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From:	Presidency
To:	Working Party on Financial Services and the Banking Union (CMDI) Financial Services Attachés
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Presidency note on PIA

WP CMDI 09-10-2023

1. Introduction: previous discussions and Member States views

At the Council Working Party meeting of 20 July, the Presidency presented a note on resolution objectives and the public interest assessment with questions and some options. The paper was then discussed by Member States (MS), which also sent written comments by 31 August. The objective of this note is to provide a recap of those discussions and summarise the views of Member States based on the oral interventions and written comments. It also suggests possible ways forward.

The Presidency has concluded that the Council would like to advance along the following lines:

- Most MS agree that more institutions should be subject to resolution, but not all of them.
- Most MS agree that there is not a general case for "too small for resolution": while small institutions could be subject to national insolvency procedures if those are efficient and do not endanger the resolution objectives, it could be conceived that, depending on the circumstances, a small institution could be earmarked for resolution.
- At the same time, the existing practice with the current BRRD shows that the same wording can lead both to an ample resolution scope and to a limited resolution scope.
- Most MS agree that, if insolvency proceedings are efficient and/or the resolution objectives are not considered to be at risk, wind-down through ordinary insolvency procedures is to be expected.
- Most MS agree that imposing losses on some deposits might have an impact on financial stability and effects on the real economy, but their views differ (i) on the need to include the protection of those deposits as a resolution objective in absolute terms, and (ii) on what such deposits really are.
- Some MS consider that more clarity should be given to what a new resolution scope would look like. However, it is also noted that resolution authorities, and in a Banking Union context, national resolution authorities in particular, have discretion on the matter. Hence, to some extent, they should be best placed to estimate the impact of the changes in their Member State for the entities under their direct responsibility.
- Most MS are aware that expanding the scope implies additional costs for the institutions. Some MS believe that, in some instances, these costs would not be proportionate to the benefits of preparing for resolution instead of insolvency.

Q0: Do Member States agree with the description of the current state of affairs?

2. Introduction of explicit reference to 'national or regional level' in the definition of 'critical functions' (Article 2(1), point (35), of BRRD)

As stated in a former Presidency note, the current definition of 'critical functions' in the BRRD does not include an explicit reference to the impact of their disruption on the real economy and financial stability at a regional level. In the Commission's view, this leads to a possible interpretation that functions may only be deemed critical when their discontinuation has impacts at a national level. To avoid divergent interpretations, the Commission proposes to add a reference in the definition of 'critical functions' to the 'national or regional level' of the impact of the disturbance of their discontinuation to the real economy or to financial stability (Article 2(1), point (35) of BRRD).

In their written comments, most MS agreed with the proposed addition. In particular, some MS highlighted the importance of allowing resolution authorities to assess the geographical scope of the disturbance. Other MS considered that the current definition could already cover such interpretation, but they did not oppose the addition. A minority of MS opposed the addition, on the ground that it was not needed, mentioning that a regional bank is unlikely to have an impact on financial stability and that any regional assessment would be difficult.

In terms of the possibility to further specify what regional impact means, most MS believe it should not be done and thus resolution authorities should have the flexibility to interpret it. These MS argue, among other things, that regional impact might be a fuzzy concept not directly referred to administrative divisions (such as NUTS2), that it could even imply local impact and that each MS has different ways of defining regions. In this regard, even within one MS, administrative regions are defined on the basis of political and historical criteria and they can vary widely in extension and economic relevance. Some MS stress that the regional assessment of the impact should be independent from the national assessment and no link between the two should be sought, for instance, through the share of the regional GDP in the national GDP. On the other hand, some MS believe that additional framing is needed; the interpretation of "regional level" should not be left to the entire discretion of RA because, without further details, there would not be a true harmonization and a consistent application of the resolution framework across the Banking Union (and across the Union as a whole). One MS considers that the mere regional impact should not warrant the use of resolution financing arrangements.

Based on the existing feedback, the Presidency considers that there is broad support for the clarification that resolution authorities can assess the impact of the possible discontinuation of critical functions on the real economy and financial stability also at regional level. Furthermore, article 6 in the Commission's Delegated Regulation (EU) 2016/778 of 2 February 2016 currently specifies criteria relating to the determination of critical functions, with references to the regional level but without any specific definition of such scope.

