Reform of the European Crisis Management and Deposit Insurance (CMDI) framework

Views from supervisory perspective

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Introduction
Introduction

- General importance of the current review of the European crisis management and deposit insurance (CMDI) framework
- Successful progress in crisis management at European level
- Practical experience gained in the banking union has supported this review
- Today’s focus topics:

The role of supervisors in crisis management

Ensuring optionality in crisis situations
Role of supervisors in crisis management
Role of supervisors in crisis management

Development of stress level

**Preparation/planning**
- Assessment of banks' recovery plans and recoverability
- Consultative role in resolution planning & assessment of banks' resolvability

**Early intervention**
- e.g. possible application of supervisory or early intervention measures

**Assessment of Failing Or Likely To Fail**
- e.g. supervisor in consultation with resolution authority

**Determination of conditions for resolution**
- Resolution authorities are responsible for deciding on the appropriate resolution action
- Close cooperation with the respective resolution authorities

| Business as usual | Distressed situation | Failure or likely failure |
ECB welcomes the proposals on Early Intervention Measures (EIM), in particular:

- **Direct legal basis** for the ECB
- **Removal of overlap** between EIM and supervisory measures
- **Alignment of the conditions** to use supervisory measures and EIM.

ECB supports very much the **proposal to further enhance cooperation and information exchange with resolution authorities in legislation.**

As proposed by the Commission, it will be important that **this new early warning process does not affect the well-established resolution procedure.**
Ensuring optionality in crisis situations
Ensuring optionality in crisis situations

- Supervisory measures and EIM
- DGS preventive measures
- Precautionary recapitalisation
- DGS alternative measures
- Liquidation
- Resolution

Before FOLTF

After FOLTF
Role of DGSs

Pay-box (20%) Pay-box plus (45%) Loss Minimiser (20%) Risk Minimiser (15%)

Source: 2021 IADI Annual Survey
Advantages of transfer strategies

Compared to a liquidation, transfer strategies can:

- **Improve value recovery** by preserving franchise value and through faster process
- **Reduce strains on DGSs’ liquidity** arising from payouts
- **Improve depositor protection**: Uninterrupted access and broader scope of protection
- **Strengthen financial stability** and minimise the need for government support
How can value recovery be improved by a transfer?

Transferring the **whole bank – or key parts** – often generates more value than liquidating **individual assets**

- Customer relationships
- Experienced staff
- Deposit base
- Transfer of whole bank minimises administrative costs

Example: **Banco Popular:**

- Liquidation would have inflicted 2-3 times the amount of losses on shareholders and creditors than the transfer.
- Looking at creditors alone, costs would have been 7-12 times higher.

Pay-outs can strain the DGS (1/2)

Looking at gross payout amounts, in each Member State in the banking union, at least one less significant institution can deplete its fully filled DGS with a single depositor payout.

Source: Eule, Kastelein, Sala (2022) Protecting Deposits and Saving Money, Q4 2020
Notes: The chart counts the number of LSIs, LSI groups and LSIs' hosted subsidiaries per Member State whose covered deposits match or exceed the target level of the relevant DGS.
Pay-outs can strain the DGS (2/2)

Even with eventual full recovery of its initial outlay (best-case scenario), a payout of €5bn can currently cost **more than €400m** in lost interest income/financing costs.

Assuming 4% annual costs of the outstanding claim. Repayment path is only illustrative, but inspired by real cases.
DGS bridge function to the SRF

Builds on single-tier depositor preference/least cost test and is subject to several further safeguards, e.g.:
- Only banks earmarked for resolution
- Transfer strategies which lead to a market exit
- Compensating only for deposits and up to the amount necessary to meet the 8% TLOF requirement to access the SRF; for uncovered deposits only in exceptional circumstances to be confirmed by the resolution authority
- Contribution capped by the amount of covered deposits at the respective credit institution

Shareholders and creditors bear losses first

DGS contribution counts towards 8% threshold

Recourse to the single resolution fund