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REPORT

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Summary

The discussions on the strengthening of the Banking Union in the Council Working Party during the Slovenian Presidency focused on the elements of the crisis management and deposit insurance framework.

In the view of some Member States, **the EBA's analysis of EU banks' capacity to access resolution financing** supported the notion that the current resolution framework is incomplete, as it does not prevent the bail-in of eligible deposits above the coverage limit. Other Member States highlighted the fact that, in their jurisdictions, even very small banks were recently able to issue MREL-eligible instruments. These Member States stressed the importance of MREL in preventing these deposits from being used in burden sharing. Member States generally supported a further **analysis of banks' capacity to issue MREL and of related costs**.

Regarding the proposal to **enable access to industry-provided resolution financing to prevent bail-in of eligible deposits above the coverage limit**, with a view to reducing the use of liquidation aid, there were three groups of Member States. Several did not support the proposal. Member States saw the MREL requirement as a sufficient line of defence that can be set in all cases to prevent deposit bail-ins or did not see a need to prevent the bail-in of deposits. A widely shared view among these Member States was that the financing commitments of DGSs should not be broadened. In addition, the super-priority of covered deposits/DGS should be kept. Proposed alternative solutions to financial stability risks of bail-in of deposit above the coverage limit included increasing awareness of depositors that the bail-in of some deposits is possible and increasing the transparency of banks' financial condition to assess this possibility. These Member States were opposed to financing options that would require changes to the 8% TLOF threshold condition. Other Member States, however, supported the proposal. In their opinion, the lack of access to resolution funds or DGSs where needed undermined the credibility of the resolution framework. These Member States supported a more frequent use of transfers of assets and liabilities in resolution of banks. In order to expand the scope for engaging DGS in financing transfers, they supported changes to the creditor hierarchy. Some Member States in this group were also open to the possibility of revising the 8% TLOF threshold as a financing option. A third, smaller group of Member States acknowledged the existence of some of the problems cited with the current framework. They remained open to some of the solutions proposed, provided that certain strict conditions were met. These Member States were open to the use of transfer strategies financed by DGS, but not to changing the 8% TLOF threshold.

In view of some Member States, **to reduce the use of liquidation aid as an alternative to MREL and industry-provided funds in resolution**, there was no need to change incentives, but rather to close loopholes that currently enable the use of the alternatives. Other Member States acknowledged that part of the problem stems from the current framework's deficiencies. These included insufficient access to industry-provided financing in resolution, or PIA not being defined broadly enough. However, there were substantial differences in views on how to resolve this.

In the discussion of a **possible harmonisation of winding-up procedures for banks,** a vast majority of Member States supported the dichotomy of 'resolution versus liquidation' in the BRRD framework. A few agreed that, in terms of outcomes and tools used, a more continuous framework could be envisaged, but did not necessarily agree with the notion that winding-up framework should be the starting point. In that spirit, Member States widely supported the central point the PIA has in the resolution framework, and some considered that it should be widened to include more banks into resolution. Some Member States supported the use of resolution tools and powers in winding-up procedures, while respecting the proportionality principle. Others, however, found that the normal insolvency proceedings in place in their jurisdictions provided for sufficiently sound frameworks for orderly market exits by banks. Some opposed further harmonisation of national winding-up frameworks or the application of resolution-like tools in their national liquidation frameworks. Member States broadly supported refining the definition of winding-up in the BRRD and the objective of market exit following a negative PIA. However, they had divergent views on what the market exit should entail. Most Member States agreed, in principle, that the withdrawal of authorisation of a FOLTF bank should be non-automatic. There was no support as regards the proposal to use the orderly market exit of a bank as an additional explicit resolution objective. Member States saw the powers of competent/resolution authorities to deal with FOLTF banks in general as sufficient.

1. Introduction

Pursuant to the Council Conclusions on a Roadmap to complete the Banking Union, as adopted by the Council on 17 June 2016 (doc. 10460/16, '2016 Roadmap'), the Council has continued its work aimed at strengthening the Banking Union.