Hence, the Presidency proposes to keep the Commission proposal as currently drafted. Article 2(1)(35) is, therefore, suggested to be amended as follows:

(35) 'critical functions' means activities, services or operations the discontinuance of which is likely in one or more Member States to lead to the disruption of services that are essential to the real economy or to disrupt financial stability at national or regional level, due to the size, market share, external and internal interconnectedness, complexity or cross-border activities of an institution or group, with particular regard to the substitutability of those activities, services or operations;

Q1: Do Member States agree with the proposed way forward?

3. New reference to support provided from 'the budget of a Member State' in the resolution objective of protecting public funds (Article 31(2), point (c), of BRRD)

As stated in a former Presidency note, the Commission proposal amends the objective of protecting public funds by providing that reliance on extraordinary public financial support ('EPFS') should be minimised 'in particular' when it comes from the budget of a Member State. In the Commission's view, the current BRRD wording does not allow for a distinction between the use of national budget money and the use of industry-funded safety nets (national resolution funds, SRF or DGSs in those MS where the DGS is considered public funds).

In their written comments, most MS agree that the EPFS stemming from budgetary resources of a MS differ from existing industry-funded safety nets. While agreeing, some MS highlight that, although different in concept, there might be a link between the two if the MS budget backstops the industry funds and that the use of both should be discouraged in favour of MREL. Another MS considers that financial support provided by industry-funded safety nets should not be qualified as extraordinary public financial support. Finally, other MS disagree with the establishment of such differentiation because the moral hazard created is the same and it would result in an unlevel playing field. One MS considers that private DGS should be considered public funds.

In terms of the possibility to reflect this differentiation in the text, most MS believe it should be done. Furthermore, in the September Working Party, in relation to the Presidency note on funding, all but one MS agreed that, in case of need, it would be preferable to use industry funds rather than taxpayer funds. On the other hand, some MS believe the relevant question is not whether industry funds or taxpayer money should be used, but rather if there has been enough burden sharing or whether mutualisation in the Banking Union should take place. Some argue that it might give the impression that the use of the industry-funded safety nets is promoted, other MS fear that it might be interpreted as meaning that further EPFS is to be expected after the exhaustion of industry funds, and finally other MS raise the issue that the State Aid regime does not differentiate between those funds.

Based on the existing feedback, the Presidency considers that there is broad support for making explicit the differentiation between funds stemming from the Budget and

(public) funds stemming from the industry. The Presidency nevertheless takes into consideration the concerns expressed by some MS and proposes to add a recital to ensure the new wording is not interpreted incorrectly.. For all of the above, the Presidency, proposes:

- To introduce wording in the recital 11 which is suggested to be drafted as follows:

> (11) The assessment of whether the resolution of an institution or entity is in the public interest should also reflect, to the extent possible, the difference between, on the one hand, funding provided through industry-funded safety nets (resolution financing arrangements or DGSs) and, on the other hand, funding provided by Member States from taxpayers' money. Funding provided by Member States bears a higher risk of moral hazard and a lower incentive for market discipline. Therefore, when assessing the objective of minimising reliance on extraordinary public financial support, resolution authorities should find funding through the resolution financing arrangements or the DGS preferable to funding through an equal amount of resources from the budget of Member States**. <u>In any case, the differentiation between both public and industry funding should not lead to the conclusion that extraordinary public financial support through the Budget is to be expected after the possible use of industry-funded safety nets.</u>**

- To keep the Commission proposal as currently drafted. Article 31(2), point (c) is suggested to be amended as follows:

> (c) to protect public funds by minimising reliance on extraordinary public financial support, in particular when provided from the budget of a Member State.

Q2: Do Member States agree with the proposed way forward?

4. Changes to the resolution objective of protecting depositors (Article 31(2), point (d), of BRRD)

4.1. Minimising losses to DGSs

The Commission proposal adds a qualifier stating that the resolution objective of protecting depositors covered by DGSD should be achieved 'while minimising losses for deposit guarantee schemes'.

MS have split views. Some MS believe that protecting DGS is a legitimate resolution goal, however some MS believe that the objective is already tackled by the Least-Cost-Test (LCT). Other MS believe it is not a resolution objective because (i) it would place the protection of taxpayers' and industry's funds on the same level, (ii) the LCT and the current superpreference of covered deposits already protect DGS, (iii) it would be difficult to estimate such losses in the planning phase.

