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Item 4: Presidency non-paper on preventive measures in the DGSD

Presidency non-paper on preventive measures in the DGSD

CWP CMDI 25-03-2024

1. Introductory comments

This non-paper covers preventive measures under the DGSD (Articles 11, 11a, 11b and 11c DGSD with the accompanying recitals).

The approach on preventive measures under the DGSD was discussed at the CWP of 9 October 2023 on the basis of the Commission services' note (WK12813/2023) and a Commission services' presentation (WK12813/2023 ADD1), both entitled '*Use of DGS for preventive and alternative measures (Articles 11-11d DGSD)*'.

The Presidency aims to summarise the comments already made by Member States to ensure that they are complete, before proposing, at a later stage, a potential way forward on the use of the DGS' available financial means for preventive measures.

It is important to note that the Least Cost Test (LCT) is not covered by this non-paper considering that the possible technical solutions for the LCT are presented in a separate non-paper and that all other elements related to the LCT will be addressed in a forthcoming CWP. Hence, this non-paper only covers selected topics related to the preventive measures under the DGSD.

2. Commission's proposal

In its presentation at the CWP of 9 October 2023, the Commission clarified the objectives of its proposed amendments to the deposit insurance framework, one of which is to preserve the possibility for Deposit Guarantee Schemes (DGS) and Institutional Protection Schemes (IPS) recognised as DGS to use DGS funds to finance preventive measures¹.

Related to this objective, the Commission identified in its presentation the key modifications to the provisions on preventive measures, in particular²: a harmonisation of rules and safeguards on the timing of preventive measures (not too early and not too late) and; a commitment of the credit institution to restructure by requiring it to issue a note outlining the measures it commits to take to ensure or restore compliance with the prudential requirements and to mitigate the risk of deterioration of its financial soundness.

The Commission further explained that the aim is not to fully harmonise preventive measures nor to regulate all the details of their design and implementation. The aim is to establish safeguards for the application of preventive measures in order to preserve the DGS' primary objective and increase convergence across Member States.

According to the Commission, this ambition is in line with the Eurogroup statement of June 2022 in which the Eurogroup called for further harmonisation of the use of DGS' funds in crisis management "while maintaining a level playing field, [...] [and taking] due account of the specificities in the national banking

¹ The second objective is to maintain the possibility for DGS to finance alternative measures in the context of winding-up proceedings, under certain (harmonised) conditions (notably the LCT) and transparent and open marketing arrangements for the assets, rights and liabilities to be transferred).

² And, besides the mentioning of the modifications to ensure a cost-effective use of DGS to finance preventive measures, by modifying and harmonising the LCT.

sectors, including by preserving a functioning framework for institutional protection schemes to implement preventive measures”.

3. Topics for discussion

The non-paper touches upon the following issues related to DGS' preventive measures: availability and purpose of preventive measures (3.1), alignment of some of the conditions for preventive measures with the conditions under Article 32c BRRD on extraordinary public financial support (3.2), replenishment requirements of DGS in relation to the use of preventive measures (3.3), timing of the preventive measures (3.4), governance (3.5), content and approval of the note accompanying preventive measures (3.6), consecutive use of preventive measures (3.7), the remediation plan (3.8) and, the safeguards on DGS' contributions to preventive measures (3.9).

3.1. Availability and purpose of preventive measures

Relevant provisions: Articles 11(1) and 11(3) DGSD

I. Availability of preventive measures

The Commission's proposal recognises that preventive measures, when used in a timely manner, can play an effective role in the continuum of crisis management tools to maintain depositor confidence and financial stability. According to the explanation provided by the Commission, the proposal amends the rules and safeguards for the use of preventive measures in view of improving their cost effectiveness, governance and transparency as well as ensuring a level playing field.

Based on the comments received so far, a number of Member States consider preventive measures as a useful or important tool in the toolbox. A couple of Member States flag the importance to keep preventive measures as a Member State option. Some agree with maintaining preventive measures but with stronger or more harmonised safeguards, while others favour flexibility and consequently prefer introducing only minor amendments to the current framework. Several Member States are of the view that the functioning of existing national systems should be preserved. One Member State indicates that preventive measures should only be available for private DGS' and voluntary schemes, while another one considers them only relevant for IPS and insists on formulating stronger additional safeguards on their use. One Member State explicitly opposes the recourse to preventive measures. One Member State considers it necessary to have a special treatment for IPS recognised as DGS which use preventive measures, as it considers that this would be in line with the Eurogroup statement that preserving their functioning is justified in substance due to the specific nature of IPS and important with regard to the requirements established in the Regulation on prudential requirements for credit institutions and investment firms (CRR). Several Member States acknowledge that the safeguards proposed by the Commission would have particular impact on IPS recognised as DGS and that the text should cater for specific systems such as IPS.

