



Irene Mecatti

The crisis management of smaller banks

EBI Global Academic Conference

Frankfurt 15 February 2024

BRRD: general settings

- The BRRD refers to the word 'crisis' more than 50 times, but does not define it
- Article 2(30) definition of systemic crisis: a disruption in the financial system with the potential to have serious negative consequences for the internal market and the real economy. *All types of financial intermediaries, markets and infrastructure may be potentially systemically important to some degree*



The SRM applies to all banks, regardless of size and complexity

(one size fits all)

However....in order to apply a resolution tool (Article 2(1)): **“resolution** means the application of a resolution tool [...] in order to achieve one or more of the resolution objectives referred to in Article 31(2)” two conditions must be met

- Article 32: **failing or likely to fail**
- Dicotomy between resolution and liquidation: “ in order to avoid moral hazard, any failing institution(...) should in principle be liquidated under normal insolvency proceedings. However, liquidation might jeopardise financial stability, interrupt the provision of critical functions, and affect the protection of depositors...”(Recital 45)
- Articles 31 and 32 – the **public interest** (ensure the continuity of critical functions, avoid a significant adverse effect on the financial system, protect public funds, protect depositors and other bank clients)

CMDI: reasons for inefficiency

1) **coexistence** of a common resolution mechanism with numerous and heterogeneous national (substantial and procedural) insolvency rules that apply when the public interest requirement, within the European dimension, does not exist

2) **rigidity** of the conditions of **access** to resolution (Article 32, BRRD), and its internal (Articles 44(5)(a); 12d(2), SRMR) and external (Articles 44(3) and 109, BRRD) **financing** → **lack of proportionality**

3) highly **restrictive approach** of the SRB in evaluating the public interest as a condition for resolution: only 2 cases (Banco Popular Español, Slovenian and Croatian subsidiaries Sberbank) - see chart *infra*



Incentive to manage the crisis of those non-systemic banks (but not necessarily LSIs) at national level and often with state aid

NB! State aid burden sharing is less restrictive than bail-in, as it only requires a contribution to loss absorption of equity, capital instruments and subordinated debt (*Banking Communication 2013*, para. 6.2.3)

Figura 1

Procedure di gestione delle crisi in Europa

Crisi bancarie Eea (2014-2023)



Fondo interbancario di tutela dei depositi, 2023

For the CMDI to be effectively applied, the scope of resolution should be extended to include smaller banks

AGENDA

1. notion of smaller bank
2. reasons for the relevance of this type of intermediary in the real economy
3. specific areas of the CMDI that are (and should be) subject to reform

1. Notion of smaller bank: 2 criteria

a) Size/complexity

- huge variation across the MS
- no definition in the resolution framework
- Prudential supervisory framework: Article 4(1) (145) (146) CRR2 (size, interconnection, economic importance, complexity)
- EBA (2021) refers to the size/complexity to classify institutions as:

“large”

“medium”

“small and not complex”



total assets below EUR 30 bn

Table 1 Simplified size clustering criteria¹²

Size	Criteria
	The institution meets <u>any</u> of the following conditions, with the exception of condition (d) which acts like a binding threshold for all the other conditions: ¹³
Large	a) Identified as global systemically important institutions (G-SIIs) in accordance with Article 131(1) and (2) of the CRD
	b) Identified as other systemically important institutions (O-SIIs) in accordance with Article 131(1) and (3) of the CRD
	c) One of the three largest institutions in terms of the total value of assets in the Member State in which it is established
	d) The total value of the institution's assets on the basis of its consolidated situation is equal to or larger than EUR 30 bn
	The institution is not a 'large' institution (see criteria above) and meets <u>all</u> of the following conditions:
Small (and non-complex)	a) The total value of its assets on an individual basis or, where applicable, on a consolidated basis in accordance with CRR and CRD is on average equal to or less than the threshold of EUR 5 bn over the four-year period immediately preceding the current annual disclosure period
	b) The total value of its derivative positions is less than or equal to 2% of its total on- and off-balance sheet assets, whereby only derivatives that qualify as positions held with trading intent are included in calculating the derivative positions
	c) More than 75% of both the institution's consolidated total assets and liabilities, excluding in both cases the intragroup exposures, relate to activities with counterparties located in the European Economic Area
Medium	The institution is neither 'large' nor 'small'

