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Council Working Party on Financial Services and the Banking Union (CMDI)

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Presidency note on resolution objectives and the public interest assessment

1. Introduction and description of the amendments proposed

The Commission proposal for amending Directive 2014/59/EU ('BRRD') introduces a number of changes to the existing framework in respect of resolution objectives and their interplay with the public interest assessment ('PIA')[1].

When performing the PIA, resolution authorities compare resolution against winding up under national law and assess how and to what extent each scenario achieves the resolution objectives. Based on the current framework, resolution should be chosen where (i) it is necessary for the achievement of and is proportionate to one or more of the resolution objectives and (ii) winding up of the institution under normal insolvency proceedings would not meet those resolution objectives to the same extent (Article 32(5) of BRRD in force).

1.1. Amendments to the resolution objectives

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, reference is added in the definition of 'critical functions' to the 'national or regional level' of the impact of the disturbance of their discontinuation[2] to the real economy or to financial stability (Article 2(1), point (35) of BRRD)[3].

The resolution objective requiring minimising the reliance on extraordinary public financial support is amended to include a specific reference to support provided from the budget of a Member State. This is explained by the Commission as a way of indicating that funding provided by the industry-funded safety nets should be considered preferable to funding supported by taxpayers' money (Article 31(2), point (c) of BRRD)[4].

[1] Similar amendments are introduced in the Commission proposal amending Regulation (EU) No 806/2014.
[2] This also ensures better alignment between the provisions of the Directive and those in Article 6(2), point (a) of Commission Delegated Regulation (EU) 2016/778 on the assessment of critical functions refers to 'the global national or regional reach' of the activity considered and point (b) of the same Article refers to 'the relevance of the institution, on a local, regional, national or European level, as appropriate for the market concerned'.
[3] Explanatory Memorandum accompanying the Commission proposal amending BRRD.
[4] Explanatory Memorandum accompanying the Commission proposal amending BRRD.

The resolution objective related to the protection of deposits covered by Directive 2014/49/EU ('DGSD') is also amended and now provides that resolution should aim at protecting depositors, without specifying the types of depositors, while minimising losses for deposit guarantee schemes.

1.2. Amendments to the comparison between resolution and national insolvency proceedings

Under the current BRRD, resolution should be chosen when winding up the institution under normal insolvency proceedings would not meet the resolution objectives to the same extent. The Commission proposes to broaden the application of resolution by amending Article 32(5), first subparagraph, of BRRD, to provide that national insolvency proceedings should, in general, only be selected as the preferred strategy when they achieve the framework's objectives more effectively than resolution (and not just to the same extent). The Commission justifies the change as keeping insolvency as the default option but increasing the burden of proof for resolution authorities in demonstrating that resolution is not in the public interest, while the PIA will remain a case-by-case decision at the discretion of the resolution authority[5].

In addition, resolution authorities will be required to consider and compare all extraordinary public financial support that can reasonably be expected to be provided to the institution in resolution against those that can be reasonably expected, based on the information available to the resolution authority at the time of resolution, in the insolvency counterfactual (Article 32(5), second subparagraph, of BRRD).

2. Assessment of individual elements of the Commission proposal

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

Following the first round of written comments, 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'.

The concept of 'regional level' is not explicitly defined and appears to leave room for discretion by the resolution authorities to choose how to calibrate their assessment. While it is difficult to draw definitive conclusions in the abstract, it seems plausible to suggest that the impact of possible discontinuation of critical functions would need be assessed *at least* at the level of some of the remote or large, easily identifiable regions with a significant size in terms of, for example, GDP, number of inhabitants (or a mix thereof), etc. At the opposite end of the spectrum, regions that are small (in economic, geographic and/or demographic sense), both in absolute and relative terms (i.e. compared to national level and to other regions), would not necessarily lead to the finding of criticality of a given function.

[5] Explanatory Memorandum accompanying the Commission proposal amending BRRD.

