EU BANK CRISIS MANAGEMENT FRAMEWORK

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A level-playing-field view of the funding mix for resolution

The fragmentation of the crisis management framework, mostly with regard to mid-sized and smaller banks, is a well-worn theme the European Union is facing. As such, reaching a fully integrated Banking Union could not be achieved if many banking crises are still handled through non-harmonized national methods that requires a strong reliance on industry funds, or even public funds. Yet, harmonization in the European Union is not out-of-reach and the last discussions on the crisis management and deposit insurance (CMDI) legislative proposal invites us to move forward.

On the positive side, it is important to keep in mind that we already did the hardest part by establishing such a European crisis management framework for the largest banks. The resources built up by the banks under the Single Resolution Board's remit to fulfil the Minimum Requirement for Own Funds and Eligible Liabilities (MREL), to absorb losses and restore capital in resolution, have reached EUR 2 500 bn in 2023 (or 34% of the total risk exposure amount). The Single Resolution Fund has now received almost EUR 80 bn in contributions from banks. Year after year, resolution plans are being complemented and tested with more and more granularity.

What has already been achieved for the largest banks should give us confidence that a broader harmonization is both feasible and legitimate. It would ensure that banks of different size and established in various Member States operate under similar rules, not only under normal circumstances but also when they face a crisis situation.

Stringent safeguards for external funding are key to hit the right balance with internal funding.

Extending the scope of resolution to more banks, while ensuring that national tools such as deposit guarantee schemes (DGS) preventive interventions are not used as a substitute to resolution to support failed banks, seems to be the best way to reach that goal. It was a key objective of the CMDI package proposed by the Commission in April 2023. As shown by the vivid discussions surrounding of the CMDI proposal, the main challenge to achieve a meaningful and workable extension of the resolution framework is to reconcile different views on the funding mix that should support the resolution of a mid-sized or smaller bank.

On the one hand, "internal funding" supported by investors is without doubt the best way to avoid moral hazard and costs for taxpayers, ensured by a sufficient level of MREL requirements. For the largest banks, MREL is the first and main line of defence and the same principle should apply for banks that would be newly included in a larger scope of resolution. However, where the use of transfer tools – used on a standalone basis or combined with other tools, such as bail-in – would decrease the need for recapitalisation, a proportionate downward adjustment of the MREL would be legitimate, irrespective of the size of the bank.

On the other hand, external funding in resolution, through resolution funds and DGS, was designed as a very restricted and last-resort option for the largest banks. These principles should be preserved to avoid the risk of ending up with two coexisting approaches for resolution: mostly based on MREL and bail-in for the largest banks; contrasting with strategies mostly based on external funding from resolution funds and DGS, akin to a form of industry-funded bail-out, for mid-sized banks and smaller banks. The latter would be a source of moral hazard and the extension of resolution would actually be a setback in terms of harmonization.

Stringent safeguards to external funding in resolution are key to hit the right balance with internal funding, and ensure that the CMDI proposal does not fall short of the initial ambition. Sensible safeguards should ensure that the use of external funding in resolution remains a last resort option where internal resources are insufficient at the time of crisis, in extreme scenarios, and would be restricted to banks that, prior to the crisis situation, were thoroughly applying the resolution planning framework.

That last consideration, in particular, would create the right incentives both for banks and for authorities to converge toward a higher level-playing-field for resolution planning. Once a bank has reached a sufficiently high level of ex ante compliance with the harmonized framework (including MREL requirements), it could then be envisioned to allow ex post a potential resolution scheme to include, as a last resort, an extended access to mutualized funding at the level of the Banking Union.

A solid governance must underpin such an ambition. In this respect, the established dynamics of the Single Resolution Mechanism should be preserved to ensure a level-playing field and take decisions in the interest of the whole Banking Union, moving beyond national banking sectors interests.

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CMDI will enhance the EU crisis management framework if its tools are effective

In 2022, the Eurogroup agreed on a number of elements to strengthen our crisis management framework. One of these elements was 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."[1] The rationale was to spare taxpayers from having to shoulder the consequences of these smaller banks' crises, as it has happened in the past.

The 2023 Commission's Crisis Management and Deposit Insurance proposal (CMDI) pointed exactly in that direction. More small banks would be earmarked for resolution. Resolution authorities, in turn, would have additional easy-to-use tools to deal with the potential failure of those banks.

