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To: Working Party on Financial Services and the Banking Union (CMDI)
Financial Services Attachés

Subject: Presidency non-paper on the scope of resolution (resolution objectives and PIA)
(CMDI Working Party on 27 February 2024)



Presidency non-paper on the scope of resolution (resolution objectives and PIA)

CWP CMDI 27-02-2024

1. Introduction

Several Council Working Parties were devoted to the scope of resolution under the Spanish Presidency. Two main building blocks were identified: the resolution objectives on the one hand and the public interest assessment (PIA) on the other hand.

Given the advanced state of the negotiations reached under the preceding Presidency, the Belgian Presidency considers that a landing zone on the scope of resolution is within reach. In the current note, the draft proposals as proposed by the Spanish Presidency in its progress report of 6 December, are taken as a starting point. Next, the (limited) remarks provided by Member States will be listed, after which new drafting proposals will be presented. This structure allows the Presidency to address the limited outstanding remarks of some Member States which may not have yet been discussed.

2. Resolution objectives

2.1 Latest draft proposals by the Spanish Presidency

BRRD1 specifies five resolution objectives:

1. to ensure the continuity of critical functions;
2. to avoid a significant adverse effect on the financial system, in particular by preventing contagion, including to market infrastructures, and by maintaining market discipline;
3. to protect public funds by minimising reliance on extraordinary public financial support;
4. to protect depositors covered by Directive 2014/49/EU and investors covered by Directive 97/9/EC; and
5. to protect client funds and assets.

With the CMDI-proposal, the Commission suggested modifying the first, third and fourth resolution objectives. After discussion on this topic at the Council Working Parties of 20 July, 9 October, and 21 November 2023, the preceding Presidency concluded its Presidency with the following remarks and draft proposals:

A. RELATING TO THE FIRST RESOLUTION OBJECTIVE OF ENSURING THE CONTINUITY OF CRITICAL FUNCTIONS

In its progress report, the Spanish Presidency concluded that most Member States could agree on the Commission proposal to include an assessment at “regional level” in the evaluation of the impact of a disruption of the entity’s critical functions on the real economy and financial stability. This inclusion can be found in the definition of “critical functions”, as drafted in the Commission proposal (Article 2(1), point (35) BRRD).

(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

The Commission not only proposed to modify Article 2(1), point (35) BRRD, it also introduced a new Recital 9 which has not yet been discussed at the Council Working Parties. The original Recital 9 was drafted by the Commission as follows:

(9) The resolution framework is meant to be applied to potentially any institution or entity, irrespective of its size and business model, if the tools available under national law are not adequate to manage its failure. To ensure such outcome, the criteria to apply the public interest assessment to a failing institution or entity should be specified. In particular, it is necessary to clarify that, depending on the specific circumstances, certain functions of the institution or entity can be considered critical even if their discontinuance would impact financial stability or critical services only at regional level.

B. RELATING TO THE THIRD RESOLUTION OBJECTIVE OF PROTECTING PUBLIC FUNDS

In its progress report, the preceding Presidency concluded that there was a large support for the Commission's introduction of protecting the budget of a Member State in Article 31(2) point c) BRRD:

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

In accordance with the amendment, new wording has been introduced in recital 11 (changes marked against the Commission's proposal):

(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, in the exceptional case where internal funding proves to be insufficient, 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. 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. When industry funds are considered part of the public budget, they should be used prior to any other budgetary sources.

C. RELATING TO THE FOURTH RESOLUTION OBJECTIVE OF PROTECTING DEPOSITORS

On the fourth resolution objective (proposal to include the minimisation of losses for the DGSs), the preceding Presidency concluded that there was a broad support to revert to the existing BRRD text of Article 31(2), point (d), and Article 14(2), point (d) SRMR:

'(d) to protect depositors covered by Directive 2014/49/EU and investors covered by Directive 97/9/EC;'

In parallel, a new recital X was proposed (mirroring recital 72 of the original BRRD):

(X) In exceptional circumstances, resolution authorities should be able to exclude or partially exclude liabilities in a number of circumstances including where the exclusion of the application of the bail-in tool to these liabilities is necessary to avoid the spreading of contagion and financial instability which may cause serious disturbance to the economy at a national or regional level. When carrying out this assessment, resolution authorities should give consideration to the consequences of a potential bail-in of non-covered deposit liabilities.

Linked to that, the Commission's initial proposal also included a new Recital 10 on the protection of depositors which has not yet been discussed at the Council Working Parties.

(10) The assessment of whether the resolution of an institution or entity is in the public interest should reflect the consideration that depositors are better protected when deposit guarantee scheme ('DGS') funds are used more efficiently and the losses for those funds are minimised. Therefore, in the public interest assessment, the resolution objective of protecting depositors should be considered better achieved in resolution if opting for insolvency would be more costly for the DGS.

2.2 Reaction of Member States on the latest drafts

Only a limited number of concerns were voiced by the different Member States in reaction to the latest proposals. They can be summarised around two topics.

