary liquidity support in the form of guarantees.	EUR 3.5 bn, EUR 1.4 bn	Acquired
National Bank[543] of Greece		EL	December 2015	Received precautionary recapitalisation	EUR 2.7 bn	In operation

[539] Case SA.47081 (2016/N) & Case SA.47677 (2017/N)
[540] Case SA.52917 (2019/N)
[541] Case SA.47149 (2016/N) & Case SA.47940 (2017/N)
[542] Case SA.47150 (2016/N) & Case SA.47941 (2017/N)

Bank	Balance sheet size at time of intervention	Home jurisdiction	Date measure taken	Description of measure taken	Amount / Source of assistance (if applicable)	Current status of bank
Piraeus Bank[544]		EL	November 2015	Received precautionary recapitalisation	EUR 2.7 bn	In operation

3. FAILING OR LIKELY TO FAIL BANKS: NATIONAL INSOLVENCY PROCEEDINGS (NEGATIVE PIA)

Bank	Balance sheet size at time of intervention	Home jurisdiction	Date measure taken	Description of measure taken	Amount / Source of assistance (if applicable)	Current status of bank
Banca Popolare di Vicenza[545]	EUR 34.4 bn (2016)	IT	June 2017	Declared FOLF by ECB; negative PIA by SRB; entered compulsory administrative liquidation under management of Bank of Italy and granted cash injection and guarantees by the State in order to facilitate the transfer to Intesa Bank.	EUR 4.8 bn cash injection and up to EUR 12.7 bn guarantees for the combined sale of Banca Popolare di Vicenza and Veneto Banca.	Acquired
Veneto Banca	EUR 28 bn (2016)	IT	June 2017			Acquired
Banca Sviluppo	N.A.	IT	July 2018	Declared FOLF with subsequent negative PIA by the Bank of Italy; entered into compulsory administrative liquidation under the management of Bank of Italy, while assets and liabilities were transferred to Banca Agricola Popolare di Ragusa.	The Italian DGS (FITD) provided contribution for the transfer of assets and liabilities to the acquirer.	Acquired
ABLV Bank	EUR 3.6 bn (Q3 2017)	LV (and subsidiary in LU)	February 2018	Declared FOLF by ECB; negative PIA by SRB; ABLV entered into self-liquidation. ABVL LU entered into normal insolvency proceedings under LU law, following an extended period under a moratorium regime.	No funds from the State budget.	In liquidation

[543] Case State Aid SA.43365 (2015/N)
[544] Case SA.43464 (2015/N)
[545] Case SA.45664 (2017/N)

Bank	Balance sheet size at time of intervention	Home jurisdiction	Date measure taken	Description of measure taken	Amount / Source of assistance (if applicable)	Current status of bank
PNB Banka	EUR 0.6 bn (Q1 2019)	LV	August 2019	Declared FOLF by ECB; negative PIA by SRB; entered normal insolvency proceedings under LV law.	No funds from the State budget.	In liquidation
Aigis Banca [546]	N.A.	IT	May 2021	Declared FOLF with subsequent negative PIA by the Bank of Italy; entered into compulsory administrative liquidation under the management of Bank of Italy, while assets and liabilities were transferred to Banca Ifis.	The Italian DGS (FITD) provided contribution for the transfer of assets and liabilities to the acquirer.	Acquired

[546] Source : EBA *Notification on the use of available financial means of Italian DGS FITD - Article 11(6) of Directive 2014/49/EU*

4. FAILING OR LIKELY TO FAIL BANKS: RESOLUTION (POSITIVE PIA)

Bank	Balance sheet size at time of intervention	Home jurisdiction	Date measure taken	Description of measure taken	Amount / Source of assistance (if applicable)	Current status of bank
Banca delle Marche, Banca Etruria, Cassa di risparmio di Ferrra, Cassa di risparmio di Chieti[547]	EUR 22.7 bn, EUR 12.3 bn, EUR 6.9 bn, EUR 4.7 bn (latest published figures at the time of the measures)	IT	November 2015;	The four banks were put in resolution with the use of four bridge banks and an asset management vehicle (AMV). The Italian resolution fund provided support to the bridge banks to cover the difference between assets and liabilities and to capitalise them. It also provided guarantees for the transfer of assets to the AMV. The decision pre-dates the entry into force of the BRRD provisions on bail-in. Therefore only the burden sharing requirements under State aid rules (requiring shareholders and subordinated debt holders to be written down) were applied.	No funds from the State budget. The national resolution fund contributed EUR 3.6 bn (EUR 1.7 bn to absorb losses, EUR 1.8 bn to capitalise the bridge banks and EUR 0.1 bn to capitalise the AMV), EUR 0.4 bn (guarantees on the AMV's liabilities)	Acquired
Banco Popular Español[548]	EUR 147 bn (2017)	ES	June 2017	Determined as failing or likely to fail (FOLF) by ECB; placed into resolution by the SRB; losses absorbed by equity and subordinated debt; sale to Banco Santander S.A. for EUR 1	No public funds used and no funds used from the resolution fund.	Acquired
KØBENHAVNS ANDELSKASSE(*)[549]	DKK 370 m	DK	September 2018	Was declared FOLF and put in resolution by the Danish authorities. All creditors, with the exclusion only of covered deposits and non-bailinable liabilities, were bailed-in in full. The DGS contributed to support cover depositors. New capital provided by a bridge bank (which became the owner of the bank).	No funds from the State budget. The DGS absorbed losses in lieu of covered deposits. The national resolution fund capitalised the bridge institution.	In operation, restructuring.

[547] Case SA.39543 (2015/N) & Case SA.43547 (2015/N)
[548] Commission Decision of 7 June 2017 endorsing the resolution scheme for Banco Popular.
[549] Source: EBA (2018), *EBA acknowledges notifications from Finansiel Stabilitet*

Bank	Balance sheet size at time of intervention	Home jurisdiction	Date measure taken	Description of measure taken	Amount / Source of assistance (if applicable)	Current status of bank
Andelskassen J.A.K. Slagelse(*)[550]	N.A.	DK	October 2015	Write-down and conversion of capital instruments, bail-in tool and bridge institution tool.	No funds from the State budget. The national resolution fund capitalised the bridge institution. The DGS absorbed losses in lieu of covered deposits.	Acquired
Idea Bank(*)	PLN 15 000 bn (approx.-Aug. 2020)	PL	December 2020	Sale of business tool	No funds from the State budget. The national resolution fund covered the funding gap and provided guarantees.	Acquired
Cooperative Bank of Peloponnese [551]	EUR 97 m	EL	December 2015	Sale of business tool	No funds from the State budget. The national resolution fund covered the funding gap (up to EUR 99.6 m).	Acquired
MKB[552]	HUF 1 944 bn (end-2014, consolidated)	HU	December 2015	Asset separation tool and sale of business tool.	MKB was a fully state owned Bank at the time of resolution. State shares were fully bailed-in. The national resolution fund financed the transfer of bad loans.	Acquired

[550] Source: EBA
[551] Case SA.43886 (2015/N)
[552] Case SA.40441 (2015/N)

Bank	Balance sheet size at time of intervention	Home jurisdiction	Date measure taken	Description of measure taken	Amount / Source of assistance (if applicable)	Current status of bank
Jadranska banka d.d. Šibenik.(*)	Around EUR 300 m	HR	October 2015	Bail-in tool, asset separation tool and sale of business tool.	No funds from the State budget. The DGS absorbed losses in lieu of covered deposits. The national resolution fund covered the remaining funding gap and recapitalised the transferred activities and supported a transfer of part of NPL to an AMV[553]	Acquired
Panellinia Bank[554]	N.A.	EL	April 2015	Sale of business tool.	No funds from the State budget. The national resolution fund covered the funding gap.	Acquired
Getin Noble Bank SA[555]	PLN 44 bn (around EUR 9.2 bn)	PL	October 2022	Bail-in tool, bridge bank tool.	The bridge bank was supported with cash injections of around EUR 1.4 bn (PLN 6.9 bn), which were provided by the resolution fund and the deposit guarantee scheme. In addition, the Polish Commercial	In operation as a bridge bank, until its eventual sale to a suitable buyer.

[553] Source: *Croatian Deposit Insurance Agency (2017)*.
[554] Case SA.41503 (2015/N)
[555] Case SA. 100687 (2022/N)

Bank	Balance sheet size at time of intervention	Home jurisdiction	Date measure taken	Description of measure taken	Amount / Source of assistance (if applicable)	Current status of bank
					Banks' Protection System (SOBK) comprising the 8 largest commercial banks in the PL market, voluntarily decided to support the operation (i) with around EUR 735 m (PLN 3.5 bn) to absorb further losses and (ii) temporarily purchase a 49% share in the bridge bank, which did not constitute State aid.	
Banco Internacional do Funchal, S.A. (BANIF)[556]	EUR 12.8 bn	PT	December 2015	The business of BANIF and most of its assets and liabilities were transferred to Banco Santander Totta for EUR 150 m, under the sale of business tool. The Portuguese resolution fund and the Portuguese State provided support intended to cover future contingencies. Additionally, some of BANIF's assets were transferred to an AMV. The transfer of those assets was paid by the AMV through the issuance of bonds (included in the assets transferred to Banco Santander Totta), which were guaranteed by the resolution fund and counter-guaranteed by the State. BANIF kept a very limited set of assets that were included in its insolvency estate once it entered into liquidation procedures, as well as the liabilities from shareholders, subordinated creditors and related entities.	The sale of business operation received support to the amount of EUR 2.255 bn, of which EUR 489 m by the Portuguese resolution fund and EUR 1.766 bn by the Portuguese State. The bonds issued by the AMV, in an amount of EUR 746 m, were guaranteed by the Resolution Fund and counter-guaranteed by the Portuguese State.	Acquired

[556] Case SA.43977 (2015/N)

5. THE SBERBANK RESOLUTION CASE

Sberbank Europe AG was a universal bank, owned by a Russian parent entity, operating in Austria, with a branch in Germany, subsidiaries in Croatia, Slovenia, Czech Republic and Hungary and outside the EU, in Bosnia and Herzegovina and the Republic of Serbia. It operated 185 branches and had more than 3,933 employees. Sberbank Europe AG reported EUR 13.64bn total assets at consolidated level and EUR 6.82bn in the Banking Union entities in Austria, Croatia, and Slovenia (aggregated)[557]. On 28 February 2022, the ECB declared Sberbank Europe AG and its two subsidiaries in the Banking Union, Sberbank d.d. in Croatia and Sberbank banka d.d. in Slovenia, failing or likely to fail, owing to a deterioration of their liquidity situation from significant deposit outflows[558], which resulted from the reputational impact of geopolitical tensions. The SRB adopted resolution schemes for the two Banking Union subsidiaries in Croatia and Slovenia, however, for the parent entity in Austria, the SRB assessed that there was no public interest for resolution[559]. Consequently, the Croatian and Slovenian subsidiaries were placed in resolution and sold to the Croatian PostBank and NLB, respectively, without any support from the resolution fund or public fund support. The Austrian parent Sberbank Europe AG was prohibited from continuing business operations and the bank has voluntarily initiated self-liquidation, while the Austrian DGS has paid out the covered depositors[560]. The Czech and Hungarian authorities also decided to close and wind down the Czech and Hungarian subsidiaries and pay out the covered depositors through the Czech[561] and Hungarian[562] DGS respectively[563].

[557] Source: *SRB*.
[558] Source: *ECB*
[559] Source: *SRB*
[560] Source: FMA
[561] Source: EBA
[562] Source: EBA
[563] See section 7.1.4.4 of the Annex 5 (evaluation) for more information on the impact of the payouts on the national DGSs in the case of the Austrian parent.

ANNEX 10: RATIONALE AND DESIGN FEATURES FOR A COMMON DEPOSITOR PROTECTION IN THE BANKING UNION

The Commission's legislative proposal on EDIS of 24 November 2015 has been contentious since its adoption. While political negotiations in the European Parliament and the Council stalled, technical discussions in Council Working Party (CWP) and High Level Working Group (HLWG) elaborated other models such as liquidity support in reinsurance, mandatory lending and a hybrid option combining the two. The so-called hybrid model emerged as a possible compromise between the Member States supporting the 2015 proposal, and those underlining the pre-condition of risk reduction before agreeing to share the banking sector risks[564].

However, the rationale for a common depositor protection in the Banking Union is still valid and arguably reinforced by the Covid-19 outbreak and the challenging geopolitical situation. Depositor protection in the EU is a national responsibility and liability. However, this results in a misalignment of liability and control within the Banking Union. Because supervision and resolution have been centralised with respectively the European Central Bank (Single Supervisory Mechanism) and the Single Resolution Board (Single Resolution Mechanism) being the responsible central bodies, their decisions have the potential to create liabilities for the DGSs at national level with respect to depositor protection. Moreover, a common scheme for depositor protection would benefit from an increased firepower and would reduce the vulnerability of national DGSs to large asymmetric local shocks. It is key for financial stability and depositor confidence in the Banking Union. It could also unlock further market integration and cross-border consolidation. Last but not the least, it would reduce the bank-sovereign nexus.

EDIS would be a natural complement of the CMDI framework because of the role of national DGSs in the crisis management to protect depositors, prevent bank runs and so preserve financial stability. The CMDI review seeks to reinforce the prominence of national DGSs in the continuum of crisis management. It would address the hurdles that so far hindered the DGSs and authorities when using the existing tools at their disposal. The proposed policy options would facilitate the interventions by DGSs to finance the sale of medium-size and smaller deposit-based banks, in particular bridging the access to the resolution fund for banks unable to reach the 8% TLOF requirement without necessarily bailing in deposits. The benefits of this policy avenue would be undermined if EDIS were not in place to address the risks of liquidity shortfalls in the available financial means of national DGSs, which in the past was conducive to the recourse to additional public financing.

[564] See Annex 5, Evaluation – Chapter **Error! Reference source not found.** – Section "State of play of the common deposit guarantee scheme in the Banking Union".

1. COMMISSION'S PROPOSAL ON EDIS OF 24 NOVEMBER 2015

The 2015 proposal considered the establishment of EDIS in three successive stages: a reinsurance scheme for participating national DGSs in a first period of three years, a co-insurance scheme for participating national DGSs in a second period of four years, and full insurance for participating national DGSs in the steady state. EDIS would provide funds for payout or in resolution. In all three stages, EDIS would also cover ultimate losses incurred by the participating DGS following depositors' compensation or contribution to resolution. It provided for a progressive transfer of funds of national DGSs towards a deposit central fund (so-called DIF) until a target level of 0.8% of covered deposits was attained. A national DGS would only benefit from EDIS if its funds were built up in line with a funding path and upon compliance with essential requirements under Union law. The SRB would be responsible for administering EDIS, releasing funds where clearly defined conditions are met. It would also monitor national DGSs that would remain responsible for handling depositor claims.

During the initial discussions in the CWP, a significant number of Member States considered the implementation of a third pillar of the Banking Union as a priority and welcomed the proposal. Some of them supported a faster mutualisation process, taking the view that the substance of the provisions and the timing of the entry into force should be even more ambitious. Some Member States strongly objected to the proposal and its timing, contesting the necessity and appropriateness of the proposal and the lack of impact assessment. Among the latter, some were therefore not in a position to discuss details of the proposal. A number of others, while generally supporting the proposal, have raised concerns[565]. These positions have not materially changed over the years.

The technical discussions in the CWP have been ongoing since 2016. These have built on the Commission services' effects analysis carried out in 2016 to remedy the lack of the impact assessment[566]. These discussions focused on the general concepts of the roll out of EDIS, including loss coverage, as well as on the specific elements of the 2015 proposal, sometimes proposing concrete adjustments. Overtime, the various progress reports under successive Council Presidencies highlighted the emerging divergent views and tendency to depart from the 2015 proposal. In addition to the fundamental concerns regarding risk sharing and risk reduction, the main elements put forward as reasons for requiring a substantial departure from the 2015 proposal are described below.

IPSs[567]

The 2015 proposal was silent about the treatment of IPSs, which led to criticism that the specific business model of the IPS based on failure prevention measures (beyond the "paybox" function) and its stabilising role were not recognised. IPSs can also be recognised as a DGS within the scope of the DGSD and are subject to the same requirements, including the target level of 0.8% of covered deposits.

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[565] European Council (14 June 2016), *Presidency Progress report - Strengthening of the Banking Union*, p.3.
[566] European Commission (11 October 2016), *Effect analysis on EDIS*, p. 53-54.
[567] See glossary.

The effects analysis on EDIS explored several policy options, including considering the IPS membership as a risk-mitigating factor leading to lower contributions to EDIS from IPS members that finance preventive and/or alternative measures. In recent CWP debates, some argued that IPSs and their failure prevention measures should be covered by EDIS and that their potential lower risk profile could be reflected via lower levels of EDIS contributions. Others supported covering them only from national funds (within or above the target level). Some Member States suggested excluding IPSs from EDIS because of their core functions as framed under the CRR and the cost neutrality principle[568]. However, others considered such an exclusion as suboptimal from the perspective of the coherence of the legal framework because IPSs are integrated in the SSM and SRM. Other arguments put forward in favour of the integration of IPSs in EDIS were: the order of magnitude of covered deposits in the IPSs, the risks in terms of financial stability if significant institutions were excluded from the common scheme, and the level playing field[569]. Overall, a majority of Member States seemed to support the inclusion of IPSs and their members in the scope of EDIS.

Box 19: IPS in the EU

IPSs operate in seven Member States (AT, DE, ES, IT, LT, PL). In two Member States, the **IPSs are recognised as DGSs**.

Divergences exist among the IPSs. While in some IPSs, members' contributions are capped if own viability is at risk, other IPSs have an obligation to support their members (i.e. there is a legal claim to receive support). Approaches also vary with respect to funding, with specific rules on sequencing. Some IPSs have additional funds that cannot be commingled with the DGS funds and must first be exhausted before using the DGS. Other IPSs have only one fund fulfilling both the IPS and DGS function.

In terms of the order of magnitude, they protect covered deposits amounting to 20.8% of total covered deposits in the Banking Union and 18.8% of total covered deposits in the EU (EUR 7.029 bn).

Hybrid IPSs (currently three also recognised as DGSs) encompass both less significant and significant banks and, consequently, are subject to joint monitoring by the ECB and the national authorities.

Cases where DGS funds were used in the early monitoring process to prevent banking failures are relatively rare (see for example the non-confidential decision 49094(2019/N).

Non-CRR entities and third-country branches

The 2015 proposal covered all credit institutions affiliated to a DGS. In some Member States, this includes entities exempted from the scope of the CRD/CRR – so called non-CRR entities – and third country branches.

[568] European Council (November 2020), *Presidency progress report on the strengthening of the Banking Union*.
[569] European Council (May 2020), *Presidency progress report on the strengthening of the Banking Union*, p. 4, n. 9, P. 1 Portuguese Presidency progress report.