Resolution has a number of advantages over liquidation. First, in resolution, the use of taxpayers' money is explicitly ruled out. Also, when a failing bank reopens after the resolution weekend, customers keep access to its full range of services. This is not necessarily the case in liquidation.

This does not mean that all banks running into trouble should be resolved. Even after CMDI, liquidation will stay relevant for most banks. The Banking Union is home to around 2 000 small banks and, even after CMDI, for the most part, liquidation will remain the preferred approach in case of crisis. So, resolution will not be the general solution.

With CMDI, banks entering in the scope of resolution, even the smaller ones, would have to respect the same standards as their larger peers, in a proportionate way - ensuring a level playing field. This means, among other things, that these banks would have to build and maintain their minimum requirement for own funds and eligible liabilities (MREL), like their larger peers.

At the same time, resolution authorities would need a more flexible toolset to deal with the resolution of these smaller banks. This is why the Commission introduced an alternative way of funding a market exit for the bank in crisis, if it is in the public interest and after the depletion of the MREL resources of the bank. To do so, CMDI makes the use of Deposit Guarantee Scheme funds more realistic (through the so-called "DGS bridge"), and facilitates the use of the Single Resolution Fund. This funding would help the sale of the ailing bank to a solid acquirer. By doing so, CMDI enhances flexibility, preventing the risk of unsuccessful resolution decisions.

Nevertheless, MREL will remain the first line of defence. In that sense, after the introduction of CMDI, shareholders and (MREL) creditors will clearly shoulder the burden of resolution in all banks earmarked for resolution, big or small. If anything, by enlarging the scope of resolution and leaving the MREL requirements unchanged, CMDI would increase the aggregate amount of MREL in the system.

At the same time, through the DGS bridge, CMDI would give resolution authorities the flexibility to deal with smaller banks at a limited cost for the industry[2].

Some stakeholders worry that this proposal could create bad incentives for smaller banks by simplifying the use of DGS funds or the SRF for their resolution. This is not the case. CMDI doesn't change neither the resolvability expectations, nor the loss order: shareholders are first to bear losses, then MREL-eligible instrument holders, and only then, when and where necessary, DGS and the SRF - to finalise the sale of business.

After the reviews of Council and Parliament, the CMDI proposal now seems less ambitious. In particular, the Council's text introduces 19 new safeguards restricting access to the new funding – a key element for a successful resolution. Whatever compromise legislators may find in trilogue on the sensitive issues around the DGS bridge, they should make sure it delivers in terms of funding available for a resolution decision. Without proper funding, liquidation and bailouts may become the only option.

If the CMDI's funding is too small or its safeguards too complex, the reform's impact may be limited.

The SRB will implement the final package agreed by the colegislators, whatever its content. Nevertheless, it should be clear that, if the funding provided is too limited or its safeguards too complex to satisfy during a resolution weekend, the reform's impact on financial stability and taxpayer protection may be limited. Everyone, including banks, will benefit from a more effective crisis management framework. CMDI, in the path charted by the Eurogroup, is crucial for delivering on this objective and will have a positive impact for achieving a fully-fledged Banking Union.

1. *Eurogroup statement on the future of the Banking Union of 16 June 2022*
2. *Single Resolution Board, "The Commission proposal to reform the EU Bank Crisis Management Framework: A selected Analysis", December 2023*

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Let us not overlook the small banks

According to the European Central Bank's data as of the end of the fourth quarter of 2023, in the countries participating in the Single Supervisory Mechanism, there were almost 2 000 less- significant institutions (LSIs)[1]. In Poland, there is also a great variety of small, non-complex institutions (SNCIs) in the legal form of cooperative banks (403 SNCIs among 492 cooperative banks). They support many local development initiatives and local self-governments, provide credit to local entrepreneurs and help to stimulate economic growth.

However, the current shape of the EU framework for bank crisis management and national deposit guarantee schemes (Crisis Management and Deposit Insurance – CMDI) is designed for significant, 'too big or too complex to fail' financial institutions. Such an approach is based on the (and to be honest, quite questionable) assumption that only those entities can pose systemic risk. In this situation an important question arises: should the resolution process apply only to large and medium-sized banks whose liquidation would cause significant issues in a country, or should it also include a broader range of smaller banks?