- **Need for the consideration of depositor confidence / alignment of recital X on depositor confidence with Article 44(3) BRRD / discussion on funding**

Some Member States do not support the proposed wording of Recital X on depositor protection for three main reasons:

- Some Member States mention that resolution objectives should also ensure the protection of depositor confidence.
- Other Member States argue that the wording of this Recital X is not in line with Article 44(3) BRRD on the scope of the bail-in tool.
- Finally, another Member State remarks that Recital X on depositor protection is not related to the resolution objectives but rather to funding.

- **Need for an evidence-based recital**

Several Member States do not support the statement in Recital 11 that funding provided by Member States would decrease market discipline or bear a higher risk of moral hazard as compared to funding provided by safety nets. They would consider that additional evidence should be provided to support this statement.

2.3 New draft proposals

The Belgian Presidency would like to explore the possibility of introducing the following modifications to the relevant articles to accommodate the aforementioned remarks:

- **Draft Proposal 1:** modifications to Recital 9, extending its scope from ensuring the continuity of critical functions only to all five resolution objectives. This allows the introduction of a general recital listing all resolution objectives and highlighting which resolution objectives will be modified as a result of the CMDI proposal. To further harmonize the BRRD objective of ensuring the continuity of critical functions, Recital 9 is aligned with Delegated Regulation (EU)2016/778. In addition, Recital 9 is broadened to address Member States concern to ensure the protection of depositor confidence.

(9) The resolution framework is meant to be applied to potentially any institution or entity, irrespective of its size and business model, if the tools available under national law are not adequate to manage its failure. ~~To ensure such outcome, the criteria to apply the public interest assessment to a failing institution or entity should be specified. Some objectives of the framework need to be further specified to increase harmonisation and to promote convergence.~~ In particular, it is necessary to clarify that, depending on the specific circumstances, resolution authorities should be able to conclude that certain functions of the institution or entity ~~can be~~ are considered as critical even if their discontinuance would impact financial stability or critical services only at regional level. The resolution objective of ensuring continuity of critical functions aims at safeguarding financial stability and the real economy. It is therefore necessary to ensure that their provision is not discontinued. Critical functions can notably include deposit taking, lending and loan services, payment, clearing, custody and settlement services, safekeeping of assets, wholesale funding markets activities, and capital markets and investments activities. Moreover, it is reiterated that adverse effects on financial stability should be prevented. Public funds should be protected by minimising reliance on extraordinary public financial support, in particular when provided from the budget of a Member State. Depositors covered by Directive 2014/59/EU, investors covered by Directive 97/9/EC, client funds and client assets should also be protected. When assessing whether the resolution objectives are at risk when carrying out the public interest assessment, resolution authorities should pay due attention to the risk of a loss of confidence by depositors holding uncovered deposits.

- **Draft Proposal 2:** modification of Recital 11 (deletion of the mention that funding provided by Member States bears a higher risk of moral hazard and a lower incentive to market discipline as compared to funding from industry safety nets, while keeping the idea that funding provided by safety nets should be preferred to funding through the budget of Member States).

(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, in the exceptional case where internal funding proves to be insufficient, 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. 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. When industry funds are considered part of the public budget, they should be used prior to any other budgetary sources.~~

- **Draft Proposal 3:** Deletion of Recital 10 since a majority of Member States rejected the Commission amendments to the resolution objective on the protection of depositors and the resolution objective remains consequently unchanged.

(10) ~~The assessment of whether the resolution of an institution or entity is in the public interest should reflect the consideration that depositors are better protected when deposit guarantee scheme ('DGS') funds are used more efficiently and the losses for those funds are minimised. Therefore, in the public interest assessment, the resolution objective of protecting depositors should be considered better achieved in resolution if opting for insolvency would be more costly for the DGS.~~

- **Draft Proposal 4:** provisional deletion of Recital X as proposed by the previous presidency (as it is not aligned with the wording of Article 44(3) BRRD and rather concerns funding – the reintroduction of the recital could be discussed in the context of the funding).

~~(X) In exceptional circumstances, resolution authorities should be able to exclude or partially exclude liabilities in a number of circumstances including where the exclusion of the application of the bail-in tool to these liabilities is necessary to avoid the spreading of contagion and financial instability which may cause serious disturbance to the economy at a national or regional level. When carrying out this assessment, resolution authorities should give consideration to the consequences of a potential bail-in of non-covered deposit liabilities.~~

3. Public Interest Assessment

3.1 Latest draft proposals by the Spanish Presidency

The preceding Presidency explored different options to compare resolution and national insolvency proceedings and concluded in its progress report that having a staged approach (option 5.1) could be the best way forward. First, resolution authorities should assess if the resolution objectives would be at risk; second, if resolution is necessary and proportionate to one or more of the resolution objectives, and third, resolution should be chosen if the winding up of the institution under normal insolvency proceedings would not meet the resolution objectives more effectively. This staged approach is translated as follows in Article 32(5):

(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 to one or more of the resolution objectives referred to in Article 31¹.