1. **Do Member States agree with the proposed addition of 'regional level' to the definition of 'critical functions'?**
2. **Do Member States consider that additional framing of the meaning of 'regional level' is necessary or do you prefer to leave the interpretation to the discretion of the resolution authority?**

2.2. 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)

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, this is necessary to differentiate the support provided by industry-funded safety nets, which may also qualify as EPFS, from that coming from taxpayers' money. Indeed, industry-funded safety nets differ from EPFS raised from general taxes in the following aspects:

- Funds for industry-funded safety nets are collected from those sectors that generate the risk from which precisely stems the need to use them (vs. taxpayers money, which comes from all economic agents).
- Industry-funded safety nets have specific purposes, from which a deviation is not allowed (vs. taxpayers' money, which can be used for general purposes).

However, several Member States have highlighted that the EU State aid regime does not differentiate between the sources of the funding, i.e. once a given sum of money is treated as EPFS, there should be no need for distinguishing between different types of such EPFS and how it can be used by reference to the source of the funds collected. However, it can be argued that State aid regimes focus on limiting distortions to competition rather than minimising direct impact on taxpayers.

Moreover, considering that the costs of any intervention can be recouped from the industry participants without recourse to taxpayers' money and the budget of the Member State[6], the impact on public funds is likely to be less detrimental in such a case than if the money originates from a Member State budget. This helps avoiding the risk of excessive use of taxpayers' money, one of the main objectives behind the creation of the EU resolution framework, by ensuring that, where

[6] The extent to which the banking sector may then recoup such costs from their clients is contingent on the dynamics of a given market for banking services and its competitiveness. It is difficult to predict *ex ante* to which extent clients would need to ultimately bear the increase in contributions and the impact may be heterogenous, e.g. in competitive markets with elastic demand for banking services, banks may choose to absorb the higher costs whereas, in less competitive markets with inelastic demand, banks may choose to transfer the costs to their clients.

external funding is required, preference should always be given to the industry-funded safety nets created for that specific purpose.

Finally, the evaluation of the framework has also showed that, despite funds being collected in the Single Resolution Fund, the Fund has never been used, while taxpayer support was used in the past.

3. **Do Member States agree that EPFS originating from the budget of a Member State differs from that of the industry-funded safety nets?**
4. **Do Member States agree that such differentiation be reflected in line with the Commission proposal?**

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

The Commission proposal replaces the reference to 'depositors covered by Directive 2014/49/EU', with a reference to 'depositors'. It also adds a qualifier that the objective of protecting 'depositors' should be achieved 'while minimising losses for deposit guarantee schemes'.

2.3.1. Protecting depositors

Several Member States consider that the amendment would result in an (in their view, undesirable) extension of protection to deposits that are either excluded from DGS repayment pursuant to Article 5 of DGSD, or are above the coverage level and, hence, would not be repaid by the DGS. Each Member State based its criticism on different reasons, which could be summarised as one or several of the following:

- Moral hazard: depositors will expect to be protected and will not appropriately manage their risk.
- Fairness: not all deposits merit the same kind of protection.
- Overlap with other resolution objectives: the objective of continuity of critical functions already covers the possible financial stability and real economy effects of harming deposits.
- Expanded resolution scope: the protection of all deposits will excessively expand the resolution scope, which can create costs for institutions.
- Use of DGS for purposes different than pay-out in insolvency or assuming losses in lieu of covered depositors in resolution: the protection of all deposits could lead to uses different from those referred.

However, in the Commission's view, like with any other resolution objective, the objective of protecting depositors is not absolute and remains subject to the assessment by resolution

authorities, which should balance it against the other objectives[7]. This means in particular that resolution authorities are in no way expected to protect all depositors in all circumstances, being covered deposits the only deposits mandatorily excluded from bail-in.

The proposed change to the objective appears consistent with the other amendments introduced by the Commission proposal, such as the possibility of use of DGS funds in resolution also for financing, in certain cases, the transfer of deposits, including non-covered deposits when the latter are excluded from bearing losses (in line with the criteria for discretionary exclusions from bail-in). The resolution authorities retain the possibility of deciding how best to achieve the resolution objective in any given case. For example, protecting depositors *in general* needs not necessarily be inconsistent with subjecting some of the (non-covered) depositors to bail-in, if that allows for the transfer of a deposit portfolio and avoiding larger losses to the depositors in case the bank was to be put in insolvency.