The progress made in the Council on the strengthening of the Banking Union has been presented in progress reports prepared by the Dutch Presidency (doc. 10036/16), the Slovak Presidency (doc. 14841/16), the Maltese Presidency (doc. 9484/17), the Estonian Presidency (doc. 14808/17), the Bulgarian Presidency (9819/18), the Austrian Presidency (doc. 14452/18), the Romanian Presidency (doc. 9729/19 ADD1), the Finnish Presidency (doc. 14354), the Croatian Presidency (doc. 8335/20 ADD 1), the German Presidency (doc. 13091/20) and the Portuguese Presidency (doc. 9311/21). This reporting is in line with the mandate of the Council Working Party on Financial Services and the Banking Union (doc. 8728/21, 'Council Working Party').

In June 2019, the President of the Eurogroup reiterated in his letter to the Euro Summit that further technical work would be needed to define a transitional path to the steady state Banking Union, adhering to all the elements of the 2016 Roadmap. This work should include a roadmap for starting political negotiations on a European deposit insurance system (EDIS). The Eurogroup in inclusive format mandated a High-Level Working Group (HLWG) on EDIS to continue this work and report back regularly.

In June 2021, the Euro Summit in inclusive format reiterated leaders' full commitment to the completion of the Banking Union and invited the Eurogroup in inclusive format to agree, without delay and on a consensual basis, on a stepwise and time-bound work plan on all outstanding elements needed to achieve this.

Moreover, the European Commission has been working on a review of the bank crisis management and deposit insurance (CMDI) framework in line with the Commission's 2021 Work Programme. The review focuses on three EU legislative texts: the Bank Recovery and Resolution Directive (BRRD), the Single Resolution Mechanism Regulation (SRMR) and the Deposit Guarantee Schemes Directive (DGSD). In early 2021, the Commission published two public consultations – one general and one targeted – to solicit stakeholders' views on their experience with the CMDI framework introduced after the global financial crisis. The consultations revealed a consensus among respondents that the framework was an improvement compared to the situation before the global financial crisis and that the objectives of the CMDI framework had been achieved to a large extent. However, the responses also highlighted some areas for improvement.

At the ECOFIN Council meeting in July 2021, the Commission sought more clarity on the positions of Member States and indicated that it was envisaging the review of the crisis management framework as part of the broader work plan to complete the Banking Union.

Following the approach of the previous presidencies (and most recently that of the German Presidency and the Portuguese Presidency), and in parallel with the political discussions taking place in the Eurogroup's HLWG on EDIS on all elements of the steady state of the Banking Union, the Slovenian Presidency has continued the discussions on strengthening the Banking Union. An informal video conference of the members of the Council Working Party took place on 25 October 2021. The aim of the meeting was to present the EBA's recent reply to the Commission's call for advice on funding in resolution and insolvency, and to discuss, based on two Presidency non-papers, (1) access to resolution financing, bail-in of deposits and use of state aid, and (2) a harmonised regime for the winding-up of banks. The EBA's analysis presents quantitative analysis relating to the issues discussed in Presidency non-paper (1). The discussion focused on situations following declarations of 'failing or likely to fail' (FOLTF) status.

The Presidency informed the HLWG on EDIS about the discussions in the Council Working Party at the HLWG meeting of 15 November 2021.

This progress report summarises the discussion in the Council Working Party and takes into account the views of the Working Party members. However, it was prepared under the responsibility of the Presidency. It is intended to provide continuity with the achievements under previous presidencies and to facilitate the task of the incoming presidency. It should not be considered binding, as it presents the Presidency's assessment of the outcome of the discussions.