In the context of the debates in the CWP, several policy options were discussed. Some preferred including non-CRD/CRR entities both within the scope of EDIS and CRD/CRR to ensure the alignment of the three pillars of the Banking Union. Others supported either including these entities within the scope of EDIS, complemented by an adjustment of risked-based contributions, or excluding such entities from the scope of EDIS (and covering them from national funds). Another option entailed introducing a conformity test at European level encompassing the regulation and supervision of these entities as a condition for their inclusion into the scope of EDIS.

In this respect, some Member States expressed concerns regarding the integration within the scope of EDIS certain entities that are not subject to common supervision under the CRR/CRD framework. It was argued that, while such entities are regulated at national level, possibly comparatively lower regulatory and supervisory standards could increase the risk exposure of EDIS. To reduce such a risk, some suggested including such entities under the CRR/CDR framework with either a preferential or more proportionate treatment in terms of prudential requirements[570]. Nevertheless, Member States, in which non-CRR entities are a material part of the banking markets, reiterated their stance that the proportionality provisions in the CRD/CRR framework were not suitable for all such entities. Similar concerns and preferences were voiced in relation to the third country branches[571].

Box 20: Non-CRR entities

Compared to the situation described in the effects analysis[572], the following updates are available for Member States in which non-CRR entities play the most important role. In most of these Member States, the numbers of entities and share of covered deposits have slightly declined.

In Ireland, credit unions provide deposits to 3.45 million consumers subject to specific legislation and Fitness and Probity Regime. 62 of these 226 credit unions are over EUR 100 million in assets, representing 64% of that sector's assets. Conversely, there are 164 credit unions below EUR 100 million in assets. The largest credit union in Ireland has less than EUR 400 million in deposits, amounting to approximately 0.3% of the DGS. It is worth noting that there is a Savings Protection Scheme for Credit Unions established in 1989. The latter is a discretionary scheme funded by credit unions affiliated to the Irish League of Credit Unions. Similar to IPSs, the scheme operated by the Irish League of Credit Unions may intervene to provide support to a credit union in difficulty.

In Lithuania, a reform strengthening the credit union sector has been underway since 2018. Each credit union has to belong to a group led by a Central Credit Union (CCU). Currently

[570] In 2019, the proportionality embedded in the prudential requirements was reinforced for entities subject to CRR/CRD, relative to the type and size of banking activities conducted by an entity. In particular these revisions include: reduced requirements for reporting and disclosures, a simplified net stable funding ratio (NSFR) for small and non-complex institutions and simplified approaches for calculating capital requirements for counterparty credit risk and for market risk.

[571] European Council (May 2020), *Presidency progress report on strengthening the Banking Union*, p. 4, and European Council (2 June 2021), *Portuguese Presidency Progress Report on strengthening the Banking Union*, p.7.

[572] European Commission (2016), *Effects analysis*, p.45-50. The non-CRD/CRR entities are often exempted from the CRD/CRR framework based on the principle of proportionality as their business operations are often limited to certain business of relevance for local needs.

there are two CCU groups with a total of 56 members (not counting the leading CCUs themselves). CCUs as solo entities are subject to CRR requirements and are included in the SSM. CCU groups are treated as consolidated financial groups. National prudential requirements applicable to CCU groups on consolidated level are de facto equivalent to CRR requirements. Four credit unions are currently independent. The CCUs and their members are jointly liable for mutual solvency safeguarding. Among others, the CCU has to accumulate and hold at least 1% of its total assets in the Stabilisation Fund, raised by members' contributions.

	Type	DGS member-ship	SSM	Nb. of entities	Total assets held by entities (EUR)	Total assets as share of MS' banking sector TA (in %)	Covered Deposits held by entities (EUR)	Covered Deposits as share of total covered deposits (in %)
IE	Credit unions	Yes	No	226	19.623 bn	2.6%	16.5 bn	14.00
LT	Central credit unions (CCUs)	Yes	Yes	2	268.33 m	0.69%	0.20 m	0.00
	Credit unions under either of CCU	Yes	No	56	787.75 m	2.02%	632.20 m	3.78
	Credit Unions (under restructuring)	Yes	(Yes from 2023)	4	177.18 m	0.45%	164.11 m	0.98
PL	Credit unions	Yes	No	23	2.099 bn	0.49%	1.905 bn	0.90
PT	Savings banks	Yes	No	3	379 m	0.09 %	245	0.19

ONDs

The 2015 proposal opted for preserving a degree of discretion to accommodate national specificities. The treatment of ONDs set out in the DGSD also gave rise to numerous discussions, analysing their interaction with the 2015 proposal and exploring possible options[573].

The possible options were further harmonisation of ONDs in the DGSD, their general exclusion from EDIS or a two-tier system. Some Member States also supported covering some of the options from the mutualised funds during the reinsurance or liquidity support phase, because the latter would be repaid to the DIF[574]. In the recent discussions, the majority of members supported harmonising these options and discretions to the extent possible to cover them, at least to a certain degree, by EDIS. Several Member States argued in favour of harmonising substantive regimes on the use of preventive and alternative measures in EDIS, in particular in what concerns the least cost test[575]. As for the extent of coverage by EDIS, the views were split between allowing coverage by EDIS, in view of their enhanced efficiency with a positive financial impact on the funds,

[573] European Council (November 2019), *Finnish Presidency* Progress report of 25 November 2019, p. 4; *Effect analysis on EDIS* p. 5, 39-57.
[574] European Council (12 June 2018), *Bulgarian* Presidency Progress report on European Deposit Insurance Scheme, p. 9.
[575] See Chapter 6, sections 6.1.3.3 and 6.1.4.3.

and maintaining these measures at national level. Some were of the view that the inclusion of these measures under EDIS would require a larger DIF[576].

2. HYBRID EDIS[577]

2.1. Key features, benefits and drawbacks

The hybrid EDIS is built around the idea of a network of national DGSs coexisting with deposit insurance fund at central level while funds remain within the national DGSs[578].

The setting of the parameters of the model allows for an array of options. The gradual rollout of hybrid model (starting from a liquidity phase) could be more palatable to the co-legislators through a transition to a loss-sharing phase and thanks to a multitude of calibration options for the main parameters. The Commission services' survey on the hybrid model collected the views of Member States on individual parameters, summarised in Box 21[579].

Box 21: Member States' views on the hybrid model (CWP of November 2020)

This table summarises the outcome of the responses from 24 Member States received to the Commission services' survey on the hybrid model circulated in the context of CWP in July 2020. This summary focuses on the main technical views and points raised in the responses, not necessarily reflecting all the nuances. The brackets reflect the number of respondents supporting a particular feature. The numbers do not add up where respondents did not respond to every (sub-)question.

It follows from this survey that, while 8 respondents favoured a fully-fledged EDIS as the final objective, 9 respondents considered the hybrid model as a compromise to bridge the divergent views on the transition towards a fully-fledged EDIS. 4 respondents stated the contingency of any decision on EDIS, including loss sharing on the risk reduction.

Some positions on the below features might have been refined during the subsequent discussions on the hybrid model in the CWP. However, these discussions, as documented in the progress reports, appear less representative absent the feedback from a high number of Member States.

Allocation of funds	in favour of a large central fund (5)	in favour of even allocation (5)	in favour of a limited central fund (4)
Caps on liquidity support on central fund	in favour (8)	Against (6)	
Cap on mandatory lending	in favour (17)	Against (2)	
Build-up of the central fund and of the mandatory	In favour of parallel build-up of the two	In favour of build-up of mandatory	In favour of prior build-up of the central

[576] European Council (2 June 2021), *Portuguese Presidency Progress report on strengthening the Banking Union.*

[577] This section aims to summarise technical discussions that took place in Council working parties on EDIS for the benefit of transparency to all stakeholders. It does not prejudge the Commission's position as the 2015 EDIS proposal is still on the table.

[578] Whereas the available financial means could either remain in the national DGSs or be transferred to individual compartments associated to each Member State within the DIF (see further 2.3.1).

[579] European Council (23 November 2020), German Presidency progress report, p.18.

lending component	(8)	lending component before the central fund (3)	fund (1)
Should the loan be repaid with interest rates?	In favour (16)	Against (3)	
What should be the duration of loan maturities?	Majority of respondents were open to a compromise on the trade-off involving financial stability in the banking sector of the beneficiary DGS and the need for replenishment of the central fund or the lending DGSs. A higher number of respondents supported maturities longer than 5 years.		
What is the sequence of repaying the loan to the hybrid EDIS (the DGS would be repaid the last)?	In favour of repaying first the mandatory lending component prior to the central fund (10)	In favour of repaying mandatory lending and central fund in parallel (2)	
When should the DGS in need raise ex post contributions?	Before the liquidity support (2)	After the liquidity support (17)	
What crisis management tools should be included in the scope of intervention?	Payout and resolution (9)	Payout, resolution and alternative measures (4)	All measures (7)
Should non-CRR entities be included in the scope?	In favour (8)	Against (8)	
Should ONDs be financed by the common schemes?	In favour (9)	Against (6)	
Should IPSs be included in the scope? (3 flagged limited experience)	- in favour of financing preventive measures from the common scheme (2) - in favour of financing from national funds within or above the target level (5)	Against (1)	
Path to loss coverage	- in favour of the same percentage of loss sharing for funds coming from the central funds and for funds coming from mandatory lending: 8 - against using the mandatory lending for loss sharing: 2 - loss sharing could start once the liquidity scheme is fully built-up: 5		

In a first phase, the hybrid EDIS would provide liquidity in case of shortfall in a national DGS. The DIF would provide liquidity support to a beneficiary DGS, once the latter has exhausted its funds (or the mandatory share thereof, if the DGS funds were in excess of the required minimum target level). If the DIF were depleted at the time an intervention is needed, the SRB, on behalf of the DIF, would be able to borrow from national DGSs through a mandatory lending mechanism.

As one of the main benefits, the pooling of resources would increase the firepower of national DGSs, as compared to the status quo, reduce the likelihood of shortfall and subsequently possible recourse to public funds. Depositors would benefit because of their continued access to deposits and enhanced confidence in the robustness of the safety nets. It would also allow lowering bank contributions while maintaining an appropriate firepower and ensuring a more sustainable replenishment. Hence, the banking sector would be in a better position to face structural challenges (transition to digital, consolidation, low interest rate environment, etc.) and international competition.

The concept of the hybrid EDIS mitigates moral hazard concerns as national funds are used before requesting support from the pooled resources. The co-existence of the DIF at central level and national DGSs allows for a modulation of the interventions between the two levels to reassure the concerns raised by Member States that want to keep national sovereignty and/or discretion but also accountability (moral hazard argument). Accordingly, the hybrid EDIS would also facilitate the integration of the IPSs, in view of their concerns about the compatibility of the 2015 proposal with their prevailing business model based on failure prevention. Similarly, the concept would also provide a solution for the debate on the national options and discretions set out in the DGSD. The latter raised concerns that pooled resources should not finance the claims that accommodate national specificities across Member States, sometimes leading to a higher protection of some depositors. The hybrid model creates an environment where, after further harmonisation, some aspects could benefit from the coverage by EDIS and other kept as an option for the national level.

Therefore, this concept could alleviate the main concerns that emerged during the past discussions on the Commission proposal of 2015. Unlike the latter, the hybrid EDIS would as a first step provide liquidity support only whereby the ultimate loss are borne at the national level. While retaining the original ambition through its evolutive nature, it inspires an incremental approach to build trust between Member States while continuing to assess and tackle risks in the banking sector with the view to prepare the ground for loss coverage.

The drawback would be an increased complexity of the hybrid EDIS as compared to the 2015 proposal, which envisaged one fund at the end of the third stage. In addition, the hybrid EDIS, restricted to liquidity support and involving no loss sharing, would not fully mitigate the bank-sovereign loop. Therefore, it would still maintain discrepancies in depositor protection and only partially address financial stability risks in case of strong financial disturbance. The success of the hybrid model would be reliant on a seamless cooperation and robust governance set up between the involved authorities and DGSs.

2.2. Overview of the main possible design features and parameters

Taking into account the feedback from the CWP, a hybrid EDIS model could be based on different assumptions representing varying levels of ambition measured with the degree of allocation between the national funds and the DIF and the extent to which the national funds can be mobilised for mandatory lending. ***Table 37*** presents the overview of the main parameters in more detail.

Table 37: Main parameters of possible designs of hybrid-EDIS

	Low-ambition hybrid EDIS (0.8% target level)	**Medium-ambition hybrid EDIS** (0.7% target level)	**High-ambition hybrid EDIS** (0.6% target level)
Allocation of the funds (the numbers are based on the amount of covered deposits as of end 2020)	The DIF is allocated with 25% of funds, while 75% of the funds remain at the national level. With a 0.8% target	The DIF is allocated with 50% of funds, while 50% of the funds remain at the national level. With a 0.7% target	The DIF is allocated with 75% of funds, while 25% of the funds remain at the national level. With a 0.6% target

	level, EUR 55 bn allocated in: (i) DGSs: EUR 41 bn (0.6% covered deposits). (ii) DIF: EUR 14 bn (0.2 covered deposits).	level: EUR 48 bn allocated in: (i) DGSs: EUR 24 bn (0.35% covered deposits). (ii) DIF: EUR 24 bn (0.35% covered deposits).	level: EUR 41 bn allocated in (i) DGSs: EUR 10 bn (0.2% covered deposits). (ii) DIF: EUR 31 bn (0.4% covered deposits).
Mandatory lending (In case the DIF is depleted, the DGS in need is allowed to solicit a loan from other DGSs. Its amount would be **capped** to protect the funds remaining in the DGSs).	Maximum 30% of the funds remaining in the DGSs could be mobilised for mandatory lending to the DIF.	Maximum 50% of the funds remaining in the DGSs could be mobilised for mandatory lending to the DIF.	
Scope of intervention	The support from the DIF and mandatory lending could finance various types of DGS interventions. The least cost test would be harmonised.	From an economic point of view, it would be relevant that DGSs would be entitled to a support from the DIF to finance all types of interventions outside the payout of covered deposits. Indeed, the least cost test would be harmonised, ensuring level playing field and avoiding any excessive uses of DGS and EDIS funds. Consequently, the least costly option would always be applied, ensuring efficiency for the EDIS scheme. With EDIS in place, the CMDI review could rely on important funds available to deal with smaller and medium-sized banks failures.	
National options and discretions	If harmonised, national options and discretions would be financed by the DIF and mandatory lending. National options and discretions that are not harmonised could be financed at the national level, with funds above the target level.		
Maturity of the loans	Maximum 6 years from loans coming from the DIF and from the mandatory lending component.		
Interest rates	Interest rates would be equal to the ECB marginal facility rates, increased by 1% after 3 years in order to encourage fast repayment.		
Repayment sequencing	The payments of the beneficiary DGS would be repaid in the following sequence: first to reimburse the mandatory lending component and then the DIF. After full repayment of the loans, the DGS would start its own replenishment.		
Extraordinary contributions and alternative funding arrangements	Extraordinary contributions and alternative funding arrangements obtained by the beneficiary DGS would be used to reimburse the loan. These could be seen as an ultimate guarantee of reimbursement.		
Governance	The governance could follow the principle to align liability and control[580] and imply the following: - A more decentralised decision-making under a low ambition hybrid EDIS. With the majority of funds remaining at the national level, the national authorities would have a greater role, in particular in case		

[580] See also European Council (2 June 2021), *Portuguese Presidency Progress Report on strengthening the Banking Union* in which some Member States supported the alignment of liability and control.

	only national funds are used, subject to appropriate involvement of the central authority as a safeguard. - A more centralised decision-making under a medium and high-ambition hybrid EDIS. The role of the central authority (SRB) would increase with the ambition of EDIS. - The activation of the liquidity support and its subsequent replenishment would require involvement of the central authority for assessing compliance of the measure decided at the national level. - The concrete application and implementation of measures and conditions under all options would require the involvement at central level in the context of the hybrid EDIS, entailing a network of national DGSs and a central fund. The type of the involvement would range from the monitoring, consultation and approvals depending on the option to ensure a harmonised application of the measures and sufficient safeguards across the Member States.

2.3. Effectiveness and efficiency of the hybrid EDIS

Effectiveness

The Commission services performed various simulations to test the robustness of the hybrid EDIS in reimbursing depositors in case of payout, under various scenarios of financial crisis of different severity[581]. It demonstrated the effectiveness of various designs of the hybrid EDIS compared to the status quo (i.e. national DGSs only). Pooling resources has a strong positive impact on depositor confidence and financial stability.

This analysis compares (i) the different designs of hybrid EDIS and (ii) the status quo where 19 national DGSs guarantee deposit protection in the Banking Union. The following assumptions apply:

- Only liquidity support in the payout scenario is analysed under various designs of hybrid EDIS, i.e. hybrid EDIS with different degree of pooled resources and a so called 'full liquidity pooling' which corresponds to the pooling of all DGS funds in line with the Commission 2015 proposal for liquidity support only (first phase). Loss coverage (genuine mutualisation of the risks) is not analysed.

- The pooled funds include the financial means in the DIF and the part of funds in national DGSs that could be mobilised for mandatory lending. In this analysis, a hybrid EDIS with a large DIF and a high share of national funds that can be mobilised for mandatory lending represents a high degree of pooling.

- The analysis evaluates the effectiveness of various hybrid models based on the following two criteria: (i) the presence of a DGS liquidity shortfall (i.e. the inability of one DGS to fully reimburse the depositors), and (ii) the amount of these liquidity shortfalls. It uses the SYMBOL model to simulate a very high number of financial crisis leading to banks' failures and payout of covered depositors.

[581] See JRC report (Annex 12).

It concludes that all variants of hybrid EDIS are able to protect a higher amount of covered deposits than under the status quo.

- All designs of the hybrid EDIS and the full liquidity pooling significantly reduce the likelihood and the sizes of liquidity shortfalls, even under a systemic event. The more resources are pooled, the more effective and robust the depositor protection is.
- It presented the results based on three crisis scenarios of different intensity: (i) a comparable to the financial crisis in 2008, (ii) less serious and (iii) more serious[582].
- For instance, under a financial crisis as severe as in 2008[583]:
  - The hybrid EDIS would reduce the probability of a liquidity shortfall from 87% (i.e. probability of liquidity shortfall under the current framework) to 47%-56% (depending on the degree of pooling of funds[584]).
  - In extreme cases where a liquidity shortfall would occur both under the status quo and under a hybrid EDIS, the amount of shortfall would be significantly lower under the hybrid EDIS. The hybrid EDIS would cover from 60% to 68% (depending on the degree of pooling of funds) of liquidity shortfalls that would otherwise be unprotected under the current framework.
  - The hybrid EDIS would have the capacity to reimburse larger amounts of covered deposits. On average, under the current framework, EUR 22 bn of covered deposits would be reimbursed to depositors and EUR 31-36 bn under the hybrid/EDIS (depending on the degree of pooling of funds).
- Even in case of a systemic crisis, the hybrid EDIS outperforms the status quo. The probability of liquidity shortfall and the amount of covered deposits that would not be protected are lower:
  - The probability of a liquidity shortfall is 87% under the status quo, 46%-56% under the hybrid EDIS (depending on the parameter settings).
  - The hybrid EDIS covers 60%-68% of liquidity shortfalls that otherwise remain unprotected under the status quo.
  - Under the status quo, all national DGS protect EUR 22 bn on average, while the hybrid EDIS allow covering EUR 31-36 bn of covered deposits on average.