At the same time, any resolution objective must be interpreted in the context of the entire framework, i.e. in light of the tools given to resolution authorities to pursue that objective. In this case, BRRD provides that non-covered deposits are in principle bail-inable, and they can only be exempted from absorbing losses where the resolution authority can demonstrate that their protection is justified (on the existing legal bases related to contagion, protection of value, continuation of critical functions and operational difficulties).

5. **Do you agree with replacing the reference to 'depositors covered by Directive 2014/49/EU' with a reference to 'depositors' in Article 31(2), point (d)? Please provide reasons for your answer.**
6. **Do Member States agree that including depositor protection as a resolution objective does not imply per se that all depositors will be protected? Would Member States like to reinforce this 'protection' or to water-it down?**

2.3.2. Minimising losses to DGSs

Some Member States, while agreeing with the goal of minimising DGS losses in certain situations, questioned the rationale for including that goal as a resolution objective and expressed concerns that it might make it more difficult to put a bank into insolvency (i.e. harder to prove that insolvency would be more efficient than a transfer in resolution, if that transfer could be credibly achieved). As above, these Members States criticise the effects of such inclusion because it would lead, in their view, to a too broad expansion of the resolution scope.

[7] All resolution objectives remain, in principle, of equal significance and subject to balancing by resolution authorities in light of the nature and circumstances of each case (Article 31(3) of BRRD).

All else being equal, minimising DGS losses is a legitimate aim since, at a minimum, it contributes to avoid value destruction unless necessary to achieve the resolution objectives (Article 31(2), last subparagraph, of BRRD).

However, earmarking institutions for resolution is likely to imply additional costs for these institutions such as MREL in (higher) amounts, as well as increased reporting obligations, costs which, for some (very) small banks, might not be proportional to the marginal impact on DGS funds in resolution vs. in liquidation. At the same time, it is important to ensure time-consistency and so in cases in which the resolution authority considers that the smaller or medium-sized bank concerned should be resolved at FOLF moment, then it should also plan and prepare for it rather than attempting to resolve a bank that was earmarked for liquidation.

Moreover, the inclusion of minimising DGS losses must not imply that resolution is the only path forward for failing institutions. As above, all resolution objectives remain, in principle, of equal significance and must be interpreted in the context of the entire framework.

Such inclusion is connected to the changes made to Article 109 of BRRD, i.e. ensuring that any use of DGS funds in resolution pursuant to that provision remains subject to the more general objective of minimising DGS losses (and the least cost test). However, given the concerns expressed by some Member States, one way to take them into account could be to remove the reference of minimising lossess to DGSs from the resolution objective. Article 109, as proposed, subject to the outcome of the discussion by the Working Group, could still be correctly applied if the reference to minimising losses of DGS is removed from the resolution objective.

Another way to tackle this issue could be to use the 'necessity and proportionality' assessment under Article 32(5), first subparagaph, in a way that ensures that application of resolution is not automatic in cases in which the marginal benefit of resolving a bank (as opposed to winding it up under national law) for the achievement of certain resolution objectives is so small that the resolution authority can still decide to wind up the bank under national law without significant detriment to the resolution objectives. However, achieving such result may necessitate some amendments going beyond the Commission proposal that would make the use of the 'necessity and proportionality' assessment more clearly relevant for the outcome of the PIA (please see also the discussion in section 2.5 below).

7. **Do Member States agree that minimising DGS losses is a legitimate resolution objective?**
8. **What do Member States prefer?**
    a. **Removing the reference to minimise DGS losses from the resolution objectives?**

b. **Clarifying that the addition to the resolution objectives can and should be interpreted in light of the other objectives in a proportionate way, and in particular, be balanced with the protection of deposits?**
c. **Other alternatives (please specify)?**

2.4. 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).