2. The EBA's reply to the Commission's call for advice on funding in resolution and insolvency

In the context of the CMDI review, the Commission requested that the EBA provide targeted technical advice on possible funding sources (internal and external) to handle a bank failure in resolution and insolvency, including on the conditions for accessing external funding. The EBA analysed EU banks' internal loss absorption capacity, potential bail-in of depositors in resolution as well as banks' capacity to access resolution financing arrangements based on descriptive statistics relating to bank balance sheet data, which allow the marginal impact of the implementation of various policy options to be assessed and compared, and used a modelling approach to simulate a banking crisis scenario. The reply also assesses the difficulties that small and mid-sized banks report facing in issuing MREL-eligible instruments.

Some Member States saw significant drawbacks in exposing non-covered deposits to bail-in and viewed the current resolution framework as incomplete in respect of preventing their bail-in, in particular after most of the bank's buffers are exhausted, as this is likely at the point of FOLTF. A few Member States saw access of small banks to capital markets as difficult. Others, however, welcomed the fact that, in their jurisdictions, in particular during the recent period of favourable financing conditions, even very small banks were able to issue MREL-eligible instruments. They stressed the importance of MREL in preventing deposits being drawn into burden sharing.

Member States generally supported, and encouraged the EBA to conduct further analysis of banks' capacity to issue MREL and how much this costs. In the meeting, the Commission reported results of its own analysis that, for now, indicate that banks in a number of Member States have not issued MREL-eligible liabilities, owing to either transitional and/or structural reasons. The reasons need to be further explored.

3. Access to resolution financing, bail-in of deposits and use of state aid

The non-paper is composed of two parts. The first focuses on making specific improvements to the EU resolution framework by proposing to extend the protection of eligible deposits beyond covered deposits in situations where their mandatory bail-in – which would be required to reach the 8% TLOF threshold needed to access resolution financing – would lead to a trade-off between preserving financial stability and access to industry-funded safety nets. The premise of the non-paper is that deposits have characteristics that may make them different from other bank liabilities that are in principle bailinable. They can be an important conduit of indirect contagion. Another premise is that the credibility of the resolution framework depends on ensuring that all banks that need to be resolved can be resolved within the framework, and that this is done by minimising access to taxpayers' money.

The proposal would be applicable to banks in general, i.e. not limited to banks with any specific characteristics. At the same time, it would strengthen the business model neutrality of the current resolution framework: keeping the MREL as the first line of defence against using external financing in the event of a bank's failure, but set in a manner proportionate to the bank's financing structure (and related asset composition). For example, small and mid-sized banks, in principle, may not be subject to MREL requirements at a level that ensures that the 8% TLOF threshold will be reached in the event that they fail. The proposal would be applicable to any bank where (a) the public interest assessment (PIA) at the point of FOLTF concludes that the resolution objectives would be better preserved by resolution than by liquidation; (b) the 8% TLOF threshold can only be reached by bailing in eligible deposits above the coverage limit; (c) application of a transfer tool is possible; and (d) market exit of the bank is assured. In such a case, financing from resolution and/or DGS funds would be available.

Most Member States saw MREL as the crucial first line of defence. Several Member States also saw it as a sufficient line of defence. This was because they saw bailing in non-covered deposits as, in principle, unproblematic for financial stability (and one Member State had already successfully tried it out). Others agreed with the premise that bailing in deposits should, in principle, be avoided, but argued that sufficient MREL, in particular in the form of subordinated instruments, should and can be set in all cases to prevent such bail-ins without endangering bank business model diversity in the EU. They did not support the proposal, though some kept the door open to it in the event that further analysis, as discussed in the context of the EBA's presentation, were to prove that some banks do indeed have issues relating to their capacity to issue MREL or with the cost of doing so. A few Member States saw the proposal as creating an unjustified exception, or another layer of resolution for a specific bank business model, or as unfair to those banks which have amended their business models since MREL rules were introduced 2015. In the context of the financing solutions proposed, some Member States highlighted that in their view, DGS funds should primarily be used to pay out deposits. Some also opposed a change to the creditor hierarchy, which would be needed to increase the financing power of DGSs. They spoke in support of keeping the super-priority of covered deposits/DGS.

