SRB Bi-annual reporting note to Eurogroup

This note is aimed at reporting to the Eurogroup of 7 November 2022 on: 1) resolvability progress of SRB banks; 2) the build-up of the Single Resolution Fund (SRF); and (3) lessons learned from recent cases, for the benefit of the upcoming crisis management and deposits insurance (CMDI) discussions.[1]

1. SRB's banks resolvability progress

Resolution planning

The SRB 2022 Resolution Planning Cycle, launched in April 2022, is well on track. The SRB, together with the National Resolution Authorities (NRAs), has updated 102 resolution plans for the banking groups under its remit[2]. These plans are currently under review by the ECB and the SRB's horizontal quality-assurance team and a first batch has already entered the SRM decision-making process. To recall, 82% of the SRB's banks (accounting for 97% of total exposure at risk) are earmarked for resolution.

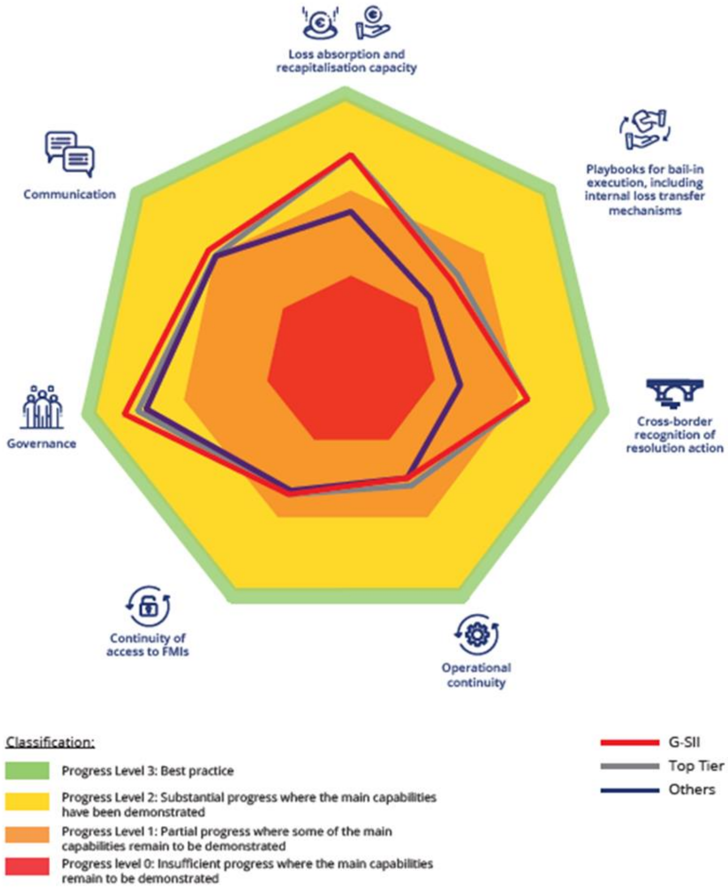
In parallel, the SRB has sent letters with the 2023 working priorities to the CEOs of the banks under its remit in recent weeks. The remaining common priority for all banks under our remit is "liquidity management and funding in resolution". This priority will mark the final stage of the phase-in of the SRB's Expectations for Banks (EfB), which were published in 2020. As has been reiterated many times, banks need to meet the EfB by end-2023 to demonstrate they are resolvable. These general priorities are complemented by bank-specific requests addressing areas where the individual bank is lagging behind or that are of particular relevance for the credit institution.

2023 is thus a decisive, but also transitional year, where the SRB is shifting focus from the general EfB phase-in and preparation of the basic resolution plans to even more targeted bank monitoring. In this context, testing, dry-run exercises and deep-dives are being intensified and will play a major role to evidence the banks' resolvability.

Resolvability assessment

As announced in previous reports, the SRB this summer published its first heatmap on the resolvability of Banking Union banks. This is an annual exercise that will increase transparency similar to international peers. The level of progress achieved by the banks in the 2021 cycle has been reviewed against the phase-in of the EfB. The main outcomes are as follow:

- Large banks (G-SIIs and Top Tier banks) are the most advanced, showing sound progress on the resolution capabilities that the SRB has prioritised in 2020-2021.
- Banks significantly improved their ability to absorb losses and recapitalise (Minimum Requirement for own funds and eligible liabilities (MREL)).
- Banks have taken significant actions to be able to execute bail-in at short notice, to maintain the



[1] Neither the Single Resolution Board nor any person acting on behalf of the Single Resolution Board is responsible for the use that might be made of the following information.