As practice shows, to date, the resolution proceedings have been applied rarely, while many failing small banks have been liquidated under national liquidation regimes, in certain cases with the involvement of taxpayer funds (bailouts), instead of industry-funded mechanisms, such as the Single Resolution Fund (SRF). A notable examples of this were Banca Popolare di Vicenza S.p.A. and Veneto Banca S.p.A., liquidated in 2017 under national insolvency proceedings with the use of public funds. As a result, the harmonised resolution framework was bypassed and superseded by non-harmonised national arrangements which involved public support. As these cases clearly show, narrowing the application of the resolution procedure only to large banks can result in resorting to the use of state aid, which is not in line with the whole post-crisis CMDI philosophy.

While assessing whether the public interest premise is fulfilled, which is a trigger for resolution, it is necessary to take into consideration not only the impact of a bank's failure on an entire country's financial system and on national or transnational financial stability (which usually is not the case for small banks), but also to perceive the bank as an element of a complex ecosystem, performing critical functions for the local economy. Apart from that, for example in the case of a cooperative bank, also the potential impact of its insolvency on the cooperative banking sector as a whole must be considered.

The current CMDI framework is designed for 'too big or too complex to fail' financial institutions.

Previous episodes of cooperative bank failures in Poland have shown that in this part of the banking sector, the risk of contagion is relatively high. Additionally, the resolution procedure proved to be key for preserving financial stability at a regional level. The least-cost test conducted by the resolution authority in Poland has shown that the cost connected with resolution was lower than the cost related to the pay-out of covered deposits in regular insolvency proceedings.

The European Commission has acknowledged the existence of the problem of marginalising small banks in the context of resolution proceedings and on 18 April 2023 proposed a reform of the CMDI framework to widen understanding of public interest, i.e. to broaden the scope of resolution also to small entities. The aim of the proposal is to facilitate application of the resolution procedure to the LSIs. The general direction of the proposed reform is desirable, however, there are still areas that need to be improved to make resolution a strategy feasible for small banks. In particular, such entities have their business models based mainly on funding via retail deposits, thus issuing liabilities in order to comply with MREL requirements may be challenging and costly for them. In this way, they may also face difficulties with meeting the requirement of bail-in of at least 8 per cent of total liabilities including own funds (8% of Total Liabilities and Own Funds (TLOF)), which is the condition necessary to access national resolution financing mechanisms or the Single Resolution Fund. As a consequence, in the case of small banks with the traditional funding model, the bail-in of uninsured deposits in order to meet the 8% TLOF requirement may be necessary, however it could in turn undermine depositors' trust in the banking system.

In conclusion, the resolution process should apply to a broader range of smaller banks. However, all the considerations raised above point to the need for a further reform of the resolution framework (including the MREL requirements) to make it more adjusted for small institutions, including those operating within Institutional Protection Schemes.

1. *https://data.ecb.europa.eu/data/datasets/SUP/SUP.Q.B01._Z._Z.R0104._T.LSI._Z._Z._Z.Z.C*

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The next step for a more efficient crisis management

The EU banking resolution framework is relatively new. Still, after 10 years we are currently working on its second review, which shows of its importance. Clearly the move that the framework was setup by the EU, including the infrastructure of resolution authorities and funds, the crises preparedness by the resolution plans and build-up of bail-in eligible liabilities (MREL) has made EU banking system very stable, which has also increased the confidence in the sector. This was clearly tested last year for example. We all see its benefit and it seems to be a logical move to use it to broader range of smaller banks. Clearly with the enlarged scope we shall have a more holistic view considering various tools of crisis management. We can say the resolution framework has matured and now we shall see how it fits in well with older tools of banking crises management.

This is the current challenge to make sure that the bail-in can play with tandem with other crises management strategies while we build on the benefits of the new framework. Also we should defend taxpayer money and save the still viable part of the bank. Clearly financing burden is firstly borne by shareholders and creditors, we base the preparation on this principle. Still, it is the nature of the crises that one could never be 100% ready for it, and that is where other financing sources should come into play. Furthermore, I believe in several cases we need only liquidity support, so the replenishment of safety nets is expected.

Another challenge with the enlarged scope is that we should take care of the diversity of banks, which can be even more complex in the strongly integrated Banking Union framework, here I shall also refer to the mutualised system of Single Resolution Mechanism. The credibility of the financing of is a crucial issue. The build-up of loss-absorbing capacity, typically through successful issuance of eligible instruments, and the conditionality of accessing the safety nets, like resolution funds a deposit guarantee schemes, are all elements for this credibility. Also the transfer tools should be taken more into account as we broaden the scope and strengthen the framework.