[582] See JRC analysis on "Measuring the effectiveness and the pooling effect of EDIS" p.21.

[583] The relative effectiveness of the status quo and the hybrid EDIS does not change under other severities of crisis.

[584] Hybrid models with a low degree of pooling of funds are close to 56% and hybrid models with a high degree of pooling are close to 47%.

Efficiency, pooling effect and target levels

Pooling of resources increases the probability of full protection of the covered deposits without liquidity shortfall. Therefore, it delivers a higher efficiency for various hybrid EDIS designs creating room for lowering the target level and, consequently, reducing the cost for the banking sectors across Member States.

The possibility to collect lower amount of *ex ante* funding by the industry without jeopardising the current level of depositors' protection was also explored. This analysis compared the performance of the hybrid EDIS under various shares of pooled resources and reduced target levels with the status quo. The main results point to the possibility to maintain or even increase the current level of depositor protection with a lower target level. The more resources are pooled, the lower the target level could be. As a result, depending on the design of the hybrid model, the target level could be set between 0.5% and 0.8%, without lowering depositor protection.

For instance, under a target level of 0.7% of covered deposits, the probability that a hybrid EDIS would allow a better depositor protection than under the status quo is around 99.8%[585]. Under a significantly reduced target level (0.5-0.6%), there is a 95% probability that a hybrid model[586] provides a better protection than under the status quo.

This quantitative analysis supports the potential reduced target level under an ambitious EDIS. However, this quantitative work only considers the hybrid models for payout, under the current creditor hierarchy. A single category of claims for all deposits and a more frequent use of measures like transfer strategies was also taken into account. The impact of two latter create upward or downward pressure on the amount of funds used by the DGS and hybrid EDIS that are hard to precisely calculate. The net impact is likely to be positive for the DGS and hybrid EDIS funds and is explained in more details below (see **Error! Reference source not found.**: Implications of the scope on the uses of DGS and hybrid EDIS funds).

2.3.1. How do the main parameters of the different hybrid EDIS designs compare?

The possible designs of hybrid EDIS vary in the degree of allocation between the national funds and the DIF and the extent to which the national funds can be mobilised for mandatory lending. The likelihood of the recourse to the mandatory lending is directly proportional to the amount of available funds in the DIF. The other parameters are common to the various designs and relate to the modalities of the repayment of the liquidity support, i.e. maturity of loans, interest rates, repayment sequencing and replenishment, and the scope of coverage.

2.3.1.1. Low-ambition hybrid EDIS

[585] 99.8% for hybrid EDIS with reduced shared of pooled resources and 99.9% for hybrid EDIS with high shares of pooled resources.

[586] 95% for hybrid EDIS with reduced shares of pooled resources and 98% for hybrid EDIS with high shares of pooled resources.

In this scenario, hybrid EDIS would imply a larger role for national solutions and resources and a smaller role for central funding.

Allocation of the funds and mandatory lending

The allocation of funds would maintain 75% of the funds at national level. Accordingly, 25% of DGS funds would be transferred to the DIF, while 30% of the funds remaining in the national DGS could be mobilised for mandatory lending (i.e. cap amounting to 30%). Unlike in the case of mandatory lending, there is no cap on the DIF. Indeed, while setting such a cap would arguably protect the funds in the DIF, it would increase the complexity of the hybrid EDIS and lower the capacity of an effective crisis response. Moreover, the probability of recourse to the mandatory lending would be higher, more prone to operational challenges than accessing the resources in the DIF and less effective in terms of crisis response due to the limited amount in national DGSs.[587]

This scenario would be more efficient than the status quo for the banking industry because it would address more effectively the risk of shortfalls. However, the relatively lower pooling effect leads to a higher risk of DGS liquidity shortfall than under a high-ambition model (as well as the middle-way option). Therefore, by providing limited scope for synergies it would maintain the target level (i.e. 0.8% of the covered deposits).

Scope of intervention

In line with the limited share of funds transferred to the DIF and the cap on mandatory lending, the available firepower in hybrid EDIS would only allow to finance DGS interventions for payout and in resolution. The preventive and alternative measures would be financed at the national level.

Under this scenario, members of IPSs would be required to transfer 25% of their DGS financial means to the DIF (corresponding to the 25% earmarked for payouts). This would also imply that IPSs would finance preventive measures with the funds remaining at national level, in line with their business model. Compared to the baseline scenario, the change would imply a transfer of a certain portion of their DGS funds at central level, combined with the changes affecting the revised conditions of application (Annex 6). This would, however, not affect the amount available for preventive measures because, under the current framework, if the available financial means fall below 25%, the affiliated institutions must immediately provide the means used for preventive measures, e.g. in the form of extraordinary contributions.

2.3.1.2. High-ambition hybrid EDIS

In this scenario, hybrid EDIS would have a strong centralised component, ensuring a large firepower conducive to synergies to reduce the costs to the industry.

Allocation of the funds and mandatory lending

A combination of a large DIF and a significant part of funds remaining at the national level available for mandatory lending would imply a large firepower. To this end, a large

[587] The mandatory lending would require prior collection of funds from all national DGSs.

share of the national funds (i.e. 75%) is transferred to the DIF. In case the DIF is depleted, 50% of the funds remaining in national DGSs could be mobilised for mandatory lending. The cap on the amount potentially mobilised for mandatory lending would be set at 50% of the funds remaining in the national DGS. Like under option 3, no cap would be applied on the DIF.

Compared to a low-ambition model, the larger firepower would allow to exploit maximum synergies as a result of the pooling effect and would reduce the cost of funding, putting the banking sector in a better position to face the current challenges and contribute in the ongoing economic recovery. According to the quantitative analysis performed by the JRC, the combined target level for the Banking Union Member States would be reduced from the current 0.8% to 0.6%. Such a lower target level would correspond to a 25.5% cost reduction (around EUR 14 bn) for the banking sectors in the Banking Union.

Scope of intervention

The economic rationale for allowing support from the DIF to national DGSs to finance preventive and alternative measures is clear. Indeed, the least cost test would be harmonised, ensuring level playing field and avoiding any excessive uses of DGS and EDIS funds. Consequently, the least costly option would always be applied, ensuring efficiency for the EDIS scheme.

This approach would provide incentives to integrate the members of IPSs (recognised as DGS) within the European system of safety nets. Similar to other banks, members of IPSs would be included in the scope of the hybrid EDIS and eligible for liquidity support for all EDIS interventions. Through the funds remaining at the national level and the target level reduction, they would also have large amount of funds at the IPS level to finance the preventive measures. Consequently, IPSs would retain their current business model based on the failure prevention using preventive measures, subject to the modifications proposed in Annex 6. In particular, like any other DGS, IPSs would be subject to a least cost test and more harmonised conditions when financing preventive measures. In addition, a specific mechanism could determine an appropriate reduction from the contribution to the DIF to reflect a lower risk profile and effectiveness of the monitoring functions. For the sake of completeness, an alternative approach would be required in case preventive measures were subject to a tailored least cost test reflecting the features of IPS, e.g. the presence of a legal commitment to intervene.

2.3.1.3. Medium-ambition hybrid EDIS

In this scenario, hybrid EDIS would have a medium centralised component, ensuring a medium firepower conducive to certain synergies to reduce the costs to the industry.

Allocation of the funds and mandatory lending

Under this scenario, the allocation of funds would maintain 50% of the funds at national level and 50% of DGS funds transferred to the DIF. In case the DIF is depleted, 50% of the funds remaining in the national DGS would be mobilised for mandatory lending. The

cap on the amount potentially mobilised for mandatory lending would be set at 50% of the funds remaining in the national DGS, while no cap would be applied to the DIF.

Compared to a low-ambition model, a larger firepower would generate certain synergies because of the pooling effect and reduce the cost of funding, putting the banking sector in a better position to face the current challenges and contribute in the ongoing economic recovery. According to quantitative analysis, the combined target level for the Banking Union Member States would be reduced from the 0.8% of covered deposit to 0.7%. On average, it would lead to a 12.7% cost reduction for the banking sector (contributions corresponding to the target level would decrease from EUR 55 bn to EUR 48 bn).

Scope of intervention

Like in a high-ambition model, it would be economically efficient to include all DGS interventions in the scope of EDIS.

This approach would provide the same incentives to integrate the IPSs within the European system of safety nets, while preserving their business model, as described above for a high-ambition model.

2.3.2. Focus on the remaining parameters

Features of the loans from the DIF and mandatory lending

The liquidity support would take the form of a loan from the DIF, including resources from paid-in means and/or those mobilised via the mandatory lending mechanism. Taking into account the discussions in the CWP, the best policy option would be to provide for high-level features of the loan, such as loans and interests, set out in a repayment plan to be agreed in advance between a national DGS and the SRB as the central authority. This approach would also be broadly in line with the feedback of members in the CWP where a higher number of members supported a maturity longer than five years as well as the interest rates. Nevertheless, also in line with this feedback, these rules would also require a specified degree of embedded flexibility to reflect the effect on financial stability on a case by case basis.

When setting the loan maturities, the main trade-offs involve an incentive for the beneficiary DGS to reimburse the loan within a short period and, thereby, ensuring a fast replenishment of the DIF (including the national DGSs involved in mandatory lending) balanced against the financial stability objectives in the beneficiary DGS' banking sector.

While a short maturity is susceptible to put a national DGS under pressure, a long maturity would limit the funding capacity of the DIF for years. Accordingly, the best option would be to set a maximum threshold of up to 6 years for the loans to a beneficiary DGS. This approach would be consistent with Article 10(2) DGSD on the replenishment of the available financial means to ensure a level playing field in the single

market.[588] Hence, the same replenishment rules should apply in the Member States within and outside the Banking Union.

The loans would be subject to interest rates. When determining the level of interest rates, the interest rates should compensate the opportunity cost of the DIF and the national DGSs as they have to lend to a beneficiary DGS instead of investing their funds in low-risk assets, while encouraging a fast repayment of the liquidity support. Consequently, the best option would be to set the interest rates at the ECB marginal lending facility rate[589], plus 1% for years 3 to 6.

In this respect, the discussions in the CWP highlighted the importance of avoiding any first mover advantage, i.e. where the first mover gains access to the central fund under better conditions than a second beneficiary DGS. For this reason, the same maturity and interest rates from loans coming from the DIF and from the mandatory lending component would appear the most suitable means to avoid any first mover advantage. The alternative option would be to subject the loans to different conditions, e.g. higher interest rates if they come from mandatory lending. This would imply that, depending on the actual funding capacity of the DIF, the second beneficiary DGS would have no choice than to request support from the DIF relying on mandatory lending of the hybrid EDIS.

Sequencing of the repayment

In line with the feedback received in the CWP, a specific sequencing mechanism would be appropriate to prioritise the replenishment of the loans provided by other DGSs over the loan from the paid-in means in the DIF. Accordingly, the beneficiary DGS would repay the liquidity support in instalments, to be specified in the repayment plan, to the DIF. The latter would repay first the other national DGSs involved in the mandatory lending and, second, would replenish the amount due to the DIF itself. Consequently, the loans from mandatory lending component is likely to be subject to a maturity shorter than six years. The national DGS would replenish their own funds as a last resort.

Replenishment by extraordinary contributions and alternative funding arrangements

Beneficiary DGSs would repay the liquidity support in line with the rules set out in Article 10(8) DGSD. According to this provision, in case the available financial means are insufficient, DGS members shall pay extraordinary contributions, and the *ex post* contributions should not exceed 0.5% of the covered deposits of DGS members per calendar year. Among the policy options discussed, extraordinary contributions would be raised either before requesting support from the hybrid EDIS or subsequently. The trade-off to consider would be between financial stability in the concerned banking sector *versus* the protection of the means of the DIF and incentive compatibility.

[588] Article 10(2) DGSD provides: "*If, after the target level has been reached for the first time, the available financial means have been reduced to less than two-thirds of the target level, the regular contribution shall be set at a level allowing the target level to be reached within six years*."

[589] Potentially with a floor at 0%.

In line with the feedback received, the best policy option would be to raise *ex post* contributions after receiving liquidity support in order to repay the loan. In this scenario, the DGS would receive fast liquidity support, facilitating the DGS' intervention and strengthening the confidence of depositors. Together with alternative funding arrangements under Article 10(9) DGSD, to be reinforced as proposed in Annex 6, extraordinary contributions may be seen as a reliable ultimate guarantee of reimbursement, contributing to build trust among the participants in the hybrid EDIS.

Governance

The discussions in the CWP on governance highlighted the importance of the alignment of liability and control. There was a general support for the SRB as a central authority administering EDIS. A number of members also acknowledged that, whilst dependent on the design of EDIS, the governance arrangements should not be overly complex to ensure effective decision-making. For several members, it would be important to envisage a role for national DGSs in the decision-making process and allow access to the national resources in the central fund (in the individual compartment) irrespective of the central authority's authorisation.

The low- and high-ambition models would each involve either a more decentralised or more centralised approach, subject to appropriate safeguards and in line with the principle of subsidiarity. A possible alternative middle-way option involving an equal split of resources at national and central level would require a more balanced approach between the two options conducive to a system of shared governance. All options should result in a balanced combination of a centralised, involving a participation by national authorities and where appropriate, national DGSs, and a decentralised approach, where national authorities take the lead under consultation mechanism involving the central authority.

Non-CRR entities and third country branches

In view of the importance of such non-CRR entities in a small number of banking markets, the non-CRR entities could be covered by EDIS because the liquidity support would be repaid in any case. Taking into account the feedback received, the best option to address the concerns regarding their supervision would be to provide for a transitional period during which the non-CRR entities could be repatriated under the CRD/CRR framework's provisions that have recently reinforced the embedded proportionality. Depending on the developments around the common authorisation requirements in the ongoing review of the CRD/CRR framework, the third country branches could be included in the scope of EDIS. Alternatively, they should be protected by national funds above the target level.

ONDs

The revised framework should provide incentives to finance as many ONDs as possible. Moreover, given any liquidity support provided would be entirely repaid, it would be sensible for the hybrid EDIS to finance at least the major ONDs. This would also be beneficial in terms of administrative burden for the DGS that would otherwise have been required to distinguish the OND-related claims, not eligible for EDIS coverage, from

other depositor claims. Moreover, this would also be in line with the rationale and analysis substantiating further harmonisation of several ONDs explained in the EBA opinions and in Annex 6.

During the last CWP discussion on the treatment of ONDs in the context of EDIS, the feedback received supported a creation of as harmonised system as possible to preserve level playing field. The majority of Member States considered that ONDs should be harmonised, where possible, and covered at least to a certain degree by EDIS. Some Member States nevertheless underlined the need for flexibility to preserve national specificities. Others mentioned their preference to keep the ONDs in the current form and cover them by national DGS only, possibly with funds above the target level. Others were willing to consider eliminating some of the ONDs.

The following table provides an overview of ONDs, based on the findings of the CEPS study as concerns their estimated impact in terms of either covered deposits or available financial means and the number of Member States in which each OND was transposed. The ONDs were distinguished according to their impact which is either financial for the DGS, with effects on depositor confidence, or other impact that would represent a higher exposure for EDIS.

Table 38: Other ONDs and the corresponding provision under the DGSD (*[590])

		Proposed for further harmonisation	Covered by EDIS	Impact*	Rele-vance*
	1. ONDs THAT MAY HAVE AN UPWARD FINANCIAL IMPACT ON EDIS (I.E. THEY IMPACT THE AMOUNT, AND THUS THE RISK PROFILE OF NATIONAL DGS/EDIS) AND POSSIBLE IMPACT ON DEPOSITOR CONFIDENCE AND/OR THE LEVEL PLAYING FIELD				
	Coverage level and payout procedure				
1.	Coverage of Pension Schemes (Article 5(2)a)	No	No	Up to 1.4%	4
2.	Deposits held by small local authorities (Article 5(2)b)	Yes (to be removed)**	It is proposed to cover public authorities	Up to 0.1%	6
3.	Temporary high balances relating to certain transactions (Article 6(2))	Yes**	Yes	Up to 10%	27
4.	Old-age provision products and pensions (Article 6(3))	No	No	Up to 22%	2
	Contributions and available financial means				
5.	Payment commitments	Yes**	Yes	Up to 63%	24
6.	Participations by branches from outside the EU (Article 15(1) 2nd subpara)	Yes**	Yes	n/a	27
7.	Lower contributions for members of IPSs (Article 13(1) 3rd subpara)	Yes	Yes	(to be addressed in risk-based contributions)	5
8.	Lower contributions for low-risk sectors (Article 13(1) 2nd subpara)	Yes (to be removed)	No	not used in practice	4
	2. ONDs THAT MAY HAVE AN IMPACT ON THE DEPOSITOR CONFIDENCE AND/OR THE LEVEL PLAYING FIELD BUT NO UPWARD FINANCIAL IMPACT ON EDIS				

[590] The impact of each OND is measured either in terms of covered deposits or, in the case of payment commitments, in terms of available financial means. The relevance sets out the number of Member States that transposed the respective ONDs.

	Coverage level and payout procedure				
9.	Treated as single depositor (Article 7(2))	No	Yes	Up to 9%	13
10.	Set-off of depositor liabilities (Article 7(5))	Yes (to be removed)**	No	Up to 5.9%	17
11.	Longer repayment period for certain deposits (Article 8(3))	Yes**	No impact	Up to 2%	21
12.	Deadline on validity of repayment claims (Article 9(3))	Yes**	No impact	Up to 0.2%	20
	Contributions				
13.	Minimum contribution (Article 13(1) 5th subpara DGSD)	Yes	Yes	(to be addressed in risk-based contributions)	8
	3. ONDs THAT DO NOT HAVE ANY IMPACT ON EDIS				
	Coverage level and payout procedure				
14.	Exclusion of deposits to pay off a loan on private immovable property (Article 5(3))	No	No	Up to 22%	3
15.	Exclusion of deposits fulfilling a social purpose (Article 7(8))	No	No	Up to 25%	1
	Contributions and available financial means				
16.	Contribution to existing mandatory schemes (Article 10(4))	Yes (to be removed)	No	n/a	0
17.	Voluntary lending between DGSs (Article 12(1))	No	No	n/a	14
18.	Use of a uniform risk-weight affiliates of central bodies (Article 13(1) 4th subpara)	No	No impact[591]	n/a	6

** *See Annex 6*

The above table indicates the ONDs for which further harmonisation would be proposed, as set out in Annex 6, so that they can be covered by the DIF (at least to a certain extent). For example, the temporary high balances are one of the options that could have an upward financial impact on EDIS, although they appear to be rare. In line with EBA's recommendations, the option would be harmonised by setting a minimum harmonised threshold. Consequently, while some Member States would be required to increase the current threshold, others that already have a higher threshold would be entitled to retain it. While the latter would benefit from a guaranteed coverage by EDIS of up to EUR 500 000, they would be required to cover any amount in excess of the minimum harmonised threshold from the funds above the target level. Under a high-ambition model envisaging a lower target level than the current 0.8%, this approach would be cost-neutral. The same would apply to the alternative middle-way option. Under a low-ambition model, the limited risk that a DGS would cover a portion of such temporary high balances from national funds above the target level would mitigate the impact on cost neutrality because the increased coverage level should cover the majority of estimated temporary high balances.