[2] All resolution plans expected for the 2022 Resolution Planning Cycle with the exception of 2 resolution plans which have a dedicated timeline due to M&A activity.

continuity of their critical functions and core business lines, and to produce the information required for resolution action.

- This said, banks still need to improve their capabilities on those EfB which are yet to be phased-in, such as the ability to swiftly mobilise liquidity and collateral in resolution, further automation of the management information systems for the purposes of valuation and resolution, or further operationalisation of restructuring and separation capabilities post-resolution. As such, these areas are the key priorities of our 2023 Resolution Planning Cycle.

Now that the resolution plans have become more and more mature and the SRB's policies and guidance are well developed, the SRB is focusing on the operationalisation of the preferred resolution strategies, and also – as a lesson learned – further developing alternative strategies where feasible. A key strategic priority is strengthening the SRB's crisis readiness to be able to swiftly implement and execute, together with the NRAs, the resolution of any failing bank. In previous crisis cases, the SRM has proven that the framework is fit for purpose and now needs to ensure its readiness also for complex resolution decisions. For instance, this year we are conducting several tests with the banks on their ability to apply bail-in, or to separate portfolios to facilitate a (partial) transfer strategy. In addition, a broader SRB dry-run on the "single point of entry" (SPE) strategy and bail-in execution is ongoing, as well as a cross-divisional project, jointly with the NRAs, to clearly establish the legal and operational mechanisms for executing an SPE strategy.

MREL policy and dashboard
In June 2022, the SRB also published the 2022 update of its MREL policy. The main novelties relate to new legal requirements, such as changes to the CRR[3] on the indirect holding of internal MREL and MREL for banks with a multiple point-of-entry (MPE) resolution strategy. As previously announced, the policy also enlarged the coverage of entities under internal MREL and made the subordination policy more dynamic.

Regarding the build-up of MREL, the latest data available show that, at the end of Q2 2022, SRB banks reduced on aggregate their MREL-shortfalls (plus Combined buffer requirement (CBR)) by EUR 4.7 bn, reaching the total shortfall of EUR 32.2 bn (or 0.4% Total risk exposure amount (TREA)). MREL gross issuances amounted to EUR 67.27 bn, decreasing from the previous quarter but remaining broadly in line with the level of the same quarter last year. More detailed MREL data can be found on the SRB quarterly dashboard, which has been expanded, and now provides more granular breakdowns.

Overall, it is important and positive to note that most banks already meet the final MREL target (of 1 January 2024). This said, the challenging economic outlook results in headwinds and unknowns. In this context, sufficient MREL is a precondition for resolvability. Thus, the SRB monitors closely the funding plans and the MREL build-up of those banks that still need to close a gap to meet the final MREL targets.

2. SRF & Common Backstop

In May 2022, after a consultation in which the SRB gave banking institutions the opportunity to comment on the main elements of the ex-ante calculation decision and received valuable feedback on several aspects, including on the annual target level, the SRB adopted the calculation of ex-ante contributions. For 2022, the total amount transferred to the SRF is €13.7 bn. This brought the SRF to €66 bn, with a projected size of around €80 bn at the end of the transitional period in 2023. 2022 and 2023 will be the last years in which the SRF is still being built-up, after which contributions should level off. After 2023 the SRB will only collect the amount necessary to cover for the annual growth of covered deposits, with the aim of fulfilling at all times the legal obligation to keep an SRF reflecting 1% of covered deposits of all credit institutions in the Banking Union.

The SRB hopes that the efforts by Eurogroup members that led to the agreement of a common backstop do not remain in vain. The ratification of the ESM treaty changes and the relevant Intergovernmental Agreement

[3] Capital Requirements Regulation

(IGA) are necessary to provide the Banking Union with the required firepower to manage bank failures, bring further confidence to the system and help the SRB to promote financial stability and protect the taxpayer.