We shall have an efficient system with the flexible use of toolbox fit for different banks.

In fact I would go further, we should also treat the diversity of the situation of different Member States. The structure of the banking markets are different inside and outside of Banking Union, and there are also different tools of crisis management which have worked well in the past. However I would like to underline that we should avoid free-riders of the system, as the moral hazard can endanger financial stability as well. We should have a balanced system that takes care of more fragile domestic banks, which may be in an even more difficult situation because of their country of origin. In a flexible system we should be clear that in some cases the goal is orderly market exit of the nonviable bank. Contemplating on this balance, on the issue of level playing field between large and small banks we shall not make hasty assumptions, but look into the details. For example MREL is not a fee, but a factor that shows the resilience to consumers and investors. Clearly a larger bank can build up MREL more efficiently, and the bank gets stronger by it. Also a smaller bank who enters into a difficult situation is clearly not doing that intentionally. We can all agree that MREL is the first line of defence, but we should pay greater attention to the type of clients, who invest in these types of instruments, as these may affect the financial stability of a Member State, if the clients are unaware of the associated risks. Therefore MREL eligible instruments should only be available to retail clients with strict safeguards, or market them to professional investors.

In summary the resolution framework is clearly beneficial, so the logical next step is to enlarge the scope, see how different crisis management tools can work together and even identify synergies. We shall have an efficient system with the flexible use of toolbox fit for different banks. Taking into account the long standing experience of crisis management gained through resolution and insolvency procedures we can have a holistic review of the framework, so we can provide solutions to the unaddressed problems, strengthening further the resilience of the EU banking sector. I believe that the work of the Hungarian Presidency is to move forward toward a more effective crisis management framework, but also taking care of the diverse nature of banking systems and the Member State specificities.

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The need for a liquidity facility for banks in resolution

Liquidity has been a hot topic since the 2023 banking turmoil, but the central role of liquidity in resolution is not a new insight. Without liquidity, continuity of critical functions is not plausible. Even though resolution action will have restored capital levels, a firm may not have access to market sources in the weeks or months following a resolution.

Recognising this, the FSB specified in 2016 that jurisdictions should have credible arrangements for public backstop funding with capacity to meet the needs of systemic firms in resolution and promote market confidence.

The failure of Credit Suisse (CS) highlighted the consequences of shortcomings in this regard. In March 2023, Switzerland did not have arrangements for resolution funding or a public liquidity backstop.

Prior to reaching the point of non-viability, CS received CHF 50bn of emergency liquidity assistance (ELA) from the Swiss National Bank (SNB). This significantly depleted its available collateral, so when the SNB had to provide up to CHF 200bn in additional liquidity in the run-up to and following the merger with UBS, that lending was uncollateralised. To protect the SNB for part of that lending, emergency legislation was adopted to put in place a public sector backstop – a guarantee by taxpayers against any losses it might occur.

The CS case has lessons for the EU. Here, the current picture is complex: different public sources of liquidity apply, depending on whether it is needed before or during resolution, or to support post-resolution restructuring. And, crucially, there is currently no adequate public backstop mechanism.

The ECB's liquidity facilities are part of its monetary policy operations, although they may serve to provide liquidity to individual solvent banks that have the required collateral. During crises, the ECB has occasionally temporarily extended the maturity of its lending or widened its eligible collateral.

ELA for individual banks that are liquidity stressed but solvent falls to national central banks. NCBs have considerable discretion as to the terms on which it is provided, including the collateral.

Once a bank is in resolution, the Single Resolution Fund (SRF) may provide loans, provided the conditions for access have been met. Notoriously, those conditions require the prior bail-in of at least 8% of the bank's total liabilities, including own funds (TLOF). The amounts that may be used in a single resolution are capped at 5% of the bank's TLOF.

Time to consider a new facility for the ECB to lend in resolution with a mutualised public indemnity.

The SRF currently stands at its target level of approximately €75 billion. This is a considerable sum. However, looking at the amounts of liquidity required by CS in the run-up to and following the merger transaction, the SRF's prefunded resources clearly fall short.

Potentially, there is a backstop that almost doubles its firepower. In 2018, it was agreed that the European Stability Mechanism (ESM) could lend the SRF up to €68 billion. The ESM would introduce mutualised financial backing by MS into the framework. However, that public backstop is not yet in force, since ratification of the ESM Treaty is currently blocked at the political level.