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..²

By modifying said article, the preceding Presidency departed from the Commission's proposed Article 32(5), second subparagraph BRRD, which included the requirement for resolution authorities to compare all extraordinary public financial support that could reasonably be expected to be granted to the institution (EPFS).

¹ Note that the underlined text was omitted from Article 32(5) in the Progress Report on CMDI.

² Note that a second sentence was included in the Progress Report on CMDI : "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". This sentence is redundant and it was confirmed that its inclusion was most likely resulting from a formatting error.

In addition to the modification of said article, a new recital (X) was introduced:

(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 are deemed by the resolution authority to have an impact on the provision of critical services or 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.

In its initial proposal, the Commission also proposed a new Recital 12 on the public interest assessment. This Recital has not yet been discussed at the Council Working Parties.

(12) To ensure that the resolution objectives are attained in the most effective way, the outcome of the public interest assessment should be negative only where the winding up of the failing institution or entity under normal insolvency proceedings would achieve the resolution objectives more effectively and not only to the same extent as resolution.

3.2 Reaction of Member States on the latest draft proposals

The majority of Member States agreed on having a staged approach when carrying out the public interest assessment. However, some mentioned that the steps of proposed Article 32(5) BRRD could be clarified. Some Member States formulated additional remarks:

- **Need for a PIA presumption**

During the Council Working Parties of 9 October and 21 November 2023 some Member States suggested to combine the staged PIA approach (of option 5.1) with a PIA presumption for certain types of institutions (option 5.2).

- **Clarification of the steps and considering only a significant impact on the provision of critical services or financial stability, and on the losses of deposits**

In addition, some Member States also suggested a clarification in Recital X to ensure that only losses on a material share of deposits are taken into account, and that the resolution authority should only consider a significant impact on the provision of critical services or financial stability when assessing whether the resolution of an institution or entity is in the public interest.

- **Need for a cost-minimisation principle**

Some Member States also raised the concern that crisis management solutions may be costly. Those Member States seek the introduction of an overall cost-minimisation principle, be it via the resolution objectives, or the public interest assessment.

3.3 New draft proposals

In this context, the Belgian Presidency would like to explore the feasibility of the following amendments.

- **Draft Proposal 4:** modifications to Article 32(5) (combining the assessment's second and third stage) and inclusion of Recital 12

(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 conclude that a resolution action is in the public interest where the 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.

~~*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.*~~

(12) To ensure that the resolution objectives are attained in the most effective way, the final outcome of the two-stage public interest assessment should be negative only where the winding up of the failing institution or entity under normal insolvency proceedings would achieve the resolution objectives more effectively and not only to the same extent as resolution.

- **Draft Proposal 5:** new Recital Y in the SRMR (introduction of a rebuttable PIA presumption for resolution planning purposes only – there is no presumption for PIA conducted in resolution).

(Y) The assessment of whether the resolution of an institution or entity is in the public interest is amended by Directive 2014/59/EU. In this context, assessing whether the resolution of an institution or entity is in the public interest or not should continue to require the exercise of discretion by the resolution authority. However, for resolution planning purposes, it should be presumed that the assessment of whether the resolution of a group under the SRB direct remit is in the public interest would result in a positive outcome, while it is likely that the public interest assessment for an institution or entity to which the national resolution authority has applied simplified obligations would result in a negative outcome. Remaining institutions and entities exhibit a wide range of different characteristics and for them the outcome of the public interest assessment cannot be presumed and therefore the use of presumption would not be appropriate.

- **Draft Proposal 6:** modification of Recital X (only a significant impact on the provision of critical services or financial stability, and on the losses of deposits, should be considered)

(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 a material share of ~~some~~ deposits or significant difficulties in the continuity of access to ~~some~~ deposits, which and when those losses or those difficulties are deemed by the resolution authority to have an significant impact on the provision of critical services or 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.

- **No Draft Proposal for the cost-minimisation principle:** The Belgian Presidency has carefully taken this remark into consideration but concluded that the current BRRD text incorporates a cost-minimisation principle. Article 31(2) last subparagraph current BRRD text states the following: “When pursuing the above objectives, the resolution authority shall seek to minimise the cost of resolution and avoid destruction of value unless necessary to achieve the resolution objectives.” Since the CMDI-framework does not amend this article, the Presidency concludes that Member States’ remarks seem to be already covered by the current BRRD text and therefore does not propose to include another cost-minimisation principle in the CMDI-framework, unless there would be a proven need to extend the existing cost-minimisation principle.

4. Questions for Member States

In view of reaching an agreement on the scope of resolution, subject to an overall compromise on CMDI as a whole, could you confirm whether:

- Q1: the proposed way forward, including Proposals 1-6, could be accepted as a basis for a compromise?
- Q2: all important comments and aspects on the scope of resolution have been tackled?