3. Lessons learned from resolution cases and the way forward for CMDI

Sberbank

At the last reporting, the SRB informed on the Sberbank case. Since then, the SRB increased transparency by publishing further documents (non-confidential versions of the valuations and resolution decisions), and by reflecting on lessons learned. The case originated from a sudden crisis, due to the war in Ukraine and the reputational impact of the sanctions on Russia. Given the specific circumstances, one should be careful when generalising the lessons learnt from this case. This said, some issues are obvious.

First of all, it was a reminder that time is of the essence. The SRB applied a fairly new tool for the first time, the moratorium. This was vital to assess the public interest, conduct an open and transparent sales process and, ultimately, for the success of the resolution scheme. However, the way BRRD2[4] frames this tool can be constraining, hence a targeted modification of the duration should be explored.

In this case, cooperation worked excellently among all EU authorities. However, the processes proved to be highly convoluted, in particular in the context of the compressed timeframe. In a case where the SRF use were necessary, this would be further complicated by the existing requirement of a double review by the Commission (before the SRB's decision and then thereafter to endorse the resolution scheme). As such, one could explore the removal of the Article 19 SRMR[5] State aid review, by folding it into the endorsement of the SRB scheme by the Commission (under Article 18 SRMR).

The fact that the SRB deviated from the original plan, i.e. bail-in and internal upstreaming of losses, should not put into question the validity of the SPE strategy. This is the preferred strategy for most SRB banks, including nearly all globally systemic banks. Therefore, as explained above, we devote significant work to the SPE operationalisation. In the Sberbank case, the deviation from the plan was due to the unique reason of failure, which meant the Russian parent could no longer act as the ultimate provider of liquidity. The deviation from the plan highlighted the ability of the resolution framework and authorities to swiftly adapt to the case at hand and carry out – in a coordinated fashion across borders - two resolutions using the sale of business tool and a liquidation to achieve optimal results. Ultimately, this was still a single coordinated solution and all objectives were achieved: financial stability, protection of depositors (with continued access to their accounts in Slovenia and Croatia), and no use of public funds.

BPE

Since the latest report, another important development is the landmark judgments from the First Instance Court in Luxembourg, which dismissed the appeals against the Banco Popular resolution decision in their entirety. The ruling confirmed the legality of the SRB's decision to resolve Banco Popular and of the resolution legal framework. This judgment may also give clarity for future resolution cases, including that of Sberbank AG, and it ultimately vindicates our actions and the SRMR-BRRD framework.

CMDI review

These resolution cases highlight the validity of our framework and mandate. The SRB's resolution decisions, but also the cases where the SRB determined there was no public interest in resolution and that the banks should therefore be wound down in insolvency, demonstrate the need for harmonising the national procedures and strengthening the deposit guarantee schemes (DGS). Making banks' crisis management more fragmented across national divides would be a mistake.

[4] Bank Recovery and Resolution Directive

[5] Single Resolution Mechanism Regulation

Co-legislators now have a chance to discuss whether, after burden-sharing (i.e. equity and MREL), funds collected from the banks, such as DGS funds, can play a role and support the market exit of ailing banks while transferring their deposits. Looking at past cases and the US experience, this could indeed minimise the costs for the DGS intervention (as opposed to disruptive pay-outs) while ensuring continuity of access to deposits (something that becomes even more important as digitalisation advances).

In 2024, the SRF will be fully mutualised and stand at around €80 billion (1% of covered deposits), and the national DGSs should also have reached their targets of 0.8% of covered deposits. This means that the funds available to the Banking Union will be comparable to those in the US (2% of covered deposits). However, while the US has a single, central fund, the Banking Union funds for management of bank failure are pooled separately by both Member States and purpose. While we have the SRF at the Banking Union level, DGS funds are pooled separately at the individual Member State level. Ensuring that DGS funds can be used by the SRM in resolution, subject to the strict condition that it be less costly than a pay-out, could already significantly improve the effectiveness of the framework, and ultimately the competitiveness of our Banking Union. It is all the more urgent to do so given the upcoming economic challenges, from the energy crisis to climate change and digitalisation.