On the possibility to remove the reference to minimising DGS losses, most MS agree this should be the right path. Other MS would maintain the Commission's wording or

explain that the protection of deposits while minimising DGS losses has to be interpreted in light of the other objectives in a proportionate way.

Based on the existing feedback, the Presidency considers that there appears to be little support for amending the article. Moreover, as some MS have observed, the minimisation of DGS losses appears to be implicitly considered by the LCT. Hence, the Presidency proposes not to amend the current BRRD wording (see that options below delete the reference to minimising DGS losses).

Q3: Do Member States agree with the proposed way forward?

4.2. Protecting depositors

The Commission proposal replaces the reference to 'depositors covered by Directive 2014/49/EU', with a reference to 'depositors'.

In their written comments, MS have split views about whether the proposed wording implies or not that all depositors will be protected. On the one hand, for some MS it is clear that under the Commission proposal it is possible for deposits to suffer losses. Some MS even consider that it should be explicitly clarified that some deposits cannot suffer losses. Finally, other MS consider that the wording implies, either explicitly, or implicitly, that all deposits will be protected, creating, at the very least, a presumption of protection, which they oppose.

This divide translates into different opinions by MS on whether to replace "depositors covered by Directive 2014/49/EU" by just "depositors". Most MS disagree with such replacement. Some of these MS consider that, when the protection of deposits for financial stability is needed, the existing resolution objectives already cater for this eventuality. Other MS disagree because they consider that not all deposits merit the same protection, in relation to covered deposits and among non-covered deposits, or because it may increase moral hazard to depositors and credit institutions. A few MS argue that such replacement would imply an inevitable expansion of the resolution scope and hence disproportionate cost to institutions in terms of MREL. Finally, some MS raise the inconsistency between the general reference to the protection of deposits as a resolution objective and the fact that deposits and still be MREL-eligible (and bailed-in).

Based on the existing feedback, the Presidency considers that the Commission proposal includes wording that can be subject to different interpretations. Furthermore, there appears to be little (but some) support for amending the article. Finally, as some MS have raised, the protection of deposits can be included in other resolution objectives. Hence, the Presidency proposes two options:

Option 4.2.1: Not to amend the current BRRD wording on resolution objective of deposits. Article 31(2), point (d) would then be drafted as follows:

> '(d) to protect depositors ~~while minimising losses for deposit guarantee schemes~~ **covered by Directive 2014/49/EU** and investors covered by Directive 97/9/EC; '

Option 4.2.2: Amend the Commission proposal text to specify when the protection of deposits might be a resolution objective. Article 31(2), point (d) would then be drafted as follows:

> '(d) to protect depositors **insofar as it is strictly necessary and proportionate to achieve the continuity of critical functions or to avoid giving rise to widespread contagion which would severely disrupt the functioning of financial markets** ~~while minimising losses for deposit guarantee schemes~~, and investors covered by Directive 97/9/EC. '

Q4: Which option do Member States agree more with?

5. Amendments to the comparison between resolution and national insolvency proceedings (Article 32(5), first subparagraph, of BRRD)

The proposal introduces an amendment to the way in which the PIA should be carried out by specifying that resolution will be in the public interest where resolution action is necessary for the achievement of, and is proportionate to, one or more of the resolution objectives and where winding up of the institution under normal insolvency proceedings would not meet those resolution objectives more effectively (as opposed to 'to the same extent' as in the current text).

Once again, views are split. Some MS are willing to accept the Commission's new way of formulating the PIA. On the other hand, other MS, while agreeing with the intention to expand the scope of institutions earmarked for resolution, reject the proposed amendments because they believe that (i) it would be make following insolvency proceedings unlikely or too difficult to justify or (ii) the current wording already allows the expansion of the resolution scope. Some MS suggest establishing presumptions about which institutions should go to resolution. In addition, although some MS consider useful a clarification that, for resolution to be decided, a necessity and proportionality assessment must be made in relation to the resolution objectives, other MS oppose as it would complicate matters or because it is considered insufficient.