II. Purpose of preventive measures

The current provision of Article 11(3) DGSD refers to the term '*alternative measures to prevent the failure of a credit institution*'. The DGSD proposal refers to '*preventive measures for the benefit of a credit institution*'. Recital (24) highlights that the purpose of preventive measures is to restore long-term viability of a credit institution.

One Member State suggests that the purpose of preventive measures should be aligned with Article 32c(b) BRRD that defines objectives of these measures as preserving the financial soundness and long-term viability of a credit institution. One Member State opposes the inclusion of 'for the benefit of the credit institution' as it would increase the scope beyond failure prevention.

The Commission clarified in the CWP of 9 October that the amendments aim at streamlining the terminology used in DGSD and BRRD and distinguishing between different measures. Recital (24) DGSD clearly states that the purpose of preventive measures is to restore long-term viability of credit institutions.

3.2. Alignment of some of the conditions for preventive measures with the conditions under Article 32c BRRD on extraordinary public financial support

Relevant provision: Article 11(3) DGSD

Some Member States argue that the conditions for precautionary recapitalisation as laid down in the proposed new Article 32c(2) BRRD should also be applicable for DGS' preventive measures and plead for a reference to Article 32c BRRD in Article 11(3) DGSD. One of them also proposes a claw-back mechanism based on an ex-post quantification of losses and a cap of 50% of DGS' available financial means to use for preventive measures. One Member State considers that the failure of a credit institution to repay the amount contributed under the preventive measures should have the same consequences as those envisaged under Article 32c(2) BRRD, i.e. the relevant authority should conclude that the credit institution is failing or likely to fail (FOLTF).

It is worthwhile to clarify that preventive measures and precautionary recapitalisation are different tools in the crisis management toolbox. The instruments are tailored to specific contexts. DGS' preventive measures focus on internal risks and early detection and involve industry-funded financial support, while precautionary recapitalisation addresses external shocks and preserves systemic stability using tax-payers money.

3.3. Replenishment requirements of DGS in relation to the use of preventive measures

Relevant provision: Article 11(5) DGSD

The existing DGSD text of Article 11(5) requires that affiliated credit institutions provide immediately, where necessary by way of extraordinary contributions, the financial means used for preventive measures if: (a) the need to repay depositors would arise and the available financial means of the DGS amount to less than 2/3rd of the target level, or (b) if the available financial means fall below 25% of the target level.

Although the Commission did not propose modifications to the content of this provision (in proposed new Article 11(4) DGSD), some Member States have requested to do so. One Member State considers the need to include an intervention in resolution as a reason for affiliated credit institutions to provide immediately financial means. This Member State argues that not only the repayment of deposits, but also an intervention in resolution is mandatory for DGS'. Two other Member States want to raise the threshold that gives the mandate to DGS to collect immediately the means used for preventive measures from the current 25% of DGS' target level to two-thirds, respectively 75%, of the target level. One Member State asks to remove the words 'where necessary' as the DGS should be replenished only by means of extraordinary contributions as no other sources could be used for its replenishment. One Member State expressed a preference for keeping the existing text of Art. 11(5) DGSD.

3.4. Timing of preventive measures

Relevant provision: Article 11(3), point (a) DGSD

According to the Commission's proposal, in order "to ensure the continuum of crisis management tools and recourse to preventive measures in a manner consistent with the resolution framework and the State aid rules, it is necessary to specify the timing and conditions for their application" (recital 25). Under the existing DGSD, preventive measures can be implemented as long as no resolution action has been taken. The Commission's proposal limits preventive actions, as they can be used up to the failing or likely to fail (FOLTF) determination. According to the Commission's proposal, preventive measures are not appropriate for the absorption of incurred losses when the credit institution is already FOLTF (recital 25). Preventive measures should be used early when it is still possible to prevent deterioration of the financial situation of the bank (recital 25).

While preventive measures would no longer be possible after a FOLTF determination, alternative private sector measures, including measures by an IPS, referred in Article 32(1), point (b) BRRD would remain possible after FOLTF and before the execution of resolution actions as far as such measures are not financed with funds collected for DGSD purposes.