Conversely, ONDs, for which no harmonisation is proposed, would not be eligible for liquidity support from EDIS and would remain covered by national funds above the target level (still cost neutral as the result of the reduced target level under a high-ambition model and a possible middle-way option). This approach appears as the most

[591] The amount of contributions would be re-distributed among the different entities within the same group, without affecting the total amount of contributions to be paid to EDIS.

suitable because these ONDs are applicable in very few Member States (some outside the Banking Union). Other ONDs would not have impact in terms of coverage by EDIS and could be retained in the current form or subject to more harmonisation when reflected in the risk-based contributions[592].

2.3.3. Implications of the scope on the uses of DGS and hybrid EDIS funds

The financing of resolution measures could have positive implications for the resources available in the DGS and in the hybrid EDIS. As explained above in the case of ONDs and compared to the status quo, there could be elements under the revised rules that could create upward or downward pressure on amount of funds used by the network of DGSs and the hybrid EDIS. Nevertheless, the net impact is impossible to assess accurately, given a number of variables.

On the one hand, whilst not altering the depositor protection up to EUR 100 000, the change to the creditor hierarchy would significantly affect the outcomes of the least cost test, increasing the frequency of DGS uses due to higher financial cap for any DGS intervention. In the calculation of the revised least cost test, the likelihood of DGS' ultimate losses in case of payout would be higher compared to the current preferential ranking of covered depositors.[593]

On the other hand, facilitating the use of other measures like transfer strategies, whether in resolution[594] or in insolvency, would be more efficient. It would lower the costs for the DGS and hybrid EDIS and better preserve its funding capacities. It would also release the pressure on emergency of replenishment and reduce pro-cyclicality. Moreover, this positive effect would be reinforced by the pooling of resources, also incrementally increasing the effectiveness and efficiency of the hybrid EDIS compared to the status quo. The rationale of the advantages of DGS interventions alternative to depositor payouts is explained in **Error! Reference source not found.**

Box 22: Rationale for the broad scope of interventions by DGS and EDIS

Considerations concerning the cost of payout versus cost of other DGS interventions

The cost of DGS interventions includes two dimensions: i) the immediate disbursement need and ii) the potential ultimate loss.

In terms of immediate disbursement need, payout is very expensive, as the DGS has to immediately pay the whole amount of covered deposits to depositors and wait for recovery of its disbursement during lengthy insolvency proceedings.[595] Consequently, a payout could deplete the financial means of the DGS for years, or lead to replenishments contributions by banks potentially putting a strong financial pressure on the banking sector.

[592] This is the case of OND 9 and 15. See also section **Error! Reference source not found.**.

[593] The change in the creditor hierarchy would increase the likelihood of DGS losses in case of failure.

[594] Mostly in resolution due to the proposed changes to the PIA.

[595] See the EBA opinion on DGS funds, p. 23-24. Some Member States reported on payouts cases prior to 2015 where the insolvency proceedings was not yet completed. Some insolvency proceeding may take around 10 years, e.g. decision regarding DSB Bank N.V. in the Netherlands (also here).

In the long term, the final loss for the DGS would depend on the recovery rate. If the latter is high, the ultimate loss would be relatively low and consequently impose a lower net burden on the DGS. The recovery rates in insolvency are driven not only by the ranking of the covered deposits in the creditor hierarchy, but also the quality of assets of the failed bank, the national insolvency laws and the efficiency of insolvency proceedings.[596]

For DGS interventions other than payout, the costs and the immediate disbursement need for the DGS are dependent on the tools that are used. Some tools can be highly cash efficient, such as guarantees, in the sense that they preserve the DGS funding capacity. Other tools could strongly limit the potential final loss but be more cash consuming, such as loans. All tools entail a certain degree of uncertainty: a loan involves a credit risk, a guarantee may or may not be called, and a capital injection may be paid back but with a strong uncertainty as regards the selling price. Another variable that could lower the cost is the presence of a buyer.

The transactions, similar to so-called purchase & assumptions agreements predominantly used in the United States, are likely to be more efficient for the DGS than a payout. Indeed, the transfer of the (whole or partial) business would preserve the franchise value to a greater extent than under a piecemeal liquidation approach. It would avoid the destruction of the business brand and/or ensure preserving the commercial relationships of the exiting bank with the clients. Consequently, this approach would strive to maintain or improve the profitability of and the return on the assets, and thereby minimising the cost for the DGS.

Lastly, the least cost assessment would limit the cost of this type of DGS interventions (in insolvency and in resolution) compared to the cost of the payout. In that sense, developing the role of other DGSs interventions in the CMDI is efficient for the DGS (lowering the immediate replenishment needs) and for the economy in general (with a lower destruction of value).

Use of DGS funds in the revised CMDI

Currently, a DGS is unlikely to finance other measures than payout subject to the least cost test based on the preferential ranking of covered deposits (see section 4.1.1 in Annex 7). Changes appear necessary to make such a least cost test more realistic and there are clear trade-offs to be made.

The change in the creditor hierarchy would facilitate the uses of more efficient tools that preserve the liquidity of the DGS and/or EDIS and, consequently, also the financial stability. Moreover, this approach exploring more efficient tools than payout would bring about a number of positive effects on the depositor confidence:
In payout events, depositors must be reimbursed within 7 days. However, interrupted access to accounts, social benefits and credit facilities for even a short period in prevalently cashless societies, using or operating with credit and debit cards and electronic systems, could impact the overall economy. Conversely, under other DGS interventions, the depositor access to deposits would be unimpaired.
Changing the creditor hierarchy would increase the protection of a wider scope of

[596] See the EBA opinion on DGS funds, p. 23-24. The empirical evidence suggests that the recovery rates can be very different, ranging from 1% to 100%.

depositors by creating an environment where their deposits and commercial relationship are transferred to another bank. Consequently, this would minimise the occurrence of depositor payouts and the likelihood of DGS' subrogation into depositor claims under 'less preferential' creditor hierarchy.

Therefore, the revised framework should improve the incentives for alternatives to depositor payout, via a more realistic least cost test. Depositor payout would constitute a fallout option in case there is no potential buyer for a viable part of the bank. Last but not the least, in many cases, the counterfactual of the extensive use of DGS is ultimately the need for taxpayer money to cover the shortfall, which is more likely in the case of payouts (high cost in the short term).

2.3.4. Build-up of the DIF and contributions

Once the funding of all national DGSs has at least reached a pre-defined target level, the DIF managed by the SRB could be built up by raising subsequent bank contributions or by transferring already collected contributions from national DGSs. All national DGSs are underway to reach the target level of 0.8% of covered deposits by 2024 and most of them have already reached it.[597]

Consequently, the policy option retained in the 2015 proposal to build up the DIF directly from banks' contributions calculated at the Banking Union level would not be appropriate as it would impose an additional cost on the industry. Among the policy options discussed, the paid-in resources transferred to the DIF could either be deposited in individual compartments or be mutualised in one fund. Alternatively, the share of funds remaining in the national DGSs to be mobilised for mandatory lending could be placed in such compartments next to the DIF (one compartment per Member State) facilitating its operationalisation.[598]

In line with the feedback received, the DIF would be built-up with a one-off transfer of a share of the target level collected at national level already based on a percentage calculated according to risk-based methodology to be agreed in a delegated act[599]. This methodology would also determine the approach to some OND related to risk-bank contributions to ensure level playing field. The latter option would be sensible under a low-ambition model. In view of the higher target levels of the DIF envisaged under a high-ambition model (and a possible middle-way option), the best option would be to build up the DIF following a gradual funding path.

Risk-based contributions

[597] See also Annex 5 (evaluation).

[598] This option was supported by many members noting the lesser complexity who noted that it is administratively less complex and more likely to ensure a timely support from the DIF. Some members expressed their preference to leave the funds in the national DGSs emphasising the importance of the funds being under direct national control. A few members proposed an alternative option where the central fund would be entirely composed of individual compartments, departing from the hybrid model (see European Council (2 June 2021), *Portuguese Presidency Progress Report on strengthening the Banking Union*, p. 6).

[599] For instance, under a low ambition hybrid EDIS, in order to transfer, in total, 75% of the DGS funds to the DIF, some DGSs would transfer 74% and others 76%.

Under the status quo, each DGS has to reach a target level of 0.8% of covered deposits and the contributions take into account the amount of covered deposits and the degree of risk incurred by each credit institution relative to all other credit institutions affiliated to the same participating DGS.

Under both options, it would be crucial to maintain a risk-based approach to maintain the DGS target level and to build up the DIF. The risk-based method is an important incentive for banks to reduce their risks and also contribute to build a fair deposit insurance scheme where the more risky banks pay higher contributions than the others. The impact of the different designs on the level of contributions would be twofold.

First, the pooling of funds would create synergies that could be exploited to reduce the costs for the banking sectors in the Banking Union. Consequently, the target level would be reduced under more ambitious models susceptible to lower the level of contributions for the banking sectors (for simplification referred to as "**national reference measure**"). Conversely, a low-ambition model would maintain the target level at 0.8% of covered deposits because of limited synergies.

Second, in line with the feedback received, the build-up of the DIF would imply a calculation of contributions based on the amount of covered deposits and the degree of risk of each credit institution relative to all other credit institutions covered by EDIS (referred to as "**Banking Union reference measure**"). Accordingly, in the EDIS, the contributions would be calculated based on the Banking Union reference measures for the share of the funds transferred to the DIF, while the contributions to the national DGSs would continue using a national reference measure. The other policy options discussed were that the contributions to the DIF could be built up using the national reference measures in the reinsurance phase, implying liquidity support only, or a hybrid one, based on both a national and a Banking Union reference.

An ambitious model would imply a redistribution effect due to changes in the basis for calculating a certain portion of the contributions. This would mean that, compared to the status quo, some banks would pay more and others less. Such redistribution effect would be more material for higher ambitious models because of the higher share of funds in the DIF, and, by contrast, would be limited under a low-ambition model, envisaging a lower share of funds in the DIF.

Table 39 sets out the anonymised level of contributions per each Member State, calculated based on a database collected from Member States with data as of end 2018. 100 represents the current level of contributions, calculated at the national level, with a 0.8% target level. The impacts of reducing the target level and calculating part of the contributions at Banking Union level are presented for the various designs of hybrid EDIS. The methodology for calculating the contributions follows the indicators in the EBA guidelines[600].

[600] EBA Guidelines on methods for calculating contributions to deposit guarantee schemes.

Table 39: Impact of the redistribution effect and reduced target level[601]

	100 represents the funds corresponding to 0.8% of covered deposits	Low ambition hybrid EDIS EUR 55 bn allocated in: (i) DGSs: EUR 41 bn (0.6% covered deposits). (ii) DIF: EUR 14 bn (0.2% covered deposits).			Medium ambition hybrid EDIS EUR 48 bn allocated in: (i) DGSs: EUR 24 bn (0.35% covered deposits). (ii) DIF: EUR 24 bn (0.35% covered deposits).			High ambition hybrid EDIS EUR 41 bn allocated: (i) DGSs: EUR 10 bn (0.2% covered deposits). (ii) DIF: EUR 31 bn (0.4% covered deposits).		
		contributions calculated at national level	contributions calculated at Banking Union level	total contributions	contributions calculated at national level	contributions calculated at Banking Union level	total contributions	contributions calculated at national level	contributions calculated at Banking Union level	total contributions
MS1	100	*75*	*22*	**97**	*44*	*39*	**83**	*25*	*45*	**70**
MS2	100	*75*	*23*	**98**	*44*	*40*	**83**	*25*	*45*	**70**
MS3	100	*75*	*23*	**98**	*44*	*40*	**84**	*25*	*46*	**71**
MS4	100	*75*	*24*	**99**	*44*	*41*	**85**	*25*	*47*	**72**
MS5	100	*75*	*24*	**99**	*44*	*41*	**85**	*25*	*47*	**72**
MS6	100	*75*	*24*	**99**	*44*	*42*	**86**	*25*	*48*	**73**
MS7	100	*75*	*24*	**99**	*44*	*42*	**86**	*25*	*48*	**73**
MS8	100	*75*	*24*	**99**	*44*	*43*	**86**	*25*	*49*	**74**
MS9	100	*75*	*25*	**100**	*44*	*43*	**87**	*25*	*49*	**74**
MS10	100	*75*	*25*	**100**	*44*	*43*	**87**	*25*	*50*	**75**
MS11	100	*75*	*25*	**100**	*44*	*44*	**87**	*25*	*50*	**75**
MS12	100	*75*	*25*	**100**	*44*	*44*	**88**	*25*	*51*	**76**
MS13	100	*75*	*25*	**100**	*44*	*44*	**88**	*25*	*51*	**76**
MS14	100	*75*	*26*	**101**	*44*	*45*	**89**	*25*	*52*	**77**
MS15	100	*75*	*26*	**101**	*44*	*45*	**89**	*25*	*52*	**77**
MS16	100	*75*	*26*	**101**	*44*	*46*	**89**	*25*	*52*	**77**
MS17	100	*75*	*26*	**101**	*44*	*46*	**90**	*25*	*52*	**77**
MS18	100	*75*	*26*	**101**	*44*	*46*	**90**	*25*	*53*	**78**
MS19	100	*75*	*27*	**102**	*44*	*47*	**90**	*25*	*53*	**78**
MS20	100	*75*	*27*	**102**	*44*	*48*	**91**	*25*	*54*	**79**
MS21	100	*75*	*32*	**107**	*44*	*55*	**99**	*25*	*63*	**0**

*Sou*rce: European Commission services estimations based on JRC quantitative analysis (see JRC report on EDIS risk-based contributions, Annex 12)

This table shows that, under the medium- and high-ambition models, for all banking sectors, the combined impact of the redistribution effect and the reduced target level would lead to lower the contributions compared to the status quo[602].

Under a low-ambition model, as there is no target level reduction, the redistribution effect would lead to higher contributions for 10 national banking sectors and lower contributions for 11 banking sectors. The impacts on the contributions would range from a reduction of contributions of 3% to an increase of 7%.

2.4. Transition towards loss coverage and review clause

The 2015 proposal introduced a loss coverage since the start. The latter turned out to be the most contentious element, advocated by some and opposed by others. The position of certain Member States on the introduction of loss sharing was contingent on further risk reductions in the banks' balance sheets, sometimes including amendments concerning the capital requirement on sovereign exposures.

Box 23 illustrates that hybrid EDIS would provide sufficient flexibility for a gradual introduction of loss sharing. In view of the difficult political compromise on the steady-state, the best policy option would be to start with a hybrid EDIS focusing only on liquidity support as the reduction of risks in the banking sectors continues with the view

[601] This table is based on the JRC's report included in Annex 12, p. 60.

[602] Under a high ambition hybrid EDIS, the national banking sectors would pay from 30% to 12% less compared to the status quo. For comparison, under the middle way option, the cost reduction would range from -17% to -1%.

to prepare the ground for loss coverage. During the liquidity support phase, only the member institutions of the beneficiary DGS would pay contributions to replenish the DIF. In order to maintain this ambition in the steady state, a review clause would be inserted to re-engage the discussions around the path towards EDIS with a loss-sharing component.

Ultimately, the benefits of a fully-fledged EDIS, with loss coverage, would imply a harmonised level of depositor protection for all depositors in the Banking Union, regardless of the geographical location of the bank, with the view to enhance financial stability and break the bank-sovereign nexus. The element of loss sharing would make the third pillar of the Banking Union more robust as all the banks in the Banking Union would contribute to the replenishment of the DIF, ensuring a faster replenishment capacity. Similarly, sharing the losses at the Banking Union level would lower the financial strain on one single national banking sector, significantly mitigating adverse effects on financial stability and weakening of the sovereign-banks nexus. Lastly, the introduction of loss sharing would have positive benefits for the market integration in the Banking Union.

There is a clear trade-off to be made between the policy options of a fully-fledged EDIS inherent in the 2015 proposal, subject to political stalemate and contingent on additional conditionality to be agreed at political level, and the roll out of liquidity support that could be achieved in the shorter term. According to this trade-off, the hybrid EDIS would be suboptimal compared to a fully-fledged EDIS (e.g. implying a slower replenishment, taking into account the financial strain on the beneficiary DGS, constituting partial safeguards for host Member States). However, in the absence of political agreement on a fully-fledged EDIS, the liquidity support would better address the financial stability objectives to avoid liquidity shortfalls when dealing with bank failures. Therefore, the hybrid EDIS would constitute a significant improvement of the status quo.

Box 23: Considerations on the transition to the steady state[603]

From a long-term perspective, the introduction of loss coverage would entail significant changes for the parameters of the hybrid EDIS. Going forward, the following policy options would require further analysis and discussion:

- The introduction of the loss-sharing component could be progressive towards the steady state according to a specified transition timeline from the liquidity phase to the steady state. In the steady state, the funds of the national DGSs could be progressively transferred to the DIF. Alternatively, a certain share of funds could remain at national level to mitigate moral hazard and potentially finance residual national options and discretions. Under both options, the national DGS would carry out their roles in the crisis management and handling of depositor claims.
- The concept of loss sharing could be subject to different definitions. Under one definition, both the national DGS and the DIF would share a certain percentage of the losses with respect to each intervention. Under a second definition, the national DGSs would be required to exhaust their funds before the DIF would intervene, taking a share of losses.
- Further analysis will be required on the interaction between the loss coverage and other parameters of the hybrid EDIS, such as the allocation of the funds between the national and the DIF levels. The build-up of the loss-sharing component would require on a significant size of the DIF. For example, under a low ambition EDIS, the DIF would be too limited and would not be able to support a significant share of the losses, rendering the loss-sharing component rather artificial. Consequently, progressing from such a scenario to loss sharing would require a significant increase in the size of the DIF.

[603] See European Council (2 June 2021), *Portuguese Presidency Progress Report on strengthening the Banking Union*.