A bank that has been subject to bail-in or a resolution transfer should meet the solvency requirements for ELA or access to ECB facilities. In theory, these may be an additional source of liquidity until the resolved bank commands enough counterparty confidence to return to market-based funding. However, there are potential obstacles. It may require lending for a longer term than those sources are designed to provide. A bank that has emerged from resolution is unlikely to have sufficient eligible collateral to fully secure the amounts needed.

Therefore, a euro area liquidity facility with a mutualised backstop is essential for the credibility of the resolution framework in the banking union. Activation of the ESM backstop is the necessary first step. But beyond that, it is questionable whether the current resources of the SRF, even with the ESM backstop, would be sufficient to meet the liquidity needs of a large bank in resolution.

Experience in other jurisdictions show that it is difficult to envisage a sufficiently robust liquidity facility without the involvement of the central bank. To provide funds in resolution, the ECB would however need a public indemnity as it might have to lend without full collateral coverage, as happened in the case of SNB funding of the CS failure management. In order to preserve the principles of the banking union, that indemnity could only be provided by fully mutualised guarantees.

It needs to be stressed that the risk of loss for the fund providers in resolution is, by definition, quite low. No losses were incurred by the SNB, or the Swiss state under its indemnity, in relation to CS. If resolution is effective, the bank will be solvent. Effectiveness should be guaranteed by developing a sound resolution strategy and business reorganisation plan. Rigorous resolution planning is key.

by Fernando Restoy and Ruth Walters

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Crisis cycle: the key components for crisis prevention and management

Now more than one year after 2023's banking turmoil, Swiss authorities and international bodies have set out lessons to be learnt. They conclude that the existing regulatory framework worked and demonstrated that the reforms which followed the Global Financial Crisis increased the resilience of the financial sector globally. Nevertheless, in the crisis continuum, carefully calibrated adjustments will be necessary to further reinforce the regulatory framework.

While the focus of the public discussion in the EU is on the need for a liquidity facility in resolution, successful crisis prevention and management needs to be embedded in a broader setting which covers each phase in the evolution of a crisis. This starts with a strong risk culture and a solid capital base, includes early intervention measures as a crisis begins to unfold, and flexible resolution tools when it has crystallized.

A strong **risk culture** can help prevent a crisis in the first place. This includes governance arrangements with clear assignment of responsibilities and decision-making processes, and strong tone from the top on risk and compliance to foster good behaviours. There needs to be a culture of constructive challenge for all risk types, in the first line and in control functions, including clear escalation mechanisms. Long-term incentives in the remuneration and promotion framework are also a key part of a sustainable long-term business model. In Switzerland, the introduction of a senior managers regime is being discussed to ensure clarity on individual accountability.

Meeting **capital requirements** that are set by the law, including those that are set at individual firm level by the regulators, helps provide the financial strength and resilience to weather a crisis, and remains the backbone of risk management. In accordance with the Basel framework, AT1 should remain part of banks' capital structure.

The accelerated speed of bank runs in the digital age and related **liquidity** crises highlight the need for further diversification of market-based funding sources. Securitisation, for example, can provide more stable funding than short-term deposits.

If a bank's own efforts to address the causes of distress are insufficiently determined, authorities need to be able to exercise **early intervention powers** to prevent further deterioration. Regulators across jurisdictions should, where needed, strengthen their early intervention frameworks, ensuring that supervisory measures are based on clearly defined objective criteria. To the extent that an advanced framework already exists as in the case of the EU, supervisors need to be able to use their powers effectively, even where reported prudential ratios are compliant with regulatory requirements.

In the crisis continuum, adjustments will be necessary to further reinforce the regulatory framework.

Improvements in access to central bank liquidity during market stress are crucial: commercial and central banks need to collaborate to ensure they have well planned operational and legal arrangements for pledging and receiving a wide range of less liquid assets as collateral against central bank funds.

As a crisis deepens, as shown by the Credit Suisse events, the role of loss absorbing AT1 instruments for the recovery of an institution can be crucial. However, their loss absorbing function in going-concern should be reinforced: further work at supranational level may be needed to provide additional clarity on the features of these instruments and enhanced standardization may help provide clarity to investors.