One Member State expresses the view that preventive measures should not be implemented if the conditions for early intervention measures are met. Another Member State stresses that the timing restriction introduced by the Commission would seriously hamper the functioning of IPS recognised as DGS. One Member State proposes to directly refer to the absence of a FOLTF declaration in the legal text, for the sake of legal certainty. Another Member State suggests to explicitly mention the competent authority as the authority that should confirm the absence of a FOLTF declaration. Another Member State is of the view that it is important to allow for preventive measures as long as no resolution action has been taken, as under the existing DGSD.

3.5. Governance

Relevant provisions: Articles 11a(2) and 11a(3) DGSD

The Commission's proposal maintains the existing requirement for DGS to have in place appropriate systems and procedures for selecting and implementing preventive measures and monitoring affiliated risks. One Member State nevertheless requests to modify Article 11a(2) DGSD by including the possibility for the designated authority to be the entity required to comply with these requirements. Another Member State is of the view that EBA guidelines would be useful with regard to the details of the selection and monitoring systems.

The Commission's proposal amends the governance requirements for preventive measures and requires in Article 11a(3) DGSD that DGS may implement preventive measures only when the designated authority has verified that all conditions listed in Article 11a(1) DGSD are met³. While the decision to provide preventive support, or not, is solely taken by the DGS, under the proposed Article 11a(3), the designated authority would check and confirm that the conditions for the provision of such support are met as part of its supervisory function. Depending on the national arrangements, the designated authority can be the governing body of the DGS or another administrative authority. Further, the designated authority would be now required to notify the competent authority and the resolution authority, so that these authorities could take into account preventive measures and the accompanying commitments undertaken by the credit institution into account where relevant (in accordance with Article 11a(3)). One Member State considers the confirmation by the designated authority required by Art. 11a(3) DGSD to be in conflict with the mandate of IPS and the requirements laid down in Art. 113(7) CRR.

3.6. Content and approval of the note accompanying preventive measures

Relevant provisions: Article 11a(1), points a and b and Article 11b DGSD

The Commission proposes that an institution applying for preventive measures presents to the competent authority a note for consultation describing (i) the measures that it commits to undertake to restore its long-term viability and (ii) an exit strategy for any support measures received (recital 26). The Commission indicates that the note should not be too burdensome and time-consuming for the relevant credit institution to prepare, to ensure the possibility for the DGS to intervene rapidly and early enough (recital 26).

According to the additional explanation provided by the Commission at the CWP of 9 October, the proposed amendments aim at fostering the convergence of practices, streamlining the process and shifting the burden, related to the consultation on the adequacy of the measures that the credit institution commits to undertake, from the DGS to the credit institutions requesting support. The competent authority is best positioned to express an opinion on what needs to be done to ensure compliance with prudential requirements.

One Member State expresses its preference to substitute the note accompanying preventive measures with a restructuring plan. In the view of this Member State, the restructuring plan should outline measures

³ These conditions concern i) the presence of an accompanying note (point a); ii) there has been a consultation with the competent authority (point b); iii) conditions imposed on the credit institution that involve at least more stringent risk monitoring (point c); iv) the credit institution's commitment to secure access to covered deposits (point d); v) the ability of affiliated credit institutions to pay extraordinary contributions (point e); and vi) compliance with the obligations under the DGSD and the reimbursement of previous measures (f). Conditions (c), (d) and (e) already exist under the present DGSD. Conditions a, b and f will be discussed separately in the non-paper.

not only to restore compliance with supervisory requirements, but also to ensure/restore long-term viability. Another Member State expresses doubts on whether the recital which provides the rationale for the obligation to provide a note offers sufficient legal grounds for uniform application. One Member State is of the view that a credit institution that is a member of an IPS recognised as a DGS that requests financing of preventive measures should present a plan (potentially ex post) to ensure or restore compliance with supervisory requirements in accordance with the conditions laid down in the IPS statutory rules. Another Member State expressed concerns that the operative burden of preparing a complex note would be too high in situations where swift action is required.

According to the Commission's proposal, the credit institution shall consult the competent authority on the measures envisaged in the note. Some Member States express a preference to impose stricter ex ante consultation requirements with the competent and resolution authority or, as a minimum, clarify their respective roles. A few Member States are of the view that the note should be approved by the competent authority and consider that the competent authority should also confirm that the measures are necessary to secure the financial soundness and long-term viability of the credit institution. Another Member State suggests that the competent authority should be able to require changes to the note. One Member State proposes that not only the credit institution but also the DGS should be able to carry out the consultation. One Member State opposes the verification and notification procedure in general as being overly bureaucratic and unprecise.