The Commission has explained the change as aimed at ensuring that resolution can effectively be applied to banks of all sizes, including smaller and medium-sized ones. There would be no presumption in favour of resolution and resolution authorities will still be expected to justify the choice for resolution instead of insolvency. As resolution authorities are required to compare resolution against insolvency, the outcome of this assessment heavily depends on the tools available in normal insolvency proceedings in each Member State.

A majority of Member States accept a certain expansion of the resolution scope, in order to include, at least, (some) medium-sized institutions, provided that not all institutions have to be earmarked for resolution.

However, several Member States consider that the proposed change goes too far and may make it very difficult, for at least some Member States, to demonstrate that winding up under national law would achieve the resolution objectives *more effectively* than resolution. They consider that resolution should remain the exception and that such change would also have far-reaching effects on the required levels of MREL given the fact that the outcome of the PIA assessment at the resolution planning stage is often used to inform the decision on whether a given entity should be earmarked for resolution. Certain Member States have also related this change to the amendment to Article 31(2), point (d), which introduces the requirement to minimise losses for DGS as one of the resolution objectives (see above). They argue that the combined effect of changes to that provision and Article 32(5), first subparagraph, could make it difficult for them to wind up any bank under national law.

In light of the above, there may be a need to balance the broader goal of the CMDI review of ensuring that resolution can be applied also to smaller and medium-sized banks, as agreed in the Eurogroup statement, and the need to preserve sufficient discretion and flexibility of resolution authorities when deciding on whether a bank should be put into resolution. As stated before,

resolution is not and should not be the only path forward for failing institutions. As stated by the Commission during the Council Working Party of 24 May, the intention has never been to extend resolution to all banks in the Union. It may therefore be necessary to provide additional legal certainty regarding the preservation of resolution authorities' discretion when conducting the PIA pursuant to Article 32(5) of BRRD.

One solution for achieving that objective is, as mentioned above, to clarify and assign a greater role to the 'first' part of the PIA, i.e., the 'necessity and proportionality' assessment. Indeed, if resolution objectives are at risk, resolution authorities must also determine if resolution is necessary to achieve those objectives and if it is proportionate to do so. It is the assessment of all three elements of Article 32 (5), first subparagraph, of BRRD – necessity, proportionality and effectiveness – that inform the decision of the resolution authorities. Hence, a clarification on that assessment could allay fears of some Members States, reinforcing the fact that insolvency must still be possible for banks.

9. **Do Member States agree with the wording of Commission proposal?**
10. **If not the case, would Member States agree that it would be sufficient to include clarifications in the necessity and proportionality assessment or would they suggest other alternatives?**

2.5. 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.

The underlying policy objective is explained in terms of ensuring that the comparison between the different alternatives (resolution and national winding up proceedings) includes all the relevant elements that may affect the outcome of the PIA and to reduce the risk of using taxpayer money instead of industry-funded safety nets.

Some Member States have pointed out that this addition seems to duplicate the requirement that is already inherent in Article 31(2), point (c) (protecting public funds). Others have suggested limiting the additional requirement to the resolution execution stage only, i.e. not to require it in case the PIA is used for determining which entities should be earmarked for resolution at the resolution planning stage. On the other hand, there have also been suggestions to state clearly that any expected liquidation aid should automatically lead to a positive PIA and resolution.

As a matter of principle, it appears reasonable to require that all elements that may possibly influence the outcome of the PIA are taken into account. However, at the same time, the resolution authority might not have sufficient certainty of whether and to what extent EPFS will be provided, for instance because EPFS is a political decision that may not be reasonably anticipated.

The need to spell out the requirement more explicitly in the context of EPFS may be linked to the fact that, basing such requirement solely on the objective of protecting public funds could lead to divergent interpretations, i.e. not every authority may draw the same conclusion. However, there may be some procedural aspects that could require further clarification, e.g. how the relevant information should be obtained or that authorities should not be required to proactively obtain such information, but rather should not ignore the information that is available to them.

11. **Do Member States agree that resolution authorities can expect and estimate extraordinary public financial support? Should expectation of this support affect the PIA? If your answer to is 'no', please explain if you object in principle or to the specific way in which the requirement has been formulated in the Commission proposal. If the latter is the case, please specify how this requirement should be incorporated.**