ANNEX 11: EBA RESPONSE TO THE CALL FOR ADVICE

We refer to the Call for Advice report by the EBA entitled "Call for advice regarding funding in resolution and insolvency – part of the review of the crisis management and deposit insurance framework" and published on 22 October 2021[604]. With this report, and at the request of Commission services, the EBA provides targeted technical advice to assess the reported difficulty for some small and medium-sized banks to issue sufficient loss absorbing financial instruments, to examine the current requirements to access available sources of funding in the current framework, including in view of the funding structure of the above mentioned banks, and to assess the quantitative impacts of various possible policy options, as specified by the Commission services, in the area of funding in resolution and insolvency and their effectiveness in achieving the policy objectives.

Summary

The EBA response to the Call for Advice provides a quantitative analysis on banks' capacity to access available sources of funding under the current framework and under various creditor hierarchies, and with regards to the minimum requirement for own funds and eligible liabilities (MREL).

The EBA response provides a descriptive analysis on banks' capacity to access resolution financing arrangements based on banks' balance sheets and their business models, as well as an analysis based on a modelling approach to simulate crisis scenarios.

The descriptive analysis shows the change to banks' internal loss-absorption capacity under four scenarios of depositor preferences compared to the current creditor hierarchy applicable in each Member State. The analysis, whose findings are presented under several different capital depletion scenarios, draws two main conclusions: (i) preferring deposits to other ordinary unsecured claims increases the number of banks that are able to meet the requirements to access resolution financing arrangements without the bail-in of any type of depositors and (ii) a single-tier depositor preference (i.e. all types of depositors rank *pari passu*) comes with the highest impact on covered deposits and the highest contributions from deposit guarantee schemes compared to the other policy options and the current situation. The modelling approach, which simulates an economic scenario similar to the global financial crisis confirms the findings.

In a third part, the report also investigates the issue of market access for MREL instruments for small and medium-sized banks to. A limited number of these institutions had not yet issued senior MREL eligible instrument or AT1 and Tier 2 instruments as of end-2019.

[604] EBA (22 October 2021), *Call for advice regarding funding in resolution and insolvency*.

ANNEX 12: ANALYTICAL WORK BY THE JOINT RESEARCH CENTRE

We refer to the Joint Research Centre technical report entitled 'Quantitative analysis on selected deposits insurance issues for purposes of the impact assessment' (JRC132364, available on the EU Science Hub). In this report, and at the request of Commission services, the Joint Research Centre assessed (i) temporary high balances and the impact of harmonising them, (ii) the effectiveness and the pooling effect of a central deposit insurance scheme, and (iii) different approaches to risk-based contributions to EDIS.

Review of temporary high balances

The report assesses the financial impact of harmonising the coverage of temporary high balances under Article 6(2) of the DGSD. Building on past exercises, the report quantifies the size of deposits generated from real estate transactions and insurance pay-outs linked to life events and criminal injuries protected under the DGSD. It assesses the cost for the DGS and banks when providing extra protection to these deposits. The analysis also introduces a novel angle to the problem. It looks at the impact on the wealth of households involved in real estate transaction absent the DGS protection. This double perspective on costs and benefits enables a better understanding of the implication of different policy options.

Measuring the effectiveness and the pooling effect of EDIS

The report addresses how DGS pay-out capacity would change if the current national DGS system is replaced or complemented by EDIS and whether synergies arise from pooling effects in the contributions. The analysis is based on the SYMBOL model, which simulates bank failures and the corresponding multiple pay-outs hitting the Deposits Guarantee Schemes and the common fund.

The report finds that EDIS is more effective than the status quo. A system with common financial means is able to protect a higher amount of covered deposits than under the status quo. The more resources are mutualised, the more effective the system is. All variant of EDIS considered in the analysis significantly reduce the likelihood and the size of liquidity shortfall even under a systemic event. In addition, the pooling of resources increases the probability of full protection of the covered deposits without liquidity shortfall and delivers a higher efficiency for various EDIS designs creating room for lowering the target level and consequently the cost for the baking sector.

Different approaches to risk-based contributions to EDIS

The technical framework for determining these contributions is based upon EBA guidelines on methods for calculating contributions to deposits guarantee schemes. EBA developed such guidelines pursuant to Article 13(3) of the Directive 2014/49/EU of the European Parliament and of the Council and they set alternative methodologies and risk indicators to compute risk-based contributions.

Starting from this report, the JRC developed and tested alternative scoring methods and presents the results of this analysis in the present report.

ANNEX 13: OTHER QUANTITATIVE ANALYSES

1. OBJECTIVE AND SCOPE

The objective of this Annex is to provide detailed quantitative information to support the assessment of the policy options set out in Chapters 5, 6 and 7 as well as certain aspects of the evaluation (Annex 5). In terms of scope, this Annex covers:

- An overview of the methodology
- An overview of the application of the public interest assessment (PIA)
- An overview of the operationalisation of transfer strategies
- An overview of issues regarding MREL requirements
- Caveats and disclaimers
- Other methodological considerations

2. OVERVIEW OF THE METHODOLOGY

Data sources and references

Each area of analysis outlined in section 1 builds on the data provided by the SRB and the data used in the EBA response to the Call for Advice report collected by the EBA directly from resolution authorities. ***Table 40*** provides a mapping of the data sources used in this Annex:

Table 40: Mapping data sources and references

Section #	Data sources and references
Application of the PIA	- EBA CfA report[605] - SRB data
Transfer strategies	- EBA quantitative MREL report as of 31 December 2019 of June 2021[606] and as of 31 December 2020 of April 2022[607]
MREL - *MREL build-up* - *Issuances of own funds and eligible liabilities* - *Holdings of own funds and eligible liabilities*	- SRB MREL Dashboards[608] and Annual Reports[609] - European Commission, ECB and SRB joint Risk Reduction Monitoring Reports of November 2020[610], May 2021[611] and November 2021[612] - EBA quantitative MREL reports as of 31 December 2019 of June 2021, as of 31 December 2020 of April 2022 and as of 31 December 2021 of January 2023[613]

[605] EBA (October 2021), *Call for advice regarding funding in resolution and insolvency*
[606] EBA (June 2021), *EBA Quantitative MREL report*, as of 31 December 2019.
[607] EBA (April 2022), *EBA Quantitative MREL report*, as of 31 December 2020.
[608] SRB (Q2 2020 to Q3 2022), *MREL Dashboards.*
[609] SRB (2015 – 2020), *SRB Annual reports*.
[610] European Commission, ECB, SRB (November 2020), *Monitoring report on risk reduction indicators*.
[611] European Commission, ECB, SRB (May 2021), *Monitoring report on risk reduction indicators.*
[612] European Commission, ECB, SRB (November 2021), *Monitoring report on risk reduction indicators.*
[613] EBA (January 2023), *EBA MREL quantitative monitoring report and impact assessment*

Section #	Data sources and references
	- ECB data on MREL holdings - S&P data

Detailed information on methodological assumptions is available in each section where these analyses are presented.

3. PUBLIC INTEREST ASSESSMENT

The objective of this section is to present descriptive statistics related to the outcome of the implementation of the PIA for resolution planning purposes to date[614]. The information is based on the application of the PIA under the existing rules (baseline). This section does not estimate the extension of the PIA application under the packages of options described in Chapter 6 for the reasons described in that chapter (i.e. retained discretion by authorities, PIA decision at planning phase is a presumptive path which could change at the moment of failure in function of concrete case by case circumstances).

Table 41 provides an overview, per size classification and per funding structure, taking into account the prevalence of deposits in the banks' liabilities[615], of the implementation of the PIA.

Based on data referred to in the EBA CfA report and SRB input, at the level of the EU, 90% of the large banks, including all G-SIIs and a majority of O-SIIs have a positive PIA, leading the vast majority of the systemically important banks to have resolution as presumptive path in case of failure.

The outcome of the assessment changes significantly depending on the size classification, in particular when the size of the institution decreases. In particular, while few of the largest institutions have a negative PIA, the share of institutions with a positive PIA decreases to 70% for medium-sized institutions across the EU, and down to 29% for small and non-complex institutions. In total, 187 banks out of 368 (51%) in the sample are earmarked for resolution. The proportion is similar in the Banking Union[616] (49%).

When considering the funding structure, banks with a high prevalence of deposits (i.e. proportion of deposits over 80% of TLOF) tend to be more often earmarked for liquidation (only 39% of cases with a positive PIA). However, the lower levels of prevalence of deposits do not have a material effect on the distribution between negative and positive PIA, as the proportion of banks earmarked for resolution is generally stable between 57% and 62%.

[614] Irrespective of the resolution authorities' decision regarding the PIA when an institution is at the moment of failure or likely to fail (Article 32 BRRD).
[615] In accordance with the methodology used in the EBA CfA Report.
[616] Considering all banks in the Banking Union (significant and less significant institutions).

Table 41: Outcome of the implementation of the PIA in the EU

	N.	Institutions with positive PIA	
		Count	*%*
Small	195	56	29%
Medium	124	87	70%
Large	49	44	90%
Low	107	63	59%
Mid	44	25	57%
Mid-High	63	39	62%
High	154	60	39%
Total	*368*	187	51%

Source: Commission services, based on EBA CfA report and SRB data, as of Q4 2019

4. OPERATIONALISATION OF TRANSFER STRATEGIES

In case of positive PIA, the choice of the resolution strategy and the appropriate resolution tools relies on resolution authorities' judgement and discretion. In particular, relying on the use of a transfer tool (e.g. sale of business, bridge institution or asset separation) depends on several factors aimed at supporting the feasibility and credibility of a full or partial transfer of activities to a third party in resolution. So far, evidence shows that transfer strategies have been mostly used for small or mid-sized institutions, for which the transferability is seen as more achievable compared to other, larger groups.

According to the EBA 2023 quantitative report on MREL, as of December 2021, approximately 81% of EU-27 banks' domestic assets were covered by a strategy other than liquidation: 77.3% of assets were covered by a bail-in strategy and 3.5% by a strategy relying on the use of a transfer tool. Bail-in strategies continue to be the first-choice approach for the largest banks, with a total of 144 MREL decisions covering EUR 23.5 tn in assets. Instead, the use of transfer tools is the preferred strategy for 146 banks representing approximately EUR 1.1 tn in assets, covering mostly resolution groups or stand-alone resolution entities that are relatively limited in size, with only six of them classified as O-SIIs and 140 of them classified as other (non-systemic) banks.

Table 42: Overview of resolution strategies (based on MREL decisions, as of December 2021)[617]

Resolution strategy	Total assets (EUR bn)	% of assets	Number of decisions	% of decisions
Bail-in	23 537	95%	144	43%
Transfer	1 051	5%	146	43%

Source: EBA quantitative MREL report 2021.

[617] In addition, 47 decisions – not included in this table – have been taken for banks subject to liquidation, for which MREL has been set above own funds requirements in accordance with the BRRD.

Due to a lack of available and accurate information on the precise resolution strategy, a more detailed break-down based on the sample of banks used in the EBA CfA report was not possible.

5. MREL

5.1. MREL build-up

Overview of compliance with external MREL requirements

According to the EBA 2023 MREL quantitative report[618] which analysed MREL compliance for a sample of 245 EU resolution groups and individual resolution entities as of Q4 2021, the average MREL target (weighted by TREA) was 22.6% TREA, with a combined buffer requirement of 3.3% of TREA. Subordination requirements, including CBR, were set at a level of 18.5% TREA. Out of the total sample of 245 banks subject to an external MREL, subordination requirements have been set for 169 resolution groups.

As of Q4 2021, 70 resolution groups had an MREL shortfall estimated at EUR 33 bn, down from EUR 67.6 bn for 110 resolution groups as of Q4 2020 and 102 bn for 111 resolution groups as of Q4 2019. The reduction in shortfalls should be considered against strong issuance levels over the period.

- G-SIIs: The average MREL target for G-SIIs was 22.9% TREA, including a subordination requirement of 17.6% TREA. On top of this requirement comes the combined buffer requirement of 3.6% on a weighted average basis to be met with CET1. The aggregate MREL shortfalls for G-SIIs declined most significantly between Q4 2019 and Q4 2020, from EUR 19 bn to EUR 3.8 bn attributable to one G-SII. As of Q4 2021, all G-SIIs comply with their end-state MREL targets.
- O-SIIs: The average MREL target for O-SIIs was 22.8% TREA, plus an average combined buffer requirement of 3.1% TREA. The average MREL requirement are broadly similar across O-SIIs irrespective of their size. MREL shortfalls for O-SIIs also declined from EUR 64 bn as of Q4 2019 to EUR 46.9 bn as of Q4 2020, attributable to 45 banks, further down to EUR 14.4 bn as of Q4 2021, attributable to 34 banks. The level of MREL eligible resources was higher for larger O-SIIs, particularly top-tier O-SIIs, than for smaller banks. Apart from the overall level, there was a high divergence in the distribution of eligible resources. While larger O-SIIs exhibit a lower level of common equity Tier 1 compared to smaller banks, they hold a higher level of senior non-preferred instruments, which was scarcer in the group of O-SIIs with assets lower than EUR 50 bn. Contrary to previous periods, smaller O-SIIs held subordinated debt as of Q4 2021.
- Other banks: The average MREL target for other banks was 20.8% TREA for banks not considered as G-SII nor O-SII, supplemented by an average combined buffer requirement of 2.5% TREA. Compared to systemic entities, other banks were set a lower MREL as a percentage of TREA, reflecting the prevalence of transfer strategies for which adjustment to MREL calibration are introduced by

[618] EBA (January 2023), *EBA MREL quantitative monitoring report and impact assessment*, as of 31 December 2021.

resolution authorities. The aggregate MREL shortfalls for other banks reach 18.6 bn, attributable to 36 banks, down by 27% compared to end 2020 on a comparable basis. Compared to systemic institutions, other banks held a higher level of common equity Tier 1 capital and senior liabilities. On the contrary, they exhibited lower levels of additional Tier 1 instruments, Tier 2 capital and senior non-preferred debt.

In terms of resources, the EBA MREL quantitative reports provide an overview of the structure of the MREL resources for G-SIIs, O-SIIs and other banks, highlighting the relative importance of AT1, Tier 2 and senior non-preferred liabilities across various size groups, more prone to be part of the funding mix of larger institutions than small and mid-size banks, even when qualified as O-SIIs in their jurisdiction.

This is also reflected in the composition of the liability structure of the resolution entities included in the EBA CfA report. As highlighted in ***Table 43***, issuances of senior non-preferred liabilities, senior unsecured liabilities, but also AT1 and Tier 2 instruments are relatively more important for larger institutions. In addition, the issuances of certain subordinated liabilities is concentrated in some Member States: no senior non-preferred liabilities are present for resolution entities in 12 Member States, other subordinated liabilities are either not present or in very limited amount in five Member States, but with large shares in three other Member States (DE 1.28% TLOF, HR 1.12% or AT 0.95%), senior unsecured liabilities represent on average more than 24% of TLOF in four Member States (FI, FR, NL and SE), against less than 5% TLOF in 17 other Member States.

Table 43: Composition of liability structure (resolution entities, % TLOF)

	Small	Medium	Large	Resolution	Liquidation
Subordinated liabilities	0.1%	1.1%	0.3%	0.4%	1.3%
Senior non-preferred liabilities	0.0%	1.8%	3.2%	2.9%	2.7%
Senior unsecured liabilities	2.7%	5.4%	13.4%	10.7%	22.4%
Own funds	13.2%	7.9%	8.3%	8.4%	8.1%
- Tier 2	*0.6%*	*1.0%*	*1.5%*	*1.4%*	*0.9%*
- AT1	*0.2%*	*0.3%*	*0.8%*	*0.7%*	*0.2%*
- CET1	*12.4%*	*6.6%*	*6.1%*	*6.3%*	*6.9%*
Other liabilities	84.0%	83.8%	74.8%	77.6%	65.5%
Total	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Commission services, based on EBA CfA report, data as of Q4 2019.

In the Banking Union, as per SRB's MREL Dashboard as of Q3 2022[619], the average final MREL target represented 23.3% TREA, and 26.4% TREA when including the combined buffer requirement. The average MREL subordination target including the combined buffer requirement amounted to 19.3% TREA. In terms of build-up of eligible instruments, the average stock of MREL eligible liabilities and own funds reached 31.2% TREA. In absolute terms, the stock reached EUR 2 353 bn, increasing by 6% or EUR

[619] SRB (February 2023), *SRB MREL Dashboard Q3 2022*

134.2 bn year-on-year. This trend is in line with the banks' funding plans to meet the biding final MREL targets by 1 January 2024. The average MREL shortfalls against the final target (2024) amounted to 0.2% TREA (EUR 18.1 bn) in Q3 2022, and 0.4% TREA (EUR 30.5 bn) when including the combined buffer requirement. These levels represent a year-on-year decrease, despite the recent economic uncertainty, showing the authority's progress in delivering more MREL decisions despite the increase in the sample of banks.

While compliance with MREL targets is a matter of transitional period and most banks are expected to fulfil their requirements once the transitional period expired, certain banks may be facing more structural issues to comply with their requirement (see section 5.2).

MREL calibration for transfer strategies

The SRB's MREL policy[620] describes the calibration of MREL for transfer strategies and for open bank bail-in strategies[621]. Banks with transfer strategy as the preferred resolution strategy are required to hold MREL instruments to cover for loss absorption and recapitalisation, where the latter is adjusted downwards with a factor between 15-25% of the recapitalisation amount, on a case by case basis, when compared to open bank bail-in strategy. This adjustment could be added to other adjustment factors applicable to the recapitalisation amount. The rationale for a lower recapitalisation amount for transfer strategies lies with the lack of need to recapitalise banks whose (part of the) business would be transferred to a buyer. At the same time, under the current policy, the MREL calibration goes beyond own funds (loss absorption) for banks under transfer strategies in order to cater for certain situations (such as a negative transfer price, i.e. lower than the net asset value or if the transfer does not materialise at all).

Overview of compliance with internal MREL requirements

The requirement for subsidiaries, which are part of single point of entry (SPE) resolution groups and which are not resolution entities themselves, to issue internal MREL eligible instruments to the resolution entity entered into force with the BRRD II/SRMR II in June 2020 and became applicable from 28 December 2020, upon transposition. Therefore, due to the relatively recent legal basis, calibrating and communicating internal MREL decisions to entities is still in progress. Moreover, given the large number of entities in scope of the internal MREL requirement, a prioritisation and sequencing of the work was necessary. The SRB started preparing internal MREL decisions for entities under its remit under the 2020 MREL policy and has successively expanded the scope by prioritising entities representing at least 2% of the resolution group's TREA, or leverage exposure, or total operating income or which provide critical functions or those with total assets exceeding EUR 5bn[622].

[620] SRB (June 2022), *SRB MREL policy*, section 2.4.2.
[621] While the BRRD requires that the MREL calibration reflects the resolution strategy and tools, the level 1 text is not prescriptive in terms of quantifying the differences in calibration in function of strategy.
[622] SRB (June 2022), *SRB MREL policy*, section 4.1.