Based on the existing feedback, the Presidency believes that most MS support at the same time (i) expanding the scope of institutions subject to resolution but (ii) maintaining insolvency as the default option, which should ensure that, if resolution objectives are not at risk, small institutions are wound down under insolvency procedures. Moreover, it can be argued that the current wording of BRRD already allows positive PIAs for small institutions in some MS. However, at the same time, the resolution scope remains limited in practice in some MS and there is a clear mandate in the Eurogroup Statement of 16 June 2022 to achieve a *"broadened application of*

resolution tools in crisis management at European and national level, including for smaller and medium-sized banks, where the funding needed for effective use of resolution tools is available, notably through MREL and industry-funded safety nets". It is therefore needed to introduce new wording to nudge, but not force, Resolution Authorities to expand the resolution scope, while at the same time maintaining the current discretion of resolution authorities to determine the exact scope (and hence what this expansion does look like). Hence, the Presidency proposes the following 3 options:

Option 5.1: Staged approach in determining PIA + maintaining "more effectively" in the comparison between insolvency and resolution. This Option would consist of breaking up the public interest assessment into two main parts consisting of discrete stages.

a) Resolution authorities would first assess if any of the resolution objectives would be at risk in case the entity were to fail and be wound up in normal insolvency proceedings;

b1) If the outcome of the assessment in point (a) is negative, i.e., there is no such risk to any of the objectives, then the entity should be wound up in normal insolvency proceedings.

b2) If the outcome of the assessment in point (a) is positive, then the resolution authority would be required to put the failing entity in resolution unless the resolution objectives can be achieved more effectively in normal insolvency proceedings (in line with the proposed change under CMDI).

This staged approach would allow the expansion of resolution scope but still make sure that small institutions, if resolution authorities consider that there are no resolution objectives at risk, are dealt with under insolvency proceedings.

Article 32(5) – option 5.1

'5. **In order to determine whether a resolution action shall be treated as in the public interest for the purposes of paragraph 1, point (c), the resolution authority shall, in a first stage, assess whether any of the resolution objectives would be at risk in case the institution would be wound up under normal insolvency proceedings. Resolution action shall be treated as not being in the public interest if none of the resolution objectives would be at any risk in case the institution would be wound up under normal insolvency proceedings.**

In case the outcome of the assessment referred to in the first subparagraph is such that one or more of the resolution objectives would be at risk in case the institution would be wound up under normal insolvency proceedings, the resolution authority shall, in a second stage, assess whether a resolution action is necessary for the achievement of, and is proportionate.

In case the outcome of the assessment referred to in the second subparagraph results in a determination that resolution action is necessary and proportionate to one or more of the resolution objectives referred to in Article 31, a resolution action shall be in the public interest for the purposes of paragraph 1, point (c) if, in the assessment of the resolution authority, winding up of the institution under normal insolvency proceedings would not meet those resolution objectives more effectively.

~~For the purposes of paragraph 1, point (c), a resolution action shall be treated as in the public interest where that resolution action is necessary for the achievement of, and is proportionate to, one or more of the resolution objectives referred to in Article 31 and where winding up of the institution under normal insolvency proceedings would not meet those resolution objectives more effectively.~~

Member States shall ensure that when carrying out the assessment referred to in the first subparagraph, the resolution authority, based on the information available to it at the time of that assessment, considers and compares all extraordinary public financial support that can reasonably be expected to be granted to the institution, both in the event of resolution and in the event of winding up in accordance with the applicable national law.'

Option 5.2: Presumption for insolvency + maintaining "more effectively" in the comparison. This option introduces a presumption of a negative public interest assessment for certain entities, which is based on some of the criteria used for the simplified obligations assessment. Under this approach, the resolution authority would assess if in case of failure of the institution its subsequent winding up under normal insolvency proceedings would put any of the resolution objectives at risk. This assessment would be further framed with a non-exhaustive list of criteria. The resolution authority would carry out its assessment having regard to the impact that the failure of the institution could have on some elements (among others, financial markets, the wider economy). If, based on the above assessment, the resolution authority determines that no resolution objectives are at risk, the resolution of the institution should be presumed not to be in the public interest. In case an opposite outcome is reached, the resolution authority would carry out the fully-fledged public interest assessment, including the necessity and proportionality elements as well as the comparison between resolution and winding up under normal insolvency proceedings. This option would allow that the smallest banks or those whose failure is least risky remain outside the scope of resolution. In particular, by using criteria modelled on those for application of simplified obligations, those authorities which already apply simplified obligations to a large number of small institutions (LSIs) under their remit, which are earmarked for liquidation, could simply leverage on their prior assessment for the PIA.

