

BANK RESCUES AND RESOLUTION IN EUROPE: ON THE BRINK OF REFORM?

The *Tercas* Judgment and Future Reform of the BRRD and the Banking State Aid Framework

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Disclaimer: the views expressed herein are my own and do not necessarily reflect the SRB's official views



DGS ALTERNATIVE INTERVENTIONS

➤ DGS Directive

- Article 11(3) DGS Directive: Prevention of failure of a bank
- Article 11(6) DGS Directive: Support the sale of a failing bank's business or selected assets/liabilities in the context of national insolvency proceedings

➤ Advantages of DGS alternative measures (other than pay box)

- Avoiding disruptive effects of piecemeal liquidation scenarios
- Continuity of bank's borrowing relationships and payment system functions
- Minimizing the costs for the DGS and the banking system

➤ 2013 Commission Banking Communication

- Para. 63: may constitute State aid only 'to the extent that they come within the control of the State and the decision as to the funds' application is imputable to the State'

TERCAS JUDGEMENT – MAIN FINDINGS

➤ **Imputability to the State**

- Scope of public mandate: alternative forms of intervention outside
- Autonomy of decision-making on alternative forms of intervention

➤ **State resources**

- No public control of DGS available means

➤ **Acting in the own interest of DGS members**

- Least cost principle as both a basis and a limit to voluntary intervention
- Voluntary intervention is only subject to the least cost principle? Or does the ability of the affiliated institutions to replenish ex post the DGS also act as a restriction?

CONSTRAINTS TO DGS ALTERNATIVE INTERVENTIONS

➤ Preventive measures

- Should not qualify as extraordinary public financial support, but as an alternative private sector measure, with a reasonable prospect, to prevent the failure of the institution within a reasonable timeframe (Articles 32(1)(b) BRRD / 18(1)(b) SRMR)

➤ Super priority rule

- Super priority enjoyed by DGS in liquidation (via subrogation to the rights of covered depositors) hampers the DGS's ability to undertake alternative interventions pursuant to the least cost principle
- Use of DGS in resolution: Articles 109 BRRD / 79 SRMR

➤ Computation of the least cost principle

- Wider interpretation enabling computation of indirect costs: potential failure of other credit institutions (contagion effect); financial cost related to the pay-out; lack of public confidence (e.g. general increase of funding costs)

CONSTRAINTS TO DGS ALTERNATIVE INTERVENTIONS

➤ **Lack of a fit-for-purpose liquidation framework**

- Orderly liquidation strategy requires procedural rules for transferring assets and liabilities in liquidation
- Competitive sale processes under share deal or asset deal modalities with potential carve-out strategies (ASV, APS) with bridge bank as a fallback solution

➤ **Lack of access to DGS funding by small and mid-sized banks with positive PIA**

- DGS cannot be used to bridge the gap (cover losses) where necessary to reach the 8% TLOF for capital support by the SRF

RISKS LINKED TO DGS ALTERNATIVE INTERVENTIONS

- **Fragmentation risks in the Banking Union due (i) to proliferation of voluntary schemes on deposit protection or (ii) smaller banking sectors with less financial capacity to fund DGS alternative interventions**
- **Level playing field risks due to the lack of minimum harmonized liquidation procedures and tools**
- **Renationalization risks of crisis management in the Banking Union**
 - Overreliance on national DGS for handling crisis management of small-to-medium sized banks amplifies the risks to national banking systems in case of significant financial burden (e.g. need to raise extraordinary contributions by the relevant DGS)
 - Ultimately recoups the sovereign-banks nexus

CMDI REVIEW CONSULTATION - SRB REPLIES ON DGS

- **Use of DGS (until EDIS) in resolution:** harmonise least cost test (LCT) and remove DGS super-preference to enable broader use
- **Use of DGS (until EDIS) for alternative measures:** harmonise LCT, triggers to enable national transfers of assets-liabilities
- **Governance:** progressively centralised, in line with funding:
 - ❖ in resolution, minor changes (DGS involved when contributing)
 - ❖ outside resolution, SRB to consent and ensure consistent application of harmonised LCT (central trigger and national vetoes may result in gridlock/inefficient fall-backs)
 - ❖ when EDIS + alternative measures are centralised, governance too

ANNEX

REVIEW OF THE CRISIS MANAGEMENT AND DEPOSIT INSURANCE FRAMEWORK

SRB REPLIES TO COMMISSION'S PUBLIC CONSULTATION



CMDI REVIEW CONSULTATION - SRB REPLIES

Full SRB replies are available here:

https://srb.europa.eu/sites/default/files/2021-04-20_srb_replies_consultation_cmdi_review.pdf