5.2. Issuances of own funds and eligible liabilities

The objective of this section is to provide quantitative elements related to the issuances of own funds and eligible liabilities to support the assessment of the ability of institutions to meet their MREL requirements. A specific emphasis is put on small and mid-sized banks in view of any challenges experienced in reaching the required levels of MREL buffers and the possible impact of the policy options related to an extension of the PIA.

The section is based on data from the SRB (covering the Banking Union through regular monitoring of MREL issuances), EBA (covering specifically small and medium-size banks in the context of the reply to the CfA) and publicly available information at the level of the EU.

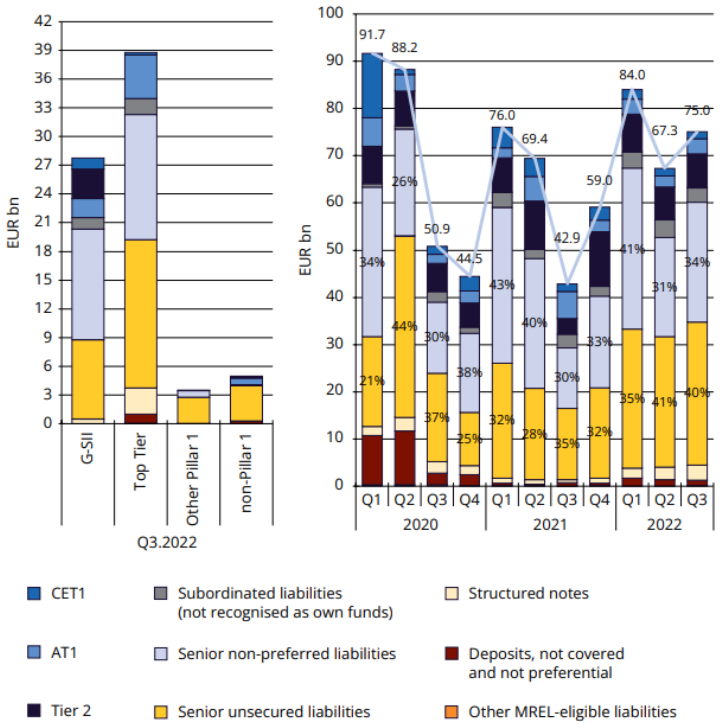
MREL issuances in the Banking Union (SRB remit)

Based on SRB data[623] covering a sample of 75 to 82 groups, the stock of MREL eligible liabilities at the level of the Banking Union reached as of Q3 2022 an amount of EUR 2 353 bn, increasing by EUR 134.2 bn year-on-year. The increase was also significant for own funds and subordinated liabilities, amounting to EUR 1 989 bn in Q3 2022.

In Q3 2022, MREL issuances amounted to EUR 75 bn, up by 11% compared to Q2 2022. Overall, year-to-date issuance volume remained rather elevated (equal to EUR 226.3 bn), increasing with respect to the same period of 2021 (up by around 20% or EUR 38.1 bn), while remaining broadly in line with the same period of 2020. Issuances by G-SIIs accounted for 37% of the total issuances in Q3 2022. The SRB also noted that issuers' preference in Q3 2022 was towards senior bonds (40% of total issuances), senior non-preferred liabilities (34%), AT1 (10%) and Tier 2 instruments (4%).

[623] SRB (Q2 2020 to Q3 2022), *MREL Dashboards.*

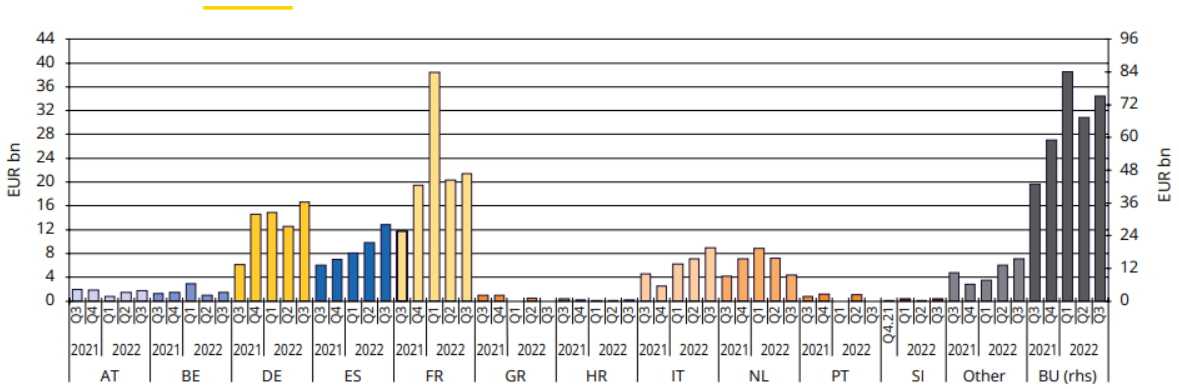
Figure 33: MREL gross issuances by type of instrument, EUR bn

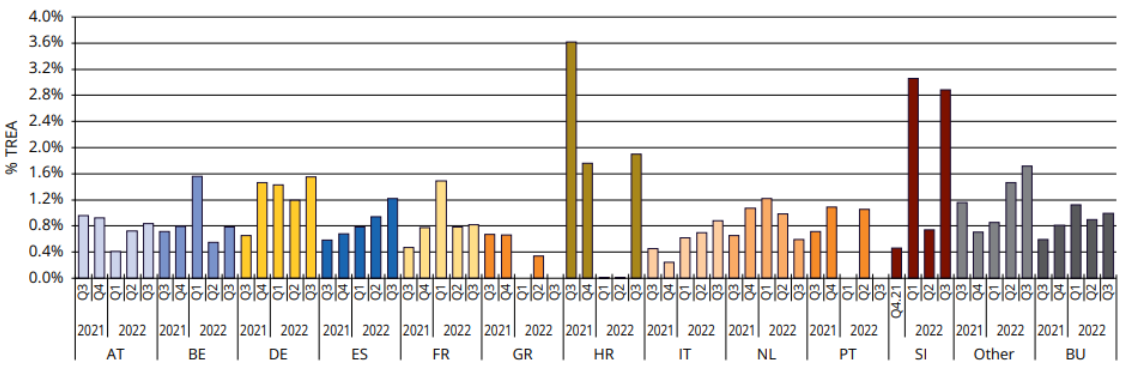


Source: SRB MREL Dashboard – Q3 2022

In particular, SRB data shows that MREL gross issuances until Q3 2022 took place in several Member States, despite the economic impact of the COVID-19 outbreak. In Q3 2022, banks showed some heterogeneity in the volume of issuances, with Top Tier banks being particularly active. Banks with total assets below EUR 100 bn accounted for 11% of the total issuance amounts.

Figure 34: MREL gross issuances by country, EUR bn and %TREA





Source: SRB MREL Dashboard – Q3 2022

5.3. Focus on small and medium-sized banks

5.3.1. General considerations on issuance capacity

Extending the PIA will impact small and medium-sized banks for which resolution authorities will more frequently consider resolution strategies at the time of resolution planning. The determination of the relevant resolution strategies will remain at the discretion of the resolution authorities, but these new candidates for resolution will likely, at least partly, be subject to strategies relying on transfer tools (such as sale of business, bridge institution or asset separation tools) given their limited size and systemic importance compared to other, larger banks. As a result, these banks would be subject to appropriate and proportionate levels of MREL requirements, in line with BRRD and SRMR.

While some banks may have sufficient own funds and other eligible instruments to be compliant with such requirements, for other banks, as MREL levels may exceed the loss absorption amount (own funds)[624], additional funding needs may emerge. The net effect of MREL-related additional costs on banks, due to the expansion of the PIA cannot be estimated because it would depend on bank-specific MREL targets set by authorities following the determination of a positive PIA and the stock of outstanding eligible instruments on these banks' balance sheets.

In this context, a study based on publicly available information extracted from S&P database, summarised in section 5.3.3, provides anecdotal evidence on the existence of issuances of various forms of instruments, subordinated and senior unsecured liabilities, across all size of institutions, including for those with a balance sheet lower than EUR 10 or 30 bn. This study shows that, while issuances are concentrated in a few Member States and that the largest institutions, as seen previously, represent the majority of the issuers in number and volume, some small and mid-sized banks have also issued subordinated and senior resources likely to support the compliance with MREL requirements, where not already achieved.

[624] The MREL calibration for transfer strategies is smaller when compared to open bank-bail-in strategies due to the adjustments currently envisaged in various jurisdictions to cater for the banks' business models and resolution strategies relying on transfer tools.

This analysis has a number of important caveats, such as the absence of clear delineation between MREL eligible instruments and the concentration of observations in certain issuers or in certain Member States, de facto constraining the presentation of the results. The moderate number of issuances for these specific types of institutions may be explained by transitional or more structural difficulties to access capital markets.

On one hand, structural challenges are mostly linked to: (i) the general features of the banks' business model and funding structure, in particular the reliance on deposits and CET1 to finance traditional lending activities, (ii) the absence of past issuance programs, ratings or listed shares (see Box 24) that may hamper the ability to access internationally active capital markets, (iii) the level of development and depth of local capital markets and (iv) the implied costs linked to the issuance of debt securities and their impacts on profitability, in particular in jurisdictions where markets are less liquid and where sovereigns have relatively lower credit ratings compared to other Member States.

On the other hand, transitional challenges mostly relate to: (i) limited issuance requirements due to high capital positions or the absence of MREL targets above capital requirements having regard to the applicable strategy in case of failure (i.e. liquidation), (ii) timeframes for MREL setting by resolution authorities based on which certain institutions, in particular the least systemic ones, may have only been notified recently about their requirements, (iii) transition periods potentially beyond 2024 allowing for a delay in issuance in order to limit impacts on profitability (interest margin) and (iv) a logic of sequencing with the AT1 and Tier 2 layers to meet prudential capital requirements and to favour subsequent senior issuances insofar as they meet the MREL requirements.

These considerations call for caution when drawing general conclusions about the explanatory factors linked to the issuances of own funds and eligible liabilities by small and mid-sized banks and the potential additional costs of such issuances.

5.3.2. EBA report on difficulties of certain banks to issue MREL eligible liabilities

A recent EBA report[625] provided an analysis of possible factors that may explain the issuance activity of MREL eligible liabilities, or lack thereof, by certain small banks. Based on data as of Q4 2021, the EBA highlighted the following aspects:

- The impact on profitability of MREL issuances, estimated via the cost of long-term unsecured debt. The study shows that, while the overall situation appeared manageable at the time (notwithstanding the changes of economic conditions and the recent general rise of interest rates), the spreads of unsecured funding were significantly higher for smaller banks than for their larger peers.
- The ability of certain small banks to issue MREL over the period analysed in the report seems linked, for certain issuers, to intrinsic financial health issues (evidenced by low credit ratings), but it is also constrained by external factors such as the sovereign rating or the apparent lack of deep markets in their home jurisdiction.

[625] EBA (January 2023), *EBA MREL quantitative monitoring report and impact assessment*

The conclusions of the report must be assessed with caution, given the limited focus on certain groups of banks and the absence of a holistic assessment. Nevertheless, the study confirms the complexity of the issue and the need to recognise the heterogeneity of the situation of small banks, given that their ability to issue MREL eligible instruments may be impacted by several factors that goes beyond their intrinsic financial position or business model.

Box 24: Small and medium-sized banks: ratings and listed entities

Based on ECB data, 115 banks out of 1 978 operating in the Banking Union have a rating at entity level. The presence of rating strongly decreases in conjunction with the size of the bank: while 41% of entities with a balance sheet of more than EUR 100 bn have a rating, the percentage falls to 6% of the smallest banks with a balance sheet below EUR 10 bn. At aggregated level, 6% of the entities have a rating (this figure takes into account all banks for which the total asset size is not available and that were not included in any other category).

Table 44: Share of banks with a rating (entity level, % of total)

	Banks with a rating (%)
Above EUR 100 bn	41%
EUR 100-50 bn	18%
EUR 50-30 bn	23%
EUR 30-10 bn	14%
Below EUR 10 bn	6%
Total	**6%**

Source: ECB computations, data as of Q4 2021

The variation is also significant, but with higher absolute levels, with respect to the share of banks that are listed in the Banking Union. While almost all banks with a balance sheet higher than EUR 50 bn are listed, the share decreases progressively down to 42% for banks with a balance sheet size lower than EUR 10 bn. At aggregated level, 34% of the entities are listed (this figure takes into account all banks for which the total asset size is not available and that were not included in any other category).

Table 45: Share of banks listed (% of total)

	Banks with a rating (%)
Above EUR 100 bn	98%
EUR 100-50 bn	96%
EUR 50-30 bn	81%
EUR 30-10 bn	78%
Below EUR 10 bn	42%
Total	**34%**

Source: ECB computations, data as of Q4 2021

Some of these banks, on an individual level, may not necessarily be standalone entities and may be part of larger banking groups and, therefore, embedded into group-wide funding structures.

5.3.3. Evaluation of the funding capacity – Study of public issuances

The subsequent study[626] is based on a sample covering 7 721 issuances by 298 issuers with a balance sheet below EUR 100 bn[627]. Issuances take the form of subordinated and senior unsecured debt securities with a maturity higher than one year, with a minimum ticket of EUR 20 million, from January 2018 to January 2023, i.e. a time period which is consistent with the progressive path followed by resolution authorities in setting MREL requirements in the EU, including under the revised Banking Package adopted in 2019.

The dataset does not include a clear delineation to single out MREL eligible instruments. As such, some liabilities included in the sample may be issued by institutions that are not resolution entities or may not comply with all the eligibility conditions set out in Article 72b CRR for MREL eligible liabilities.

Main takeaways:

- **Overview of the issuers**

Over the last five years, 298 issuers located in the EU, with a balance sheet size below EUR 100 bn, reported a total of 7 721 issuances of subordinated and senior debt instruments. The observations show that issuers are concentrated in a few Member States: AT, DE, FR, IT, LU and SE represent more than 65% of the issuers and 89% of the number of issuances, while there are only a limited number of issuances reported in eight Member States, predominantly in Central and Eastern Europe.

[626] Source: S&P data as of 19 January 2023, Commission services computations.

[627] Data quality checks led to the exclusion of a limited amount of observations, in particular when the type of instrument or the size of the issuer were not available.

Table 46: Number of issuers (per Member State* and balance sheet size)

	Size (EUR billion)				
	<10	[10-30[	[30-50[	[50-100[	**Total**
AT	15	10	2	2	**29**
BE	1	1	1	1	**4**
BG	2	1	0	0	**3**
CY	0	1	0	0	**1**
CZ	2	3	0	1	**6**
DE	9	11	4	8	**32**
DK	8	2	1	2	**13**
EE	1	0	0	0	**1**
EL	2	0	0	5	**7**
ES	1	2	0	4	**7**
FI	3	2	1	1	**7**
FR	15	17	4	7	**43**
HR	1	2	0	0	**3**
HU	9	2	0	1	**12**
IE	2	3	0	0	**5**
IT	41	14	2	6	**63**
LT	0	0	0	0	**0**
LU	4	2	2	2	**10**
LV	1	0	0	0	**1**
MT	1	1	0	0	**2**
NL	4	3	0	2	**9**
PL	0	1	2	3	**6**
PT	0	2	2	2	**6**
RO	0	4	0	0	**4**
SE	14	2	1	0	**17**
SI	2	1	0	0	**3**
SK	2	2	0	0	**4**
Total	**140**	**89**	**22**	**47**	**298**

** an issuing bank may be part of a group headed in another Member State*

Source: Commission services computations, based on S&P data as of 19 January 2023.

The number of issuers should be viewed in perspective of the total number of banks operating in the EU. Based on ECB data as of Q4 2020, approximately 1 150 banks with total assets below EUR 100 bn[628] are operating in the Banking Union Member States. As already noted, on an individual level, these banks are not necessarily standalone entities and may be part of larger banking groups and therefore embedded into group-wide funding structures. Similarly, not all banks would in any case be subject to resolution strategies and may not have to issue MREL eligible instruments beyond their capital requirements.

[628] In addition to 803 banks for which the total assets size was not reported, for a total, including all asset size groups, of 1,998 banks.

- **Overview of the issuances (types and amounts)**

Bearing in mind the caveats on the limited number of observations, issuances of subordinated instruments represent no more than 5% of the total issuances in each size group. Banks with smaller balance sheet report issuances of subordinated instruments, but in limited numbers compared to the number of issuers in most jurisdictions. Data shows that nine Member States report 10 or less issuances of subordinated and senior unsecured debt instruments. Senior issuances represent the majority of instruments issued in all size groups. In total, senior instruments account for 98% of all issuances.

Table 47: Number of issuances (per Member States* and balance sheet size)

	<10		[10-30[		[30-50[		[50-100[		**Total**
	Sub	Senior	Sub	Senior	Sub	Senior	Sub	Senior	
AT	28	955	17	122	0	76	10	83	**1,291**
BE	0	1	0	1	2	2	0	1	**7**
BG	1	1	0	1	0	0	0	0	**3**
CY	0	0	0	1	0	0	0	0	**1**
CZ	1	3	0	12	0	0	0	3	**19**
DE	4	57	0	190	4	973	4	195	**1,427**
DK	3	24	2	21	0	2	6	28	**86**
EE	2	0	0	0	0	0	0	0	**2**
EL	1	9	0	0	0	0	3	11	**24**
ES	0	4	0	4	0	0	3	13	**24**
FI	0	26	0	40	0	21	8	60	**155**
FR	0	314	0	112	0	8	0	189	**623**
HR	0	3	0	4	0	0	0	0	**7**
HU	0	45	0	7	0	0	1	4	**57**
IE	0	55	2	21	0	0	0	0	**78**
IT	6	132	3	82	1	2	10	125	**361**
LT	0	0	0	0	0	0	0	0	**0**
LU	0	36	1	16	5	2,825	0	90	**2,973**
LV	1	0	0	0	0	0	0	0	**1**
MT	1	0	2	0	0	0	0	0	**3**
NL	0	80	1	29	0	0	2	166	**278**
PL	0	0	1	1	0	31	2	9	**44**
PT	0	0	2	2	1	6	1	15	**27**
RO	0	0	2	16	0	0	0	0	**18**
SE	0	134	0	6	4	38	0	0	**182**
SI	0	4	4	2	0	0	0	0	**10**
SK	0	2	0	18	0	0	0	0	**20**
Total	**48**	**1,885**	**37**	**708**	**17**	**3,984**	**50**	**992**	**7,721**
% per size group	2.5%	97.5%	5.0%	95.0%	0.4%	99.6%	4.8%	95.2%	

*Source: Commission services computations, based on S&P data as of 19 January 2023. * An issuing bank may be part of a group headquartered in another Member State.*

The 7 721 issuances represent an amount of EUR 1 236 bn, of which EUR 1 209 bn senior instruments. In general, issuances account for a larger percentage of the institutions' total assets for the smallest banks: on average, senior unsecured debt

securities represent 5.98% of total assets for banks with a balance sheet size smaller than EUR 10 bn, with averages in certain Member States reaching up to 11% to 46% of total assets respectively, by far exceeding average levels for other size groups. Issuances of subordinated instruments represent on average 0.04% of the total assets for banks with a balance sheet size smaller than EUR 10 bn, generally higher than other size groups.

