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Commission services' note on interaction and roles of authorities in the CMDI package

Introductory comments

This non-paper covers topics related to the procedures set out in the CMDI package involving different authorities, the powers available to those authorities and the actions expected to be taken, at each stage of deterioration of the situation of an institution. It focuses only on the roles and responsibilities of the different authorities, and, on early intervention measures and precautionary recapitalisation, it does not provide an exhaustive view of the changes made by the proposal.

The non-paper covers decision-making and interaction between authorities with respect to:

1. Precautionary recapitalisation (Article 32c BRRD/18a SRMR)
2. Early intervention measures (Article 27 to 29 BRRD/13 to 13b SRMR)
3. Early warning of failing or likely to fail (Article 30a BRRD/13c SRMR)
4. Resolution/ write down and conversion (Article 32 BRRD/Articles 18 and 21 SRMR)
5. Resolution involving DGS intervention (Article 109(2) BRRD / Article 79 SRMR)

1. Precautionary recapitalisation (Article 32c BRRD/18a SRMR)

The new Article 32c BRRD / 18a SRMR on precautionary recapitalisation provides for an enhanced role of the competent authority on the following:

i) Assessing the solvency of the institution or entity applying for the precautionary recapitalisation, in line with the new definition: "*an institution for which (….) no breach has occurred, or is likely to occur in the 12 following months, of any of the requirements referred to in Article 92(1) of Regulation (EU) No 575/2013, Article 104a of Directive 2013/36/EU, Article 11(1) of Regulation (EU) 2019/2033, Article 40 of Directive (EU) 2019/2034, or the relevant applicable requirements under Union or national law"*. This is intended to increase legal certainty and objectivity around the notion of "*solvency*" for the purposes of precautionary recapitalisation and the authority responsible for the respective assessment.

ii) Quantifying the losses incurred or likely to be incurred, since precautionary recapitalisation should not be used to offset such losses. This is intended to ensure an external check of the accuracy of the estimates, in order to increase certainty around the valuations made. In order to respect the proportionality principle and the risk-based approach followed by competent authorities, as well as the changes to the accounting

framework introduced by IFRS 9, the proposal leaves flexibility for the competent authority to decide whether to base the quantification of the losses either on the bank's balance sheet (whose compliance with accounting standards is confirmed by an external auditor), or on asset quality reviews where available, or alternatively, to conduct on-site inspections.

iii) Assessing the necessity of the measures to address the capital shortfall established in the adverse scenario of a stress test, to which the support must be limited: the new provision tasks the competent authority with assessing that the support measures are necessary to maintain the solvency of the institution or entity concerned.

iv) Approving the exit strategy from the support measures. The approval of the strategy ensures a close monitoring by the competent authority of the institution or entity receiving support, and an independent validation of the strategy.

v) In case the terms of the exit strategy established at the time of granting the aid are not followed, determining that the recipient of the precautionary recapitalisation aid is failing or likely to fail and communicating its assessment to the relevant resolution authority. The role of the competent authority in determining the failing or likely to fail condition is a consequence of its role throughout BRRD and SRMR in making such determinations.

2. Early intervention measures (Articles 27 to 29 BRRD/ Articles 13 to 13b SRMR, also Article 30a BRRD/13c SRMR)

Early intervention measures have to be taken at a stage where deterioration is significant enough to warrant measures that are more intrusive than the powers of the competent authority under Directive 2013/36/EU (CRD), Directive (EU) 2019/2034 (IFD) and Council Regulation (EU) No 1024/2013 (SSMR).

In addition to the clarification of the conditions for the competent authority to apply its early intervention powers, and the introduction of a directly applicable legal basis for the ECB to take early intervention measures (new Articles 13 to 13b SRMR), new provisions are introduced by Article 30a BRRD/ 13c SRMR to enhance information-sharing and cooperation between competent authorities and resolution authorities at this early stage.

On information-sharing, paragraph 1 of Articles 30a BRRD/ 13c SRMR sets out that the competent authority should notify the resolution authority of the supervisory measures and early intervention measures taken and of any situation in which the supervisory activity would show that conditions for early intervention measures would be met.