As alternative solutions to the trade-off, they suggested increasing awareness among depositors that their non-covered deposits may be bailed in, as well as offering further transparency on banks' financial condition so that the public can reliably assess the risks of bail-in. Another proposal was to declare FOLTF early, while a failing bank has not yet accumulated losses. Member States in this group were opposed to financing options that would require changes to the 8% TLOF threshold condition, which they saw as an immutable element of the BRRD framework.

Other Member States did see a need to protect deposits other than eligible deposits from a bail-in above the coverage limit and a problem when neither resolution funds nor DGSs are accessible to finance resolution when needed. In some cases, this may make preserving financial stability and depositor confidence, while simultaneously protecting taxpayers' money, impossible. Mention was made of possible knock-on effects on financial stability in the event that the bail-in of deposits lowered the repayment capacity of banks' borrowers. Moreover, in resolution, in contrast to liquidation, the preservation of critical functions creates a need to preserve franchise value, which constitutes another reason to protect deposits other than covered deposits in resolution. Some Member States argued in favour of protecting deposits beyond those of natural persons and micro and SMEs. Corporate deposits were mentioned in this respect. Another idea was to define the scope of protection on the basis of motivations of asset/liability transfers, e.g. a need to preserve financial stability or preserve a valuable commercial relationship, depending on the nature of each resolution case. Based on similarities with depositors, one Member State argued for even broader protection (i.e. to include retail bondholders) and even for protection in liquidation.

The need for a proportionate level of MREL for small and mid-sized banks was cited by some as a reason why access to resolution funding may be lacking for these banks. These Member States largely agreed with the idea that asset/liability transfers should be the tool of choice in such resolution cases. In order to expand the possibilities for engaging DGSs in the financing of transfers, they advocated changes to the creditor hierarchy that would support the financing of such transfers. Some Members States in this group called for the possibility of revising the 8% TLOF threshold, e.g. by replacing it with a requirement that all the MREL-eligible liabilities of the bank should be subject to burden sharing. One Member State also proposed to review the maximum contribution of resolution fund of 5% of bank's TLOF allowed by the BRRD.

The Member States were sceptical of the idea of broadening the ex ante loss absorption of banks by allowing bailinable non-retail liabilities, which currently do not count as MREL, to become eligible for the 8% TLOF threshold for resolution planning purposes, as a complement to other financing options.

EDIS was mentioned as an important liquidity backstop for DGS by some Members States supporting the proposal, but also by some of those opposing it. Alignment of decision-making responsibility with allocation of cost between the national and central levels was invoked in this respect (as was, in a different context, a need for alignment in governance in the context of problems that would arise if MREL is set at central level but (DGS) financing responsibility rests at national level). However, other Member States cautioned that CMDI should not be linked with EDIS and emphasised the need for the CMDI framework to work without a common deposit insurance backstop.

In between the two above-mentioned groups of Members States was a smaller group that acknowledged the existence of some of the problems that motivated the non-paper and remained open to some of the solutions proposed therein. Some saw the benefit in differentiating the resolution strategies more, in particular between the open and closed bank ones. The promise they saw in this approach is access to resolution for more banks, but with a more proportionate MREL requirement as compared with the requirement that comes with the open bank bail-in strategy. These Member States stated that they could support the proposal only if certain conditions were fulfilled. For example, banks should exit the market, adjustments should be made to conditions for DGS preventive measures, and measures should be taken to close off alternatives that exist in the current framework and that enable banks to choose the most favourable route to exit from the market, e.g. in terms of (not) subjecting senior creditors to burden sharing (see below). In terms of what type of deposits to protect, the need to align the scope with the creditor hierarchy in insolvency to avoid violation of the NCWO principle was mentioned. These Member States may be open to the use of transfer strategies financed by DGS, but not to changing the 8% TLOF threshold to access the resolution funds.