1. Notion of smaller bank

b) Business model and funding structure

- ECB 2022, EBA 2021, SRB 2023 : smaller banks have a **business model primarily based, in terms of funding, on retail deposits**
- MREL - Articles 45 ff., BRRD
- RA must consider...: *the business model, funding model and risk profile of the institution* (Article 12d (1)(d), SRMR)
- calibration is **apparently** adjustable:
 - wide **discretionality** of the RA → legal challenges: *BNP Paribas v. SRB (T-71/2022)*, *France v SRB (T-540/22)*, *Appeal panel cases*)
 - banks have to hold relevant capital instruments and other liabilities subject to bail-in of at least 8% of total liabilities, including their own funds (**8%TLOF**) as condition to access external financial arrangements (Articles 37(10)(a), 44(5)(a)(b), 45d, and 56(1), BRRD; Article 12d(4), SRMR)
- smaller banks have difficulties in placing sufficient MREL instruments (EBA 2023; SRB 2023, 23)
- in the past, they did so to the detriment of their customers through the unfair practice of mis-selling - Article 44a BRRD on the retail sale of subordinated liabilities

Banks with high reliance on deposits (more than 80% of their balance sheet) are supposed to rely on unprotected deposits to meet the TLOF requirement (EBA 2021; 2023; ECB 2022)



Table 2 Depositor-reliance classification

Deposit-reliance	Deposits/TLOF (%)
Low	0-60
Mid	60-70
Mid-high	70-80
High	>80

EBA 2021

More severe CET1 scenario (75% depletion of capital buffers): some institutions may not even be able to meet the 8% TLOF, thus jeopardising their ability to access external resources to manage resolution (EBA 2021)

2. Smaller banks: economic and operational efficiency

- Since the Global financial crisis, the euro area banking market has become increasingly concentrated, for reasons of maintain financial stability and improving profitability and efficiency
- **ECB 2022:** since 2014 the number of LSIs has fallen by more than 1000 entities (including Italian BCCs that have now joined banking groups classified as SIs)
- **Banca d'Italia** (*Annual Report, 2022*): the number of banking intermediaries has decreased **by 73,6%** over the past 10 years
- Negative sides:
 - ✓ Too big to fail problem
 - ✓ Lack of intermediaries which have direct contacts with the territory (eg. Italy: 1 in three municipalities does not have a branch); smaller banks give to all the clients the access to banking services and better support local economies
 - ✓ Silicon Valley Bank (SVB) crisis demonstrated that a limited territorial network may not allow for an adequate fractioning of retail market deposits, thus exposing the intermediary to the bank run of large uncovered depositors
 - ✓ Smaller banks that are exposed to the same risk factors can be systemic together because they could all fail at the same time, which would in aggregation have a large effect on the financial system (“too many to fail”)



preserving the heterogeneity of the banking “eco-system” (Haldane-May, 2011)

3. CMDI package (April 2023): main proposals relating smaller banks

PUBLIC INTEREST ASSESSMENT (PIA)

- Definition of critical functions takes into account impact also at regional level (Article 2(1)(35) BRRD) – **Veneto Banks/ ABLV bank**
- Adjustments to the resolution objectives related to minimizing reliance on **public money** and ensuring depositor protection (Article 31(1) BRRD/Article 14(2) SRMR)
- Procedural changes to the comparison between resolution and insolvency (Article 32(5) BRRD /Article 18(5) SRMR)

ADEQUATE FUNDING IN RESOLUTION A) MREL

Watering down of MREL for banks with transfer strategies
(Article 45ca BRRD / Article 12da SRMR)

B) DGS

- The rules of DGS in resolution are adjusted for transfer strategy (Article 109 BRRD / Article 79 SRMR):
 - The DGS may cover the difference between the assets and the deposits transferred to a recipient and, where necessary, contribute to the own funds of the recipient
 - all deposits may be included in the transfer provided that, for non-covered deposits, the RA assesses the reasons for their protection, that is the application of Article 44(3), BRRD (bail-in exclusions)
- Introduction of a **single depositor preference** in the ranking of claims in national insolvency laws, that removes the super-preference of DGS claims (Article 108(1) BRRD) → it helps to pass the least cost test

Open issues

- Expansion of the PIA means that smaller banks may fall under the resolution regime more easily; consequently, they will increasingly be subject to MREL requirements
- The reform does not touch the 8% TLOF: *If deposits have to be bailed in, this requirement may raise financial concern*
- The constraints resulting from the latter rule should, according to the Commission, be limited by the use of DGSs as a bridge facility(art. 109 BRRD): *When non-covered deposits are included in the sale of business, at the discretion of the RA, the DGS financing may count as a "bridge" to fulfil the 8% TLOF, within the limits of the amount necessary to reach this requirement*
- However, the use of DGS as a bridge facility would be at the *discretion* of the RA on a case-by-case basis, according to a complex procedure which lacks the degree of predictability essential in any bank crisis prevention and resolution planning
- The dichotomy between resolution and liquidation implies that liquidation becomes less attractive. Then, the differences in the burden-sharing (State aid/Bail-in) conditions should be reduced within the revision of the BC2013
- Third pillar