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 FOLTFF
After FOLTFF
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.

Shareholder and creditor losses Banco Popular in €bln

- Worst case
- Best case

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)

Illustrative DGS recovery path

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