At the end of the crisis cycle, **flexible resolution tools** are key. In March 2023, the rescue of Credit Suisse was deemed the most suitable course of action, ensuring prompt stabilisation and minimising impact on financial stability. Nevertheless, recovery and resolution planning proved to be good preparation. Going forward, the degree of optionality in resolution strategies needs to be enhanced to address a range of crisis scenarios. The greater the optionality of resolution tools available to authorities, the greater the chances that resolution of a failing bank can effectively be implemented. Effective planning for the operationalization of variant strategies, including via regular testing of resolution capabilities, is therefore central.

Finally, the availability of a **public liquidity backstop** tool is fundamental to maintaining market confidence and ensuring the success of a resolution action or, as with Credit Suisse, of a rescue transaction. In the Banking Union context, political collaboration across Member States is needed to ensure a liquidity backstop that enables the SRB and ECB to fulfil their roles and mandates in preventing one or more bank crisis from causing wider, unnecessary losses and systemic instability.

While liquidity in resolution is an important part of the crisis prevention and management framework, additional targeted actions should be considered to reinforce management accountability, enhance supervisory effectiveness and ultimately ensure credible resolution planning is in place for a variety of scenarios.

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Resolution of medium and small banks: a response to the CMDI review proposals

In April 2023, the European Commission's proposals for the CMDI review suggested that the resolution mechanism should become the standard for medium-sized and small credit institutions. This proposal faced criticism from the start and both the Council and Parliament have since suggested changes in their respective positions. Our network, the German Cooperative Financial Network, which comprises around 700 small institutions, supports many of the changes requested by the Council as they take into account the specificities of the national banking sectors and the needs of smaller credit institutions.

Already for reasons of market discipline, insolvency should remain the default exit strategy.

Moreover, resolution tools are primarily designed for institutions of systemic importance. Their complex nature is not suitable for small and medium-sized credit institutions, whose failure has minimal impact, if any, on the overall financial stability of a country or region. The resolution mechanism should remain applicable only to institutions for which it was originally designed: banks which are systemically important and highly interconnected. For good reasons several jurisdictions apply a prudential approach that differentiates between larger banks and smaller retail institutions. In the same vein a single set of resolution-rules for banks of all sizes seems inappropriate from a conceptual perspective as it is not reflecting quantitative and commercial realities. Such differentiation needs to be reflected when enhancing European competitivity in a Savings- and Investment Union.

Another aspect, where we do not see the consequences adequately reflected, is the Commission's and Parliament' suggestion of an unlimited financial participation of deposit guarantee schemes in resolution financing, coupled with a deterioration of their position within the creditor hierarchy. Not only does this approach bear significant risks. The far-reaching use of deposit guarantee schemes for resolution measures could seriously weaken existing well-functioning deposit protection schemes and undermine depositors' trust. Therefore, the super preference of deposit guarantee schemes in the insolvency ranking has to remain intact, as suggested in the Council's position.

Also, from a wider perspective the additional financial burden for banks by the extension of the resolution tools and the changes to the creditor hierarchy raise concern. It would reduce the capacity of banks to support the digital and sustainable transition. The focus should rather be on enhancing banks' lending capacity in the context of a "Savings- and Investment-Union", a priority of the new Commission to enhance Europe's competitivity.

A single set of resolution-rules for banks of all sizes seems inappropriate.

Moreover, unresolved aspects of the too-big-to-fail problem persist, as highlighted by the turmoil surrounding Swiss and US-American banks in 2023. Even though these institutions are not part of Europe' Single Resolution Mechanism, the problems with resolving systemically important banks, such as size, interconnectedness, consequences of bank runs, and bail-in implementation, are similar. Additionally, the issue of breaking the "vicious circle" between banks and state through government bonds remains unaddressed. While there is much talk about completing the banking union, this crucial aspect has been neglected. Finally, the proposals do little to defuse the complexities of the home-host debate and to pave the way for a better allocation of capital and liquidity by banks operating cross-border.

Given this backdrop, focusing on the alleged problems with the failure of small institutions and proposing resolution measures that would weaken deposit guarantee and institutional protection schemes seems counterproductive.

Another debate in the context of the CMDI package focused on the appropriate approach to deposit protection. The DGSD from 2014 rightly focused on harmonization and avoided the sensitive issue of mutualizing national deposit guarantee schemes. It also effectively reflected the mode of action and effectiveness of IPSs.