The discussion continued on the use of alternatives to the resolution framework to obtain similar results (resolution or liquidation), but with a different allocation of losses among banks' (senior) creditors and financing sources used, i.e. so-called circumvention routes. State aid rules for banks are an important element of the framework guiding these decisions. In November 2020, the Eurogroup in inclusive format invited the Commission to review the state aid framework for banks, set out in the 2013 Banking Communication. While this process has just started, the discussion focused on the potential of improvements to the resolution framework to reduce the need for state aid (liquidation aid).

There was a lot of alignment between how Members States viewed the proposal and how they saw the use of alternatives to BRRD. Member States agreed that these alternatives exist. Where they disagreed was on whether or not their use is increased by deficiencies in the framework that therefore need to be fixed in order to disincentivise that use. Some Members States did not see a need to change the incentives of the framework, but a need to close off loopholes that currently enable the use of alternatives. If liquidation aid were to stay, they requested that burden sharing in liquidation aid be aligned with that in resolution to preserve the level playing field for banks.

Other Member States did see a need to close off circumvention routes, but acknowledged that part of the problem stems from the current framework's deficiencies, e.g. insufficient access to industry-provided financing in resolution, or PIA not being defined broadly enough to include all banks where resolution would be necessary. However, there were substantial differences in views on how to resolve this. Some saw closing off circumvention routes and ensuring easier access to transfer financing in resolution as directly linked, and demanded that access to liquidation aid and use of DGS alternative funds should be substantially reduced after resolution financing is made more accessible. Others argued that increasing the availability of industry-provided financing, both in resolution and liquidation, would decisively reduce the need to use liquidation aid.

Transfer tools similar to those mentioned in the proposal (to be used in bank resolution) can also reduce the cost of public intervention in liquidation (as DGS alternative measures). Therefore, another set of questions asked whether Member States agreed that when it comes to aligning burden sharing by creditors in resolution and liquidation, DGS alternative measures should not be subject to the same alignment as should liquidation aid. In addition, Member States were asked whether they saw a need for alignment beyond the state aid framework, and in relation to what elements the use of alternatives to BRRD should be closed off.

Only a few Member States answered the question of whether, in terms of burden sharing, alternative measures and liquidation aid should be treated in the same way, mainly taking the view that they should not. Some of the Member States that did not answer the question nevertheless highlighted the need to clarify the interaction of state aid with DGS alternative measures, e.g. the divergence between state aid's treatment of preventive measures and of alternative measures, and between the treatment of private vs. public DGSs, as well as the ability to impose burden sharing requirements in alternative measures.

As to what other changes are necessary in the BRRD framework in order to align incentives between resolution and liquidation, one issue mentioned was the SPE resolution strategy that creates a group-based creditor hierarchy that is different from the legal entity-based one applicable in insolvency, resulting in different burden sharing. Another idea proposed was to explicitly link the use of liquidation aid and DGS alternative measures to the market exit of a bank. Yet another was to introduce, in DGS alternative measures, a limit on the seniority of transferable liabilities to prevent transfers of bonds that could affect the level playing field among bondholders.

4. Possible harmonisation of winding-up procedures for banks

In its second non-paper, the Presidency reflects upon the interaction of the resolution regime with winding-up procedures for banks and the concept of normal insolvency proceedings under the BRRD. The intention is to reflect once more on the resolution versus liquidation dichotomy, which was built into the BRRD framework when it was created. The framework's features were built around that dichotomy, and previous debates surrounding the CMDI review showed important differences in Member States' views on some fundamental issues relating to the normal liquidation and winding-up procedures applicable to banks. The non-paper is conceptual in nature and does not contain answers to practical questions, e.g. on the issue of resolution and liquidation financing and conditions for accessing it.

The point of departure is that there is public interest not only in resolution but also in the winding-up of banks: 'atomistic' insolvency, which is envisaged for non-financial companies, is not an optimal form of winding-up for banks due to its negative effects on financial stability. The non-paper therefore proposes defining the features of a possible winding-up framework common to all Member States. This would include (i) an improved common definition of winding-up in the BRRD so that it is clear which national insolvency proceedings fall under it; (ii) clearly defined minimum features and triggers of a normal winding-up procedure for banks; and (iii) special supervisory powers applicable after a FOLTF declaration and eventual withdrawal of authorisation.