In general, several banks may be willing to ensure a layer of subordinated debt in the form of AT1 and T2 above what is required to be held as CET1 before issuing other forms of liabilities, such as senior non-preferred instruments. This progressive path allows for prudential capital requirements to be met at a lower cost than CET1 and for satisfactory capital ratios that enhance the rating of senior liabilities.

In total, small and mid-sized banks issued EUR 10.5 bn of subordinated debt (102 issuances) over the period.

Table 48: Issued amounts (per type of instrument and balance sheet size, EUR m)

	<10		[10-30[		[30-50[		[50-100[		**Total**
	Sub	Senior	Sub	Senior	Sub	Senior	Sub	Senior	
AT	2.560	340.982	678	8.134	0	25.173	770	4.711	**383,008**
BE	0	40	0	650	1.000	1.000	0	300	**2,990**
BG	30	120	0	160	0	0	0	0	**310**
CY	0	0	0	100	0	0	0	0	**100**
CZ	100	300	0	2.493	0	0	0	1.246	**4,139**
DE	145	3,190	0	22,565	377	35,246	2,028	66,474	**130,024**
DK	202	1,051	600	2,822	0	1,396	1,650	6,034	**13,756**
EE	200	0	0	0	0	0	0	0	**200**
EL	100	1,158	0	0	0	0	1,150	5,884	**8,292**
ES	0	145	0	1,600	0	0	1,100	5,575	**8,420**
FI	0	1,463	0	1,622	0	12,062	5,020	12,426	**32,593**
FR	0	24,590	0	30,423	0	426	0	88,777	**144,217**
HR	0	393	0	636	0	0	0	0	**1,029**
HU	0	4,208	0	929	0	0	650	987	**6,774**
IE	0	9,411	470	6,142	0	0	0	0	**16,023**
IT	264	6,865	115	5,360	300	600	2,684	19,329	**35,516**
LT	0	0	0	0	0	0	0	0	**0**
LU	0	3,583	125	1,578	577	122,802	0	10,250	**138,916**
LV	200	0	0	0	0	0	0	0	**200**
MT	55	0	400	0	0	0	0	0	**455**
NL	0	204,784	250	4,453	0	0	1,000	48,024	**258,510**
PL	0	0	194	52	0	23,327	175	2,664	**26,412**
PT	0	0	100	400	425	2,225	134	3,670	**6,954**
RO	0	0	250	2,131	0	0	0	0	**2,381**
SE	0	6,484	0	362	288	3,986	0	0	**11,120**
SI	0	665	510	382	0	0	0	0	**1,557**
SK	0	1,030	0	1,418	0	0	0	0	**2,448**
Total	**3,856**	**610,460**	**3,692**	**94,411**	**2,967**	**228,244**	**16,360**	**276,352**	**1,236,342**

Source: Commission services computations, based on S&P data as of 19 January 2023.

Table 49: Issued amounts (per type of instrument and balance sheet size, % total assets, average)

	<10		[10-30[		[30-50[		[50-100[		**Average**
	Sub	Senior	Sub	Senior	Sub	Senior	Sub	Senior	
AT	0.05%	6.83%	0.03%	0.31%	0.00%	1.00%	0.02%	0.10%	**2.56%**
BE	0.00%	0.51%	0.00%	5.38%	0.51%	0.51%	0.00%	0.57%	**1.12%**
BG	0.26%	1.03%	0.00%	1.23%					**1.26%**
CY			0.00%	0.53%					**0.53%**
CZ	0.80%	2.40%	0.00%	0.90%			0.00%	0.63%	**0.85%**
DE	0.03%	0.63%	0.00%	0.59%	0.00%	0.11%	0.01%	0.38%	**0.25%**
DK	0.11%	0.58%	0.14%	0.68%	0.00%	1.41%	0.06%	0.22%	**0.39%**
EE	1.46%	0.00%							**1.46%**
EL	0.33%	3.78%					0.10%	0.53%	**0.72%**
ES	0.00%	11.96%	0.00%	1.65%			0.10%	0.51%	**0.71%**
FI	0.00%	1.95%	0.00%	0.31%	0.00%	1.53%	0.08%	0.19%	**0.42%**
FR	0.00%	1.19%	0.00%	1.18%	0.00%	0.15%	0.00%	0.71%	**0.83%**
HR	0.00%	2.46%	0.00%	1.10%					**1.39%**
HU	0.00%	2.18%	0.00%	1.26%			0.17%	0.26%	**1.06%**
IE	0.00%	11.78%	0.14%	1.80%					**3.81%**
IT	0.04%	1.07%	0.01%	0.40%	0.30%	0.60%	0.02%	0.17%	**0.27%**
LT									
LU	0.00%	1.54%	0.04%	0.47%	0.00%	0.10%	0.00%	0.17%	**0.11%**
LV	3.96%	0.00%							**3.96%**
MT	1.97%	0.00%	1.39%	0.00%					**1.44%**
NL	0.00%	46.10%	0.04%	0.68%			0.01%	0.30%	**1.53%**
PL			0.43%	0.11%	0.00%	1.75%	0.03%	0.42%	**1.31%**
PT			0.12%	0.47%	0.14%	0.74%	0.01%	0.26%	**0.39%**
RO			0.09%	0.76%					**0.85%**
SE	0.00%	0.98%	0.00%	0.56%	0.02%	0.22%			**0.43%**
SI	0.00%	2.60%	0.39%	0.30%					**1.00%**
SK	0.00%	15.76%	0.00%	0.36%					**0.61%**
Average	**0.04%**	**5.98%**	**0.03%**	**0.66%**	**0.00%**	**0.15%**	**0.02%**	**0.34%**	

Source: Commission services computations, based on S&P data as of 19 January 2023.

5.3.4. Holdings of own funds and eligible liabilities

The objective of this section is to provide quantitative elements related to the holdings of own funds and eligible liabilities to support the assessment of the ability of institutions to meet their MREL requirements. Beyond the capacity to issue specific types of instruments, that may partly be due to operational or structural constraints, a key determinant of the assessment remains the nature of the investors ready to subscribe to these instruments.

This analysis is particularly relevant to single out certain types of banks, in particular small and medium-sized institutions or certain jurisdictions where financial markets may have varying levels of developments.

Based on ECB data covering issuers in the Banking Union and using a combination of several datasets subject to specific confidentiality rules, this section provides information on the holdings of instruments as of Q4 2021 by certain types of holders, broken down by type of issuers according to their size and geographical location:

- Own funds and eligible instruments:
  - CET1 and AT1
  - Tier 2
  - Other subordinated securities
  - Senior non-preferred securities
  - Senior unsecured securities

- Types of holders:
  - Financial institutions[629], of which banks, insurance companies and pension funds
  - Public authorities and central banks
  - Households and non-profit institutions
  - Other, non-financial institutions[630]

- Size of banks (total assets):
  - Below EUR 10 bn
  - EUR 30-10 bn
  - EUR 50-30 bn
  - EUR 100-50 bn
  - EUR 300-100 bn
  - Above EUR 300 bn

- Geographical location (clusters[631]):
  - AT/FI/DE
  - FR/IT
  - BE/IE/LU/NL
  - PT/ES
  - CY/GR/MT
  - BG/HR/SK/SI
  - EE/LV/LT

The data is based on specific methodological assumptions that are listed in section 6 of this Annex.

5.3.4.1. Overview of the distribution of holdings for Banking Union issuers

[629] Category comprising: deposit taking corporations, money market funds, investment funds, other financial corporations, financial vehicle corporations, insurance corporations, pension funds, monetary financial institutions and other insurance and pension funds.

[630] Category comprising: non-financial corporations, non-financial investors (third party holdings), investors from non-euro area countries other than central banks and general governments, and unallocated holders.

[631] Groupings were necessary to prevent confidentiality issues.

On aggregate, financial institutions represent the majority of holders for all forms of instruments. In particular, 58% of the reported holdings of CET1 and AT1 and up to 71% of senior non-preferred instruments are held by financial institutions. Banks, insurance and pension funds often represent a large proportion of this category, in particular for Tier 2 and senior instruments, but relatively less for CET1 and AT1 where they only account for 28%, the rest being held by other types of holders such as asset management funds.

Other non-financial holders also represent a large share of holders for all categories of instruments, while holdings by public authorities and central banks mostly relate to senior instruments. Importantly, households and non-profit institutions represent a large proportion of the holders of CET1 and AT1 instruments (6% of the holdings) and particularly for other subordinated liabilities (18% of the holdings).

Table 50: Holdings of instruments per type of holder (% of the instrument type)[632]

	Financial institutions			Public authorities and central banks	Households and non-profit institutions	Other, non-financial institutions
		Of which: banks	*Of which: insurance and pensions funds*			
CET1 and AT1	58%	*19%*	*9%*	1%	6%	34%
Tier 2	66%	*13%*	*38%*	2%	3%	30%
Subordinated debt	55%	*31%*	*27%*	1%	18%	26%
Senior non-preferred	71%	*25%*	*33%*	2%	1%	26%
Senior	59%	*47%*	*17%*	13%	5%	23%

Source: ECB data as of Q4 2021.

5.3.4.2. Focus on small and medium-sized banks

The following tables provide a granular breakdown of the holdings, for each instruments, per nature of holders by type of issuers according to their size and geographical location. They include figures for small and medium-sized institutions, as well as for largest entities to enhance the comparability of the results.

In general, figures highlight the prevalence of holdings by financial institutions, although not necessarily banks and insurance or pension funds, across all types of instruments, but point at specific features in some Member States or for specific categories of banks where public authorities and central banks, or households, represent an important proportion of the holders. This is particularly relevant for CET1, AT1 and subordinated debt held by households in certain Member States, or the absence of reported holdings of Tier 2 and senior non-preferred for many types of institutions in several jurisdictions.

[632] Example: 58% of the reported holdings of CET1 and AT1 instruments are held by financials. Banks represent 19% of the holders of CET1 and AT1 instruments classified as financials. The sum of the columns financials, public authorities and central banks, households and non-profit institutions, and other non-financial holders is equal to 100%, covering the entire amount of reported holdings of each instrument.

The outcome of the assessment suggests that the access to a wide investor base able to absorb different types of liabilities to meet MREL requirements is uneven across Member States and varies across banks.

CET1 and AT1:

- Financial institutions represent a large proportion of holders of CET1 and AT1 instruments for many issuers in all jurisdictions. The distribution remains heterogeneous in particular for small institutions with balance sheet lower than EUR 10 bn where the proportion of financials move from less than 20% to up to 99% of the holdings.
- Public authorities and central banks generally represent a small proportion of holdings of CET1 and AT1 instruments except in limited cases (e.g. publicly-owned institutions).
- Households represent an important proportion of holders of CET1 and AT1 instruments, in particular for the smallest banks with a balance sheet below EUR 10 bn, in several groups of Member States: 59% in ES/PT, 35% in EE/LV/LT, 37% in DE/AT/FI and 28% in FR/IT where this proportion remains high also for larger institutions.
-

Table 51: Holdings of CET1 and AT1 instruments (% of holdings)

CET1 and AT1		Financials			Public authorities and central banks	Households and non-profit institutions	Other, non-financial
			Of which: banks	*Of which: insurance and pensions funds*			
DE_AT_FI	Below EUR 10 billion	35%	*20%*	*4%*	3%	37%	26%
	EUR 30-10 billion	60%	*26%*	*3%*	0%	5%	36%
	EUR 50-30 billion	60%	*11%*	*3%*	0%	12%	27%
	EUR 100-50 billion	58%	*25%*	*2%*	1%	13%	29%
	EUR 300-100 billion	63%	*30%*	*6%*	0%	4%	32%
	Above EUR 300 billion	54%	*31%*	*7%*	1%	6%	39%
IT_FR	Below EUR 10 billion	16%	*8%*	*6%*	0%	28%	55%
	EUR 30-10 billion	54%	*24%*	*12%*	0%	37%	10%
	EUR 50-30 billion	63%	*11%*	*5%*	0%	9%	27%
	EUR 100-50 billion	46%	*-1%*	*17%*	1%	38%	16%
	EUR 300-100 billion	55%	*13%*	*8%*	1%	25%	19%
	Above EUR 300 billion	60%	*17%*	*7%*	1%	5%	34%
NL_BE_LU_IE	Below EUR 10 billion	39%	*6%*	*3%*	1%	4%	56%
	EUR 30-10 billion	49%	*10%*	*1%*	0%	17%	35%
	EUR 100-30 billion	65%	*22%*	*19%*		5%	29%
	EUR 300-100 billion	72%	*22%*	*19%*	4%	1%	23%
	Above EUR 300 billion	63%	*17%*	*23%*	1%	1%	35%
ES_PT	Below EUR 10 billion	13%		*55%*		59%	28%
	EUR 30-10 billion						
	EUR 100-30 billion	55%	*6%*	*9%*	0%	13%	32%
	Above 100 billion	59%	*14%*	*8%*	2%	6%	34%

GR_CY_MT	Below EUR 30 billion	54%	*59%*	*13%*	82%	12%	0%
	EUR 50-30 billion						
	EUR 100-50 billion	44%	*53%*	*2%*	45%	9%	3%
	EUR 300-100 billion						
	Above EUR 300 billion						
BG_SI_SK_HR	Below EUR 10 billion	98%	*0%*	*89%*		2%	0%
	EUR 30-10 billion	99%	*82%*	*11%*	1%	0%	0%
	EUR 50-30 billion						
	EUR 100-50 billion						
	EUR 300-100 billion						
	Above EUR 300 billion						
EE_LV_LT	Below EUR 10 billion	24%	*1%*	*6%*		35%	41%
	EUR 30-10 billion						
	EUR 50-30 billion						
	EUR 100-50 billion						
	EUR 300-100 billion						
	Above EUR 300 billion						

Source: ECB data as of Q4 2021.

Tier 2:

- Financial institutions represent a large proportion of holders of Tier 2 instruments together with other non-financial holders, across all jurisdictions.
- Holdings of Tier 2 instruments are mostly relevant for institutions with a balance sheet size of at least EUR 50 bn. In several Member States, no holdings are reported.

Table 52: Holdings of Tier 2 instruments (% of holdings)

Tier 2			Financials		Public authorities and central banks	Households and non-profit institutions	Other, non-financial
			Of which: banks	*Of which: insurance and pensions funds*			
DE_AT_FI	Below EUR 10 billion						
	EUR 30-10 billion						
	EUR 50-30 billion						
	EUR 100-50 billion	64%	*15%*	*41%*	9%	0%	28%
	EUR 300-100 billion	72%	*18%*	*24%*	1%	8%	19%
	Above EUR 300 billion	57%	*11%*	*28%*	1%	10%	32%
IT_FR	Below EUR 10 billion	63%	*24%*	*24%*		13%	24%
	EUR 30-10 billion						
	EUR 50-30 billion						
	EUR 100-50 billion	53%	*15%*	*12%*	0%	34%	13%
	EUR 300-100 billion	70%	*14%*	*30%*	1%	5%	24%
	Above EUR 300 billion	65%	*14%*	*42%*	2%	2%	31%
NL_BE_LU_IE	Below EUR 10 billion						
	EUR 30-10 billion	47%	*8%*	*11%*	1%	0%	52%
	EUR 100-30 billion	65%	*16%*	*10%*	0%		35%
	EUR 300-100 billion	79%	*17%*	*30%*	1%	0%	21%

	Above EUR 300 billion	45%	*31%*	*31%*	2%	0%	53%
ES_PT	Below EUR 10 billion						
	EUR 30-10 billion						
	EUR 100-30 billion	66%	*8%*	*19%*	0%	2%	33%
	Above 100 billion	72%	*10%*	*41%*	1%	1%	26%
GR_CY_MT	Below EUR 30 billion						
	EUR 50-30 billion						
	EUR 100-50 billion	60%	*39%*	*2%*	0%	3%	37%
	EUR 300-100 billion						
	Above EUR 300 billion						
BG_SI_SK_HR	Below EUR 10 billion						
	EUR 30-10 billion						
	EUR 50-30 billion						
	EUR 100-50 billion						
	EUR 300-100 billion						
	Above EUR 300 billion						
EE_LV_LT	Below EUR 10 billion						
	EUR 30-10 billion						
	EUR 50-30 billion						
	EUR 100-50 billion						
	EUR 300-100 billion						
	Above EUR 300 billion						

Source: ECB data as of Q4 2021.

Other subordinated securities:

- Financial institutions represent a large proportion of holders of subordinated instruments, sometimes together with other non-financial holders in certain jurisdictions.
- Similarly to own funds instruments, public authorities and central banks often represent a limited proportion of holders, and are largely outweighed by households and non-profit institutions which may represent up to 40% of the holders of subordinated instruments.
- In general, holdings by households and non-profit institutions seem to remain high irrespective of the size of the institutions, although slightly more important for banks with balance sheet up to EUR 50 bn, in those jurisdictions where they account for a large proportion of the issuers.

Table 53: Holdings of other subordinated instruments (% of holdings)

Other subordinated		Financials			Public authorities and central banks	Households and non-profit institutions	Other, non-financial
			Of which: banks	*Of which: insurance and pensions funds*			
DE_AT_FI	Below EUR 10 billion	54%	*53%*	*15%*	3%	22%	22%
	EUR 30-10 billion	34%	*20%*	*17%*	2%	40%	23%
	EUR 50-30 billion	42%	*13%*	*48%*	5%	17%	37%
	EUR 100-50 billion	74%	*35%*	*21%*	0%	6%	20%
	EUR 300-100 billion	53%	*32%*	*34%*	1%	14%	33%
	Above EUR 300 billion	63%	*70%*	*11%*	0%	12%	24%
IT_FR	Below EUR 10 billion	70%	*79%*	*5%*		19%	11%
	EUR 30-10 billion	68%	*63%*	*11%*	0%	22%	10%
	EUR 50-30 billion	100%	*100%*				
	EUR 100-50 billion	50%	*5%*	*19%*	2%	32%	16%
	EUR 300-100 billion	64%	*28%*	*19%*	0%	26%	10%
	Above EUR 300 billion	51%	*17%*	*35%*	1%	23%	25%
NL_BE_LU_IE	Below EUR 10 billion	51%	*32%*	*39%*	0%	0%	48%
	EUR 30-10 billion	51%	*13%*	*17%*	1%	8%	39%
	EUR 100-30 billion	75%	*1%*	*62%*	2%	2%	22%
	EUR 300-100 billion	70%	*7%*	*33%*	0%	1%	30%
	Above EUR 300 billion	44%	*12%*	*17%*	0%	25%	31%
ES_PT	Below EUR 10 billion						
	EUR 30-10 billion	96%	*4%*	*94%*		2%	2%
	EUR 100-30 billion	91%	*97%*	*14%*		32%	27%
	Above 100 billion	63%	*18%*	*44%*	0%	5%	32%
GR_CY_MT	Below EUR 30 billion	43%	*37%*	*16%*	34%	18%	4%
	EUR 50-30 billion						
	EUR 100-50 billion						
	EUR 300-100 billion						
	Above EUR 300 billion						
BG_SI_SK_HR	Below EUR 10 billion	68%	*69%*	*26%*		1%	30%
	EUR 30-10 billion	81%	*75%*	*8%*	0%	2%	17%
	EUR 50-30 billion						
	EUR 100-50 billion						
	EUR 300-100 billion						
	Above EUR 300 billion						
EE_LV_LT	Below EUR 10 billion	57%	*5%*	*12%*		28%	15%
	EUR 30-10 billion						
	EUR 50-30 billion						
	EUR 100-50 billion						
	EUR 300-100 billion						
	Above EUR 300 billion						

Source: ECB data as of Q4 2021.