The CMDI review proposal includes several welcome technical suggestions for the DGSD. However, we believe that it also has to ensure the functionality of institutional protection schemes (IPS) as those systems add a further layer of security for their members. Unfortunately, both the Commission proposal and the Parliament's negotiating position make preventive measures by IPS, and thereby their entire mission, virtually impossible through numerous impractical rules. The Council position, although it brings more complexity and more changes seem necessary, certainly is a step in the right direction.

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Crisis Management and Deposit Insurance (CMDI) review: where to land?

Going back to the Eurogroup statement of June 2022, the four objectives of the CMDI review were to (1) clarify and harmonise the Public Interest Assessment (PIA), (2) broaden the application of resolution tools in crisis management at European and national level, including for smaller and medium-sized banks, (3) further harmonise the use of national Deposit Guarantee Scheme (DGS) funds to facilitate market exit of failing banks, under a harmonised least cost test (LCT) and (4) harmonise targeted features of national bank insolvency laws to ensure consistency with the CMDI framework. Note that "harmonisation" comes back explicitly in three of these four objectives and that a clear link is made between the use of DGS funds in resolution and market exit.

Behind this Eurogroup call to review the CMDI and stated objectives lay the observations that resolution-like solutions were still applied at national level outside the framework, at the expense of DGSs or taxpayers, with limited burden-sharing by shareholders and creditors, and that several smaller or medium-sized banks that were not earmarked for resolution could threaten financial stability in case of failure.

Looking at the Commission proposal and the respective positions of the Parliament and the Council, it is not obvious to see whether the Eurogroup objectives will be met. Unfortunately, indeed, it seems that a genuine political will to drop national habits in favour of a harmonised EU framework is still missing among several Member States.

In a constructive mood though, let us suggest some ideas that may help achieving reasonable progresses, leaving the fourth objective open for the moment.

Starting with the PIA, assessing it at regional level should allow capturing more banks that could generate financial stability risks if failing. It is important though to define "regional level" in a way that covers truly significant geographical and economic areas and avoids further fragmentation of the EU market; the Parliament position appears somewhat misguided in that respect. More importantly, any change from a negative to a positive PIA should only be allowed under specific conditions. In particular, changing the PIA of Liquidation Entities and entities under simplified obligations at the point of quasi failure should not be allowed. Leaving such possibility of last-minute change would indeed undermine the basic principles on which the framework was built.

A genuine political will to drop national habits in favour of true EU harmonisation is still missing.

Broadening the application scope of resolution tools to smaller and medium-sized banks is generally welcome. The extent of the enlargement should not be an issue if adequate funding can be ensured, coming first from shareholders and creditors of the failing bank through appropriate MREL, as well as proper preparatory measures by both the resolution authorities and the concerned banks. Without being prescriptive, the Commission proposed guidelines to that effect, which the Parliament further detailed, and the Council did not retain at all. Could the Member States reconsider their views and so, start to gradually harmonise practices is a key question. Next to it, if funding means are available, authorities should intervene early enough upon deterioration of the situation to avoid that such means are already gone when resolution is declared. Positions appear more convergent here, particularly concerning preventive measures. Rapid handover to resolution authorities could be further prescribed for barely viable entities and maximum delays between situation assessments once preventive measures have been launched could be defined.

Facilitating the use of DGS funds and harmonising the LCT has been approached in various ways. The Commission went quite far in its proposal with a general preference for deposits, all at the same level. The Parliament was less radical with two tiers within deposits and the Council went for a more complex four-tier proposal. A mid-way approach close to the Parliament position could be reasonable. So, the LCT could more easily be satisfied for banks that are mainly funded by retail and SME deposits. Though, the link between the use of DGS funds in resolution and market exit of the failing bank should not be left aside. Furthermore, the purpose was to harmonise the use of DGS in crisis management, i.e., in resolution, and not to facilitate use of DGS funds in various alternative ways as allowed under diverse national rules. The Council position may have missed the goal in that respect. Counter-balancing that diversion, it enhanced the safeguards preventing easy access to the Single Resolution Fund (SRF). In order to evolve towards more harmonised rules and easier access to funds at European level, SRF today or EDIS tomorrow, all Member States should accept to gradually close the door to national specificities and backdoors. And, of course, to accept the principle of building adequate levels of MREL for their PIA-positive candidates and of preparing them for resolution, as per the existing framework.