The existing DGSD does not contain dedicated provisions related to the remuneration for the DGS in case of preventive measures. The Commission also does not introduce those with its proposal, although it explicitly refers to "expected earnings" of non-payout measures, when framing the LCT modalities. Some Member States suggest that preventive measures should be properly remunerated but do not provide a more specific guidance. The Presidency kindly invites these Member States to clarify their request and to provide drafting suggestions.

One Member State suggests aligning the note with the recovery plan as referred to in Articles 5-7 BRRD.

3.7. Consecutive use of preventive measures

Relevant provision: Article 11a(1) point f DGSD

The Commission's proposal contains the requirement that a preventive measure can only be allowed when a credit institution complies with its obligations under DGSD and has fully reimbursed any previous preventive measure. According to the Commission this ensures that the DGS shall not use its funds to provide continuous financial support to an institution where there are no prospects for its recovery or in breach of the LCT. In the CWP of 9 October, the Commission explained that, from a legal point of view, this condition does not exclude the possibility of structuring a particular preventive measure in such a way that a certain number of instruments (capital support, guarantees, etc.) are used in a consecutive manner as part of the same measure.

One Member State suggests a stricter requirement that preventive measures could be granted only once every 10 years to reflect their exceptional character. Another Member State suggests that a preventive measure could only be granted if all previously provided extraordinary financial support received in the last 10 years have been fully reimbursed and if the credit institution has never benefited from preventive measures. These views were opposed by another Member State which raised the concern that this provision may prevent a preventive intervention in cases where it would be appropriate to intervene. This Member State suggests limiting the requirement for consecutive interventions to the compliance with the repayment schedule. Another Member State emphasised that a DGS should be able to take preventive action when unexpected circumstances arise, including for banks which have already previously received preventive measures.

3.8. Remediation plan

Relevant provision: Article 11c DGSD

To ensure compliance with the commitments outlined in the note, the new Article 11c DGSD imposes a requirement on the DGS to inform the competent authority where the credit institution fails to fulfil them and empowers the competent authority to request a remediation plan. Where a competent authority is of the opinion that the measures in the remediation plan are not sufficient to restore the credit institution's long-term viability, the DGS should not grant any further support to the credit institution (recital 27). This is translated in Article 11c(3) by prohibiting the DGS to grant any further preventive measures if the competent authority considers that the remediation plan is not credible or feasible.

One Member State considers the provision in Art. 11c(3) to be in conflict with the mandate of IPS and the requirements laid down in Art. 113(7) CRR. The same Member State that pleads for the competent authority's ex ante approval of the note of Article 11b DGSD, also states that the competent authority should approve the remediation plan; arguing that the competent authority's role is even more important when the original plan included in the note is not complied with. Another Member State pleads for additional enforcement measures for the DGS in case the commitments under preventive measures are not complied with. For one Member State, the sanction of not providing more preventive measures is not needed as, in its view, preventive measures should be allowed only once every 10 years. One Member State considers it necessary to add a requirement for a FOLTF assessment in case of non-compliance with the remediation plan as it considers the ban on further preventive measures not sufficient. Going even further, another Member State considers that an unsatisfactory remediation plan is already sufficient grounds for an automatic FOLTF determination. One Member State is of the opinion that the resolution authority should be informed when a credit institution fails to comply with the conditions outlined in the note.

3.9. Safeguards on DGS' contributions to preventive measures

Relevant provision: Article 11e DGSD

Article 11e of the DGSD covers the LCT, including some specific safeguards which are relevant for the application of the LCT for preventive measures. Methodologies on the broadening of LCT however are discussed in a separate non-paper on the LCT.

In addition to the LCT, the Commission has introduced an additional safeguard by means of specifying that the amount dedicated to preventive measures cannot exceed the total amount of covered deposits of the supported credit institution applying for preventive measures (Article 11e(3) DGSD). In the CWP of 9 October 2023, it was clarified in response to a technical question that it concerns the gross amount dedicated to preventive measures.

One Member State is of the view that Art. 11e(3) should not apply to preventive measures.

4. Questions for Member States

To allow the presidency to move forward to drafting suggestions, could you indicate:

Q1: Whether your position is well reflected in the above summary.

Q2: Whether you would like to raise any additional issue that the Presidency needs to consider or react to any of the suggestions as summarised in the paper.