Senior non-preferred securities:

- Holdings of non-senior preferred instruments are not reported for institutions below EUR 30 bn in assets, except in a few Member States.
- Financials remain the most important category of holders of these instruments, sometimes with other non-financial holders in certain jurisdictions. Contrary to subordinated instruments, households and non-profit institutions only represent a marginal proportion of holders of senior non-preferred instruments.
- Similarly to Tier 2 instruments, no holdings are reported in several Member States.

Table 54: Holdings of senior non-preferred instruments (% of holdings)

	Senior non-preferred	Financials			Public authorities and central banks	Households and non-profit institutions	Other, non-financial
			Of which: banks	*Of which: insurance and pensions funds*			
DE_AT_FI	Below EUR 10 billion						
	EUR 30-10 billion	59%	*32%*	*10%*	2%	1%	39%
	EUR 50-30 billion	81%	*67%*	*7%*	4%	2%	13%
	EUR 100-50 billion	63%	*35%*	*31%*	3%	0%	34%
	EUR 300-100 billion	76%	*55%*	*8%*	3%	1%	20%
	Above EUR 300 billion	62%	*30%*	*21%*	1%	2%	35%
IT_FR	Below EUR 10 billion						
	EUR 30-10 billion						
	EUR 50-30 billion						
	EUR 100-50 billion	88%	*29%*	*24%*	1%	1%	11%
	EUR 300-100 billion	82%	*18%*	*42%*	1%	1%	16%
	Above EUR 300 billion	72%	*22%*	*38%*	2%	0%	25%
NL_BE_LU_IE	Below EUR 10 billion						
	EUR 30-10 billion	74%	*15%*	*28%*	2%	1%	23%
	EUR 100-30 billion	63%	*19%*	*29%*	1%	0%	36%
	EUR 300-100 billion	68%	*20%*	*27%*	2%	0%	30%
	Above EUR 300 billion	71%	*22%*	*42%*	3%	0%	26%
ES_PT	Below EUR 10 billion						
	EUR 30-10 billion						
	EUR 100-30 billion	79%	*25%*	*27%*	2%	0%	19%
	Above 100 billion	73%	*18%*	*35%*	2%	1%	24%
GR_CY_MT	Below EUR 30 billion						
	EUR 50-30 billion						
	EUR 100-50 billion						
	EUR 300-100 billion						
	Above EUR 300 billion						
BG_SI_SK_HR	Below EUR 10 billion						
	EUR 30-10 billion						
	EUR 50-30 billion						
	EUR 100-50 billion						
	EUR 300-100 billion						

	Above EUR 300 billion						
EE_LV_LT	Below EUR 10 billion						
	EUR 30-10 billion						
	EUR 50-30 billion						
	EUR 100-50 billion						
	EUR 300-100 billion						
	Above EUR 300 billion						

Source: ECB data as of Q4 2021.

Senior unsecured securities:

- Financials also represent the largest proportion of holders of senior unsecured instruments, with a relatively high share for banks, insurance and pension funds compared to other forms of instruments.
- On average, public authorities and central banks represent a larger share of holders of senior unsecured instruments compared to other, more subordinated, instruments. For certain categories of banks, they may represent up to 27% of the holders, without specific trend with respect to the size of the issuers.
- Households and non-profit institutions generally represent a large proportion of the holders of senior unsecured instruments in many jurisdictions, and in particular for small and medium-sized institutions where the share can represent up to 52% of the holdings for the smallest banks below EUR 10 bn in assets.

Table 55: Holdings of senior unsecured instruments (% of holdings)

Senior unsecured			Financials		Public authorities and central banks	Households and non-profit institutions	Other, non-financial
			Of which: banks	*Of which: insurance and pensions funds*			
DE_AT_FI	Below EUR 10 billion	51%	*59%*	*6%*	3%	25%	20%
	EUR 30-10 billion	70%	*75%*	*5%*	5%	14%	11%
	EUR 50-30 billion	51%	*56%*	*18%*	19%	7%	22%
	EUR 100-50 billion	54%	*43%*	*9%*	2%	24%	20%
	EUR 300-100 billion	68%	*83%*	*4%*	4%	20%	8%
	Above EUR 300 billion	69%	*58%*	*9%*	1%	16%	14%
IT_FR	Below EUR 10 billion	42%	*52%*	*12%*	0%	52%	6%
	EUR 30-10 billion	76%	*38%*	*7%*	1%	10%	13%
	EUR 50-30 billion	95%	*24%*	*2%*	0%	0%	5%
	EUR 100-50 billion	60%	*42%*	*8%*	12%	4%	24%
	EUR 300-100 billion	78%	*42%*	*22%*	7%	3%	12%
	Above EUR 300 billion	74%	*47%*	*18%*	1%	6%	19%
NL_BE_LU_IE	Below EUR 10 billion	59%	*38%*	*6%*	16%	1%	24%
	EUR 30-10 billion	70%	*28%*	*10%*	1%	0%	29%
	EUR 100-30 billion	52%	*36%*	*38%*	23%	1%	24%
	EUR 300-100 billion	46%	*46%*	*29%*	27%	0%	27%
	Above EUR 300 billion	69%	*48%*	*18%*	2%	1%	28%
ES_PT	Below EUR 10 billion	100%		*88%*			
	EUR 30-10 billion	81%	*22%*	*32%*	1%	0%	18%

	EUR 100-30 billion	84%	*67%*	*5%*	0%	0%	16%
	Above 100 billion	75%	*24%*	*25%*	3%	2%	21%
GR_CY_MT	Below EUR 30 billion	68%	*49%*	*8%*	0%	1%	32%
	EUR 50-30 billion						
	EUR 100-50 billion	81%	*48%*	*6%*	1%	2%	16%
	EUR 300-100 billion						
	Above EUR 300 billion						
BG_SI_SK_HR	Below EUR 10 billion	91%	*58%*	*36%*	0%	0%	9%
	EUR 30-10 billion	74%	*22%*	*33%*	0%	13%	13%
	EUR 50-30 billion						
	EUR 100-50 billion						
	EUR 300-100 billion						
	Above EUR 300 billion						
EE_LV_LT	Below EUR 10 billion	69%	*15%*	*50%*		0%	30%
	EUR 30-10 billion	61%	*13%*	*37%*	0%	1%	38%
	EUR 50-30 billion						
	EUR 100-50 billion						
	EUR 300-100 billion						
	Above EUR 300 billion						

Source: ECB data as of Q4 2021.

6. OTHER METHODOLOGICAL CONSIDERATIONS

The analyses conducted in this Annex rely on different samples of banks, depending on the source of information. Although not directly comparable due to the heterogeneity of the data sources used, these samples allow for robust analyses on a standalone basis in order to support the assessment of the policy options. All samples have been subject to data quality checks that resulted in exclusions of certain observations.

- **Overview of the application of the PIA**

The analysis pertaining to the application of the PIA is based on the information from the EBA CfA report. The analysis in the EBA CfA report is based on a sample of 343 banks, out of which 165 entities with resolution strategy, according to Q4 2019 data. This is the same sample of banks underpinning the analyses presented in Annex 7.

The classification of banks into large, medium and small banks as well as the split by deposit prevalence (i.e. share of deposits in the total amount of liabilities and own funds) follows the same methodology as described in the EBA CfA report and Annex 7.

- **Overview of the operationalisation of transfer strategies**

The analysis regarding the allocation of banks by resolution strategies is based on the EBA's 2020 and 2021 quantitative MREL reports (based on Q4 2019 and Q4 2020 data, respectively)[633]. These reports are based on the MREL decisions for a scope of 238 and 260 resolution groups and individual resolution entities, respectively covering the EU-27.

[633] EBA (June 2021), *EBA quantitative MREL report*, as of 31 December 2019.

- **MREL**

The analyses pertaining to the MREL build-up are based on the following sources of data, each featuring specificities in terms of sample size and composition:

- EBA quantitative 2020 MREL report: sample of 238 resolution groups and individual resolution entities, consisting of 10 G-SIIs, 83 O-SIIs split into four categories according to their size and 145 other banks also split into four categories of size. Figures on MREL requirements, eligible liabilities and shortfalls are weighted by TREA. The EBA's quantitative MREL 2020 report based on Q 2019 data reflects the implementation of BRRD I. Internal MREL targets and statistics not considered in the report.
- EBA quantitative 2021 MREL report: sample of 260 resolution groups and individual resolution entities, consisting of 10 G-SIIs, 88 O-SIIs split into five categories according to their size and 162 other banks also split into four categories of size. Figures on MREL requirements, eligible liabilities and shortfalls are weighted by TREA. The EBA's quantitative MREL 2021 report based on Q4 2020 data reflects the implementation of BRRD II. Internal MREL targets are also considered in the report.
- SRB MREL dashboards (presented in section 5.2 of this Annex): the most recent SRB MREL dashboard presented MREL-related information and data as of Q1 2022 for a sample of 82 resolution groups and individual resolution entities, reflecting the BRRD II MREL policy. The MREL issuances-related information is based on a sample of 82 resolution groups. The aggregated MREL targets (% TREA) are the weighted average of targets of resolution entities per Member State.
- European Commission, ECB and SRB joint Risk Reduction Monitoring Reports of May and November 2021: the overview of MREL targets, outstanding stock of eligible liabilities and shortfalls as of Q4 2019 and Q4 2020 is based on a sample of 101 and 98 resolution groups, respectively.. These samples included nine G-SII and G-SII entities in the Banking Union. The report reflects BRRD II MREL policies, however internal MREL targets and statistics are not considered in the report.
- ECB data on holdings: sample of Banking Union issuers of own funds and eligible liabilities as of Q4 2011, based on the combination of several ECB data sets. The information focuses on the buy-side (investors) of these instruments. The classification of the banks in the sample according to size was done in function of six thresholds of total assets. In order to prevent confidentiality concerns, the presentation of the issuances according to their geographical location follows seven clusters of Member States. In addition, individual observations where key data fields were missing (such as the absence of values related to the issuer's total assets or values or the indication whether senior liability were secured or not) were excluded from the analysis. Finally, the sample of issuances might not systematically capture liabilities that comply with all criteria set out in CRR to qualify as MREL eligible. The data extracted from the relevant ECB data sets is based on a proxy of MREL eligibility.

- S&P data extracted as of 19 January 2023: sample covering 7 721 issuances by 298 issuers with a balance sheet below EUR 100 bn. Individual observations where key data fields were missing were also excluded from the analysis. The sample of issuances does not provide clear delineation to identify MREL eligibility.

ANNEX 14: OPTIONS DISCARDED AT AN EARLY STAGE

Additional policy options were analysed and discarded at an early stage: (i) resolution as the sole procedure for banks needing restructuring, (ii) set-up of a parallel harmonised national regime in insolvency – an orderly liquidation tool, (iii) withdrawal of the 2015 Commission EDIS proposal without replacement and (iv) incompatible permutations between elements in the option packages presented in Chapter 6.

Under the **first discarded option**, the existing European resolution framework for dealing with failing banks would become the sole procedure for banks that need restructuring[634]. Alternative national insolvency procedures that may involve the possibility of granting liquidation aid under State aid rules, would need to be eliminated to leave only what is known as "atomistic" piecemeal liquidation in insolvency as alternative to resolution. This option would eliminate any potential alternative measures outside resolution to manage a bank failure other than piecemeal liquidation, while the latter could be difficult to implement outside a minor portion of very small banks. Accordingly, if certain banks cannot be put in atomistic liquidation, it must be possible to manage them in resolution. This entails certainty in the ability to access the resolution fund, as there would be no flexibility to find other solution. The feasibility to resolve a very large number of banks would therefore become entirely dependent on the availability of robust funding solutions in resolution. Such an approach would require considerable certainty that the current rules could be amended in a way that may accommodate access to resolution funding for also very small institutions, which in turn require substantial flexibility by Member States on certain key principles, such as deviating from the current minimum bail-in requirement (8% TLOF) to access the RF/SRF[635], in addition to accessing the DGS. This level of certainty or flexibility is not presently considered politically realistic.

Stakeholder views: Discussions carried out in the Commission's expert group and the replies to the targeted and public consultations[636] showed that several Member States are not favourable to this option. Some object to important and intrusive modifications in their national insolvency laws to eliminate alternative measures (i.e. transfer tools). Other Member States, which do not have such alternative measures in their national laws, also see this option as too rigid. Some degree of flexibility in the framework is required to deal with various cases of bank failure. Also, the above mentioned required flexibility on key principles to access the RF/SRF is not supported by some Member States.

Under the **second discarded option**, resolution would be reserved for the largest, systemic banks and a parallel harmonised regime in insolvency would be set up for the

[634] Under the watch of the SRB for the banks under its remit in the Banking Union and under the watch of NRAs for all the other ones.

[635] Flexibility regarding the 8% TLOF minimum bail-in rule to access RF/SRF would be required for those banks lacking sufficient bail-inable liabilities to reach 8% TLOF. In a scenario where resolution were applied to a very large number of EU banks as the only alternative to piecemeal liquidation, the shortfalls towards 8% TLOF are likely to be affecting many banks.

[636] See Annex 2.

vast majority of banks, which would not meet the narrower public interest to go into resolution – a so-called harmonised national administrative liquidation procedure. Creating such a new alternative regime would require harmonisation of certain important elements of national bank insolvency laws, which would present significant legal and political challenges. This procedure would be conducted under national governance, financed with DGS funds at national level with a risk of shortfalls[637]. This would mean that the funds collected from all banks for the RF/SRF would remain earmarked for a smaller scope of large banks, which could create asymmetries in terms of who pays and who has potential access to the fund, with possible effects on level playing field, competitiveness and single market in banking[638], potentially opening the possibility to narrow down the contributors to such funds. By bringing procedures and their funding back to the national level, this option would backtrack on the progress achieved in the Banking Union and the original intention of creating a European resolution framework. It would also create overlaps and duplications between existing restructuring tools available in the resolution framework and new national restructuring tools available through the administrative liquidation procedure, further exacerbating the problems related to misaligned incentives to apply tools and the legal uncertainty and predictability of outcome.

Stakeholder views: Discussions in the Commission's Expert Group, the Council's Working Party and the replies to the targeted and public consultations[639] revealed that a majority of Member States do not support this option because it would create overlaps with the resolution toolkit, as well as significant legal, technical and implementation challenges. A few stakeholders are favourable to such an option, however without offering a solution to the overlap issue.

Under a **third discarded option**, the 2015 EDIS legislative proposal would be withdrawn without replacing it by a new EDIS proposal. Such an action would be inconsistent with the framework's objective of achieving greater depositor protection and the Commission's priorities to complete and strengthen the Banking Union with its third pillar[640]. This is primarily because the risks that EDIS is meant to address would continue to exist, as explained in the problem definition. A withdrawal of EDIS would also jeopardise the technical explorations achieved over the past years in the High-Level Working Group on EDIS, the Commission's Expert Group and the Council's working party[641]. Consequently, this option would represent a step backwards in the post-crisis regulatory reforms.

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[637] The option of an orderly liquidation tool financed by national DGS funds but governed centrally in the Banking Union was also discussed and discarded by most Member States who insisted that the governance should be aligned with the funding.

[638] Retaining the broad contribution basis for the SRF is justified nevertheless on the ground of financial stability preservation, which is a common public good and efficiency gains through better risk diversification across the whole population of banks. It however creates the need for another complementing safety net, especially in case of a parallel regime.

[639] See Annex 2.

[640] European Commission (16 September 2020), *State of the Union address by President von der Leyen at the European Parliament plenary*.

[641] See Annex 5 (evaluation), section 6 on the status quo of EDIS.

Stakeholder views: With few exceptions, the majority of Member States shares the ambition to complete the Banking Union with a fully-fledged EDIS, subject to conditions, and would be expected to disagree with this option. The banking industry (smaller and larger banks equally) mostly supported a fully-fledged EDIS and acknowledged the opportunity for reduced costs in terms of yearly contributions, and, hence, would also disagree with this avenue. One notable exception are the banks participating in IPSs located in a few Member States, which advocated for their exclusion from EDIS[642]. Also consumer associations cite EDIS as a key element to ensure a uniform level of depositor protection and to increase consumer confidence across the EU and would consequently be expected to disagree with this option[643].

Finally, several incompatible combinations of elements across the option packages were also discarded such as considering an ambitious CMDI review with broad application of resolution (via legal amendments to the PIA) without the necessary changes to make funding available. Failing to secure an effective access to common safety nets to all banks would continue to expose taxpayers to (possibly increased) risks. The mere extension of resolution would deliver a dysfunctional and asymmetric framework, where the funding solutions fail to match the scope, putting the credibility and effectiveness of the EU resolution regime in doubt. Similarly, theoretical alternatives such as more resolution funding through an increase in the size of the RF/SRF (higher industry contributions) and/or increasing the flexibility to access it (i.e. loosening the minimum bail-in condition of 8% TLOF) are possible though likely not realistic, economically efficient or politically palatable. To the contrary, some industry participants are supporting a reduction of contributions to the SRF, which has never been used yet in practice. Similarly, reducing the minimum bail-in condition of 8% TLOF would also encounter political opposition from other Member States seeking to protect the fund against depletion and moral hazard. Overall, these combinations would lack cost-effectiveness by reducing the synergies in the safety nets and increasing costs for the industry (no mitigation in terms of lower contributions to DGS) without attaining the same robustness of the safety nets. It would weaken the capacity to achieve several objectives such as limiting the recourse to public funds, weakening the bank-sovereign link, level playing field and robust depositor protection.

Stakeholder views: The EU banking industry and several Member States voiced strongly the principle of cost neutrality (or possibly a cost reducing impact) of this package.

[642] German savings banks association (DSGV) (August, 2020), *This is not the time to centralise deposit guarantee schemes in Europe* and certain IPSs (April 2021), *Institutional protection schemes in Europe publish joint declaration in support of a strong Banking Union* and responses to the consultation.
[643] See responses to the public and targeted consultations.