Article 32(5) – option 5.2

'5. For the purposes of paragraph 1, point (c), a resolution action shall be treated as in the public interest where that resolution action is necessary for the achievement of, and is proportionate to, one or more of the resolution objectives referred to in Article 31 and where winding up of the institution under normal insolvency proceedings would not meet those resolution objectives more effectively.

Resolution action shall be presumed not to be in the public interest for the purposes of paragraph 1, point (c), where the resolution authority assesses, having regard to the impact that the failure of the institution could have on financial markets, on other institutions, on funding conditions, or on the wider economy, and due to the nature of its business, its shareholding structure, its legal form, its risk profile, size and legal status, its interconnectedness to other institutions or to the financial system in general, as well as the scope and the complexity of its activities, that its failure and subsequent winding up under normal insolvency proceedings would not put any of the resolution objectives referred to in Article 31 at any risk. In case the resolution authority assesses that one or more of those resolution objectives would be at risk, the presumption shall not apply.

Member States shall ensure that when **the presumption referred to in the second subparagraph does not apply, the resolution authority shall carry** out the assessment referred to in the first subparagraph**. When carrying out that assessment**, the resolution authority, based on the information available to it at the time of that assessment, considers and compares all extraordinary public financial support that can reasonably be expected to be granted to the institution, both in the event of resolution and in the event of winding up in accordance with the applicable national law.'

Option 5.3: Insolvency remains the default approach but qualified for some scenarios for which resolution is likely + reverting to "lesser extent" in the comparison. In this option, the comparison between the extent to which resolution objectives are achieved in resolution and in normal insolvency proceedings (Article 32(5) of BRRD) would be reverted to the status quo under current BRRD, and the same path for liquidation under normal insolvency procedures is maintained. However, to achieve the goal of expanding the scope of entities to which resolution could potentially be applied, such presumption is qualified with cases where it could be conceivable to apply resolution, without forcing it.

New recital – option 5.3

'**(X). Although a failing institution should in principle be liquidated under normal insolvency proceedings, such liquidation under normal insolvency proceedings might, in some cases, jeopardise financial stability and interrupt the provision of critical functions. This could be the case, for instance, when the institution is of a relevant size or when insolvency would likely imply losses on some deposits or significant difficulties in the continuity of access to some deposits, which is deemed by the resolution authority to have an impact on financial stability through contagion or on the real economy. In such cases it is highly likely that there would**

be a public interest in placing the institution under resolution and applying resolution tools rather than resorting to normal insolvency proceedings.'

Article 32(5) – option 5.3

'5. For the purposes of paragraph 1, point (c), a resolution action shall be treated as in the public interest where that resolution action is necessary for the achievement of, and is proportionate to, one or more of the resolution objectives referred to in Article 31 and where winding up of the institution under normal insolvency proceedings would not meet those resolution objectives **to the same extent** ~~more effectively~~.

Member States shall ensure that when carrying out the assessment referred to in the first subparagraph, the resolution authority, based on the information available to it at the time of that assessment, considers and compares all extraordinary public financial support that can reasonably be expected to be granted to the institution, both in the event of resolution and in the event of winding up in accordance with the applicable national law.'

Q5: Which option do Member States agree more with?

6. Requirement to consider and compare all extraordinary public financial support that can reasonably be expected to be granted to the institution (Article 32(5), second subparagraph, of BRRD)

Under the Commission proposal, resolution authorities, when conducting the PIA, will be required to consider and compare, based on the information available to them at the time of resolution, all EPFS that can reasonably be expected to be granted to the institution, both in case it would be resolved and in case it would be wound up in accordance with applicable national law.

Once again views are split. Some MS agree it is possible for resolution authorities to expect and estimate EPFS and raise the possible inconsistency of receiving EPFS in insolvency proceedings but not showing a positive PIA. On the other side, other MS believe it is impossible to effectively carry out such assessment and point out that the protection of public funds already caters for the problem.

Based on the existing feedback, the Presidency believes that, since there is no majority view, and since the current BRRD wording already takes into consideration the protection of public funds as a resolution objective, it could be suggested not to include the proposed amendment.

Q6: Do Member States agree with the proposed way forward?