A few Member States agreed with the existence of public interest in liquidation but argued that, if there is public interest, the bank should go into resolution. Some Member States did support the use of certain resolution tools and powers in winding-up procedures, and referred to the proportionality principle. They were open to the further expansion of such tools and procedures in the EU, at least if the option of using normal insolvency proceedings also remained open. Some indicated more analysis was needed in order to identify the exact obstacles that stand in the way of such tools and procedures in their jurisdictions. Others, however, found that the normal insolvency proceedings in place in their jurisdictions provided for sufficiently sound frameworks that enabled orderly market exits by FOLTF banks. Some opposed further harmonisation of national winding-up frameworks and the application of resolution-like tools in their national liquidation frameworks. They cited legal – and sometimes constitutional – obstacles to the introduction of administrative powers outside resolution.

The concept of PIA, used in the current framework as the fork in the road separating the resolution of a bank from its liquidation, was widely seen by Member States as the right approach. The dichotomy was seen as important. Although the current PIA approach was, as in previous debates in various fora, seen by some as being in need of some adjustments to ensure consistency, predictability and transparency, these Member States supported broadening the resolution remit to various extents (as opposed to extending public interest into liquidation).

Refining the definition of winding-up in the BRRD was broadly supported, as was the objective of market exit following a negative PIA. The views on what the market exit should entail, however, diverged. Further analysis was needed on how to reach a clear list of which procedures in each jurisdiction count as winding-up and what common insolvency triggers should be. A need to leave open the possibility of a judicial procedure was expressed, as this sometimes offers advantages over an administrative approach, e.g. in terms of legal certainty or of a possibility of coordinated insolvency for holdings that involve both banks and non-bank firms. As to the link with the withdrawal of authorisation, most Members States emphasised the importance of keeping the non-automatic nature of the procedure and of preserving the discretionary powers of supervisors that are needed to ensure a timely but orderly market exit. A few mentioned that the withdrawal of authorisation was the sole insolvency trigger for banks in their Member State.

The proposal to enshrine the orderly market exit of a bank as an explicit resolution objective, in addition to the existing five resolution objectives of Article 31 BRRD, was met with general scepticism. Some Members States saw it as conflicting with other resolution objectives and particularly with some resolution strategies, i.e. open bank bail-in. Others questioned the need for this action, as there are currently no obstacles to resolution authorities managing the market exit of a bank. A point was made that even a very small bank should be eligible for judicial re-organisational measures.

The non-paper proposed to equip competent/resolution authorities with additional powers to be applied to banks that have been declared FOLTF and would be wound-up. This would include powers to appoint special management, apply sale-of-business and asset-separation tools and initiate piecemeal liquidation, with the goal of better meeting public interest in due process. However, the Member States in general saw the powers provided for by the current framework as sufficient. As an alternative, one Member State proposed a better coordination between authorities when a bank is nearing a FOLTF declaration. This would ensure that the resolution authority would be prepared when the competent authority declared a bank FOLTF.

5. Topics related to reduction of risks in the banking sector

Under the Slovenian Presidency, work has started on two legislative proposals that will, once adopted, have an important impact on lowering risks in the EU banking system, i.e. the anti-money laundering package, presented by the Commission in July, and the Capital Requirements package, presented in October. The Presidency initiated negotiations in the Council on both proposals immediately. In addition, the directive on credit servicers and credit purchasers, which was negotiated between the co-legislators under the Portuguese Presidency and aims at fostering the development of secondary markets for non-performing loans, was approved by the Council on 9 November 2021 and will enter into force by the end of this year.

6. Concluding remarks

The Presidency invites the Council to take note of this report, with a view to taking the work further.

The French Presidency is invited to build on the progress made and continue to work towards strengthening the Banking Union.