On cooperation, paragraph 1 of those Articles further states that the competent authority and the resolution authority should monitor jointly the situation of an entity in relation to which a notification has been made and its compliance with early intervention measures and with those supervisory measures that aim to address a deterioration in the situation of the institution or entity. This last point is intended to filter out daily routine supervisory decisions and focus the joint monitoring on those actions that may be relevant to the resolution authority as signals or consequence of a deterioration that they would need to know about.

Paragraph 8 of those Articles states that competent authorities and resolution authorities should closely cooperate when considering taking early intervention measures and those supervisory measures that aim to address a deterioration in the situation of the institution or entity and when implementing those measures.

3. Early warning of failing or likely to fail (Article 30a(2) BRRD/13c(2) SRMR)

The new Articles 30a(2) BRRD/13c(2) SRMR refer to a situation where the institution or entity is still in going concern and as such remains within the remit of the competent authority. However, in this situation, the deterioration of the position of the entity, in particular its liquidity or solvency, is more serious than the one calling for early intervention measures and there is a material risk of the institution or entity becoming failing or likely to fail.

In such a situation, resolution is a possible outcome. Should the institution or entity be placed in resolution, this should take place early enough so that there is enough loss absorption capacity and liquidity remaining in the institution or entity in order to ensure a successful resolution, while not changing the FOLF conditions. Moreover, resolution will have to take place within a very short timeframe, ideally a resolution weekend, and, therefore, the earlier and more comprehensive the exchange of information between the competent authority and the resolution authority, the higher the chances that the measures taken will be adequate and resolution will be successful.

Therefore, the proposal provides for:

i) enhanced cooperation between the competent and the resolution authority in case a material risk of failing or likely to fail is identified in relation to an institution or entity. Once the competent authority has detected such a situation, it should notify the resolution authority and both authorities should jointly monitor the situation of the institution or entity, the implementation of any relevant measures and any other relevant developments. They should meet regularly, with a frequency set by the resolution authority and provide each other with any relevant information without delay;

ii) an assessment by the resolution authority, in close cooperation with the competent authority, of the reasonable timeframe within which any alternative private sector or supervisory solution referred to in point (b) of Article 32(1) BRRD/18(1) SRMR should be found. This assessment should be made and communicated to the competent authority as early as possible once the resolution authority has been notified of a material risk of failing or likely to fail in relation to an institution or entity.

The amendments are not intended to alter the balance of powers and responsibilities between the competent authority and the resolution authority, nor to subject some alternative private sector measures to a higher degree of scrutiny, but to allow the resolution authority to assess, together with the supervisor, when a point of no return would be reached and resolution should be launched with the best chances of success. Since the resolution authority will be ultimately responsible for the assessment of the condition referred to in point (b) of Article 32(1) BRRD/18(1) and has thus a direct interest in the outcome of the discussions on that matter with the competent authority, it is appropriate to leave the resolution authority to determine the

intensity of the interaction, through the frequency of the meetings, in the way that best suits its needs.

4. Resolution/write down and conversion (Articles 32(1) BRRD/18(1) and 21(1) SRMR)

In SRMR (Articles 18 and 21), the proposal:

i) Adds in Article 18(1) and (2) a reference to national competent authorities in order to take into account the situation of those institutions and entities for which, although the SRB adopts the resolution scheme, the competent authority is not the ECB but the national competent authority (NCA)[1].

ii) Requires ECB or the relevant national competent authority to provide without delay the SRB with any relevant information that the SRB requests to inform its assessment. The proposal also retains the possibility for the ECB or the relevant national competent authority to inform the SRB that it considers the condition set out in point (b) to be met.

iii) Aligns the procedure for deciding on the write down and conversion in Article 21 with the procedure for deciding on resolution in Article 18, specifying that the conditions for the exercise of the write down and conversion powers are to be assessed by the ECB/national competent authority and by the SRB following the same allocation of tasks made in Article 18(1) and (2)[2]. In the second subparagraph, a cross reference is added to point (b) of the first subparagraph ("*the entity will no longer be viable unless the relevant capital instruments, and eligible liabilities as referred to in paragraph 7a are written down or converted into equity*").

iv) Addresses the interaction between Articles 18 and 21 and the situations within groups in Article 21(9): when, within a group, one entity meets the conditions for the write down and conversion of its capital instruments and the resolution entity meets at the same time the conditions for entering resolution, then the SRB may adopt one resolution scheme covering both entities. This will ensure, in the context of a single point-of-entry strategy, that the decisions regarding group entities are fully aligned and are taken through the same instrument and subject to the same approval procedure.

In BRRD, the proposal:

Aligns Article 32(1) with Article 18(1) SRMR, setting out in more detail the allocation of tasks between the competent authority and the resolution authority in the assessment of the conditions for resolution. The competent authority is to provide without delay the resolution authority with any relevant information that the resolution authority requests to inform its assessment.

[1] Cross-border less significant institutions (LSIs) (Article 7(2), point (b) SRMR), LSIs using Fund Aid and for which the SRB is therefore adopting the resolution scheme (Article 7(3), second subparagraph SRMR) and LSIs under the direct responsibility of the SRB due either to a decision of the National Resolution Authority (Article 7(4), point (b) SRMR) or of a Member State (Article 7(5) SRMR).

[2] Given that the conditions for write down and conversion of capital instruments and eligible liabilities, as laid down in paragraph 1 of Article 21 SRMR, and as further detailed in paragraphs 3, 4 and 5 of that same Article, either overlap fully or partially with the conditions for resolution.

5. Resolution involving DGS intervention (Article 109 BRRD/ Article 79 SRMR and Article 11e DGSD)

Under the existing framework, the decision on the use of DGS funds to finance resolution is taken by the national resolution authorities (NRA) or, for credit institutions under the SRB's remit, by the SRB after consulting the national designated authority. The modalities of this consultation and the role of the national designated authorities/DGS are not explicitly outlined. The amount of the DGS contribution is to be determined by the SRB/NRA on the basis of the valuation of the losses that covered depositors would have suffered, had they not been shielded from suffering losses, and in compliance with the existing safeguards/caps for the use of DGS in resolution.

In line with the proposed enhanced use of DGS in resolution, the CMDI proposal clarifies and reinforces the role of DGS in the decision-making process. The decision to place the bank in resolution following a positive public interest assessment, and to apply resolution tools, including transfer tools (sale of business or bridge institution) with the support of the DGS where necessary, is still taken by the SRB for banks within the SRB's remit or by the NRA for all other banks, and no amendments are proposed in this respect. Nevertheless, Article 109(2) BRRD and Article 79(2) SRMR are amended to introduce a new requirement for the NRA/SRB to consult the DGS (and the designated authority under the SRMR provision). According to these new rules, the NRA/SRB can only determine the amount of the DGS contribution after consulting the DGS on the outcome of the least-cost test (LCT) as set out in Article 11e DGSD. This rule can also be found in the new Article 11(2) DGSD.

Allocation of powers between NRA/SRB in relation to the use of DGS in transfer strategies with a 'DGS bridge'

Where the resolution scheme envisages the use of a DGS to finance the transfer of some or all of the assets and deposits, including non-covered deposits, of a member institution of that DGS, before adoption of the resolution scheme the NRA/SRB should provide the DGS with all information necessary for the LCT. In particular, the new Article 11e(4) DGSD (in relation to Article 11e(2)(b) DGSD) requires that the RA/SRB inform the DGS of the following:

i) the intention to transfer deposits, including non-covered deposits,

ii) the results of the valuation under Article 36(1) BRRD and the estimate of the expected treatment of creditors in insolvency referred to in Article 36(8) BRRD,

iii) the amount necessary to cover losses to reach the 8% of the total liabilities and own funds (TLOF),

iv) the amount necessary to finance the transfer of assets and deposits, and the estimated cost of the DGS contribution to resolution.

The DGS should advise the NRA/SRB on the cost of repaying depositors in the payout counterfactual that should serve as the cap on the amount of the DGS contribution to resolution. Along with other safeguards for the use of DGS introduced in Article 109 BRRD/Article 79 SRMR (e.g., the 8% TLOF cap under Article 109(2b) BRRD), the NRA/SRB is bound by this cap.

Annex 1: ***Allocation of powers following the CMDI proposal***