SRB Bi-annual reporting note to Eurogroup – May 2024

This note is aimed at reporting to the Eurogroup of 13 May 2024 on the Single Resolution Board's (SRB) activities and it is structured as such: 1) some SRB's key risk reduction goals achieved; 2) SRM Vision 2028 – the new strategy of Single Resolution Mechanism (SRM); 3) important legislative files and emerging risks, 4) Conclusions.

1. Some SRB's key risk reduction goals achieved

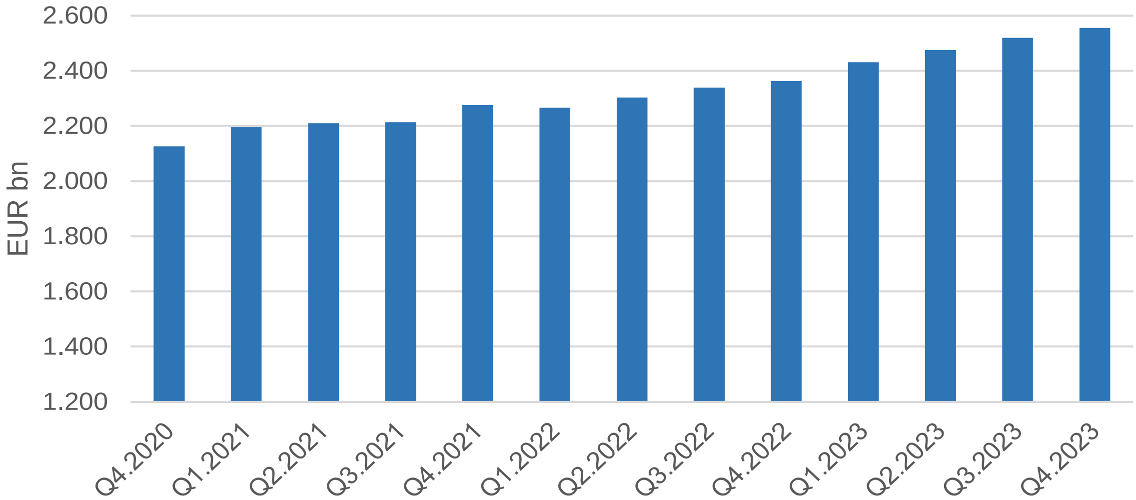
Since its inception, the SRB, together with the National Resolution Authorities (NRAs), has been working with banks, large and small, on improving their resolvability. Banks have been steadily developing a range of capacities that has made them more resilient to shocks and, ultimately, resolvable should they fail. At the same time, the SRB has been expanding its own capabilities to be able to handle any bank's failure. This has involved substantial investment of time and work from all sides. After almost a decade, it is safe to say that the SRB has come a long way and made a substantial contribution to reducing risks and increasing financial stability, even if vigilance implies continuous efforts to consolidate this outcome.

a. Minimum requirement for own funds and eligible liabilities (MREL)

In a letter to the President of the Euro Summit, dated 25 June 2018, the President of the Eurogroup expressed the need to monitor a number of risk reduction indicators[1]. One of these indicators was the minimum requirement for own funds and eligible liabilities (MREL) ratio. This ratio, which ensures that banks have a balance sheet capable of absorbing losses and enabling a resolution in case of a failure, is set and monitored by the SRB. The build-up phase for these MREL buffers is now complete. This is a key milestone that was reached, on time[2]. The risk in the Banking Union has been substantially reduced, as sought by the Eurogroup.

In fact, all significant institutions (the largest banks in the Union) met their MREL requirements on 1 January 2024. The remaining MREL shortfall is attributed to a handful of banks with transitional periods extending beyond 1 January 2024, because of individual and specific situations. The SRB is closely monitoring the reduction of this remaining shortfall and is confident that the targets will be met on time.

Figure 1 – Significant institutions' external MREL capacity evolution since BRRD2



[1] See Letter from the President of the Eurogroup to the President of the Euro Summit, 25 June 2018

[2] Article 12k SRMR

After the introduction of BRRD2, banks progressively built up their MREL capacity. In Q4.2023, the last available quarter, the total amount of MREL-eligible instruments stood at EUR 2 553 bn, while the same amount stood at EUR 2 131 bn in Q4.2020 (see Figure 1). In terms of total risk exposure amounts (TREA) percentage, there has been a clear uplift in own funds and eligible liabilities, as the ratio increased from 31.2% to 34% of risk weighted assets in the above-mentioned quarters.

This progress is not limited to the largest banks. Less-significant institutions (LSIs) have also made substantial progress in building their loss-absorption capacity. Like their larger peers, all LSIs are now compliant with their MREL requirements, besides a few exceptions due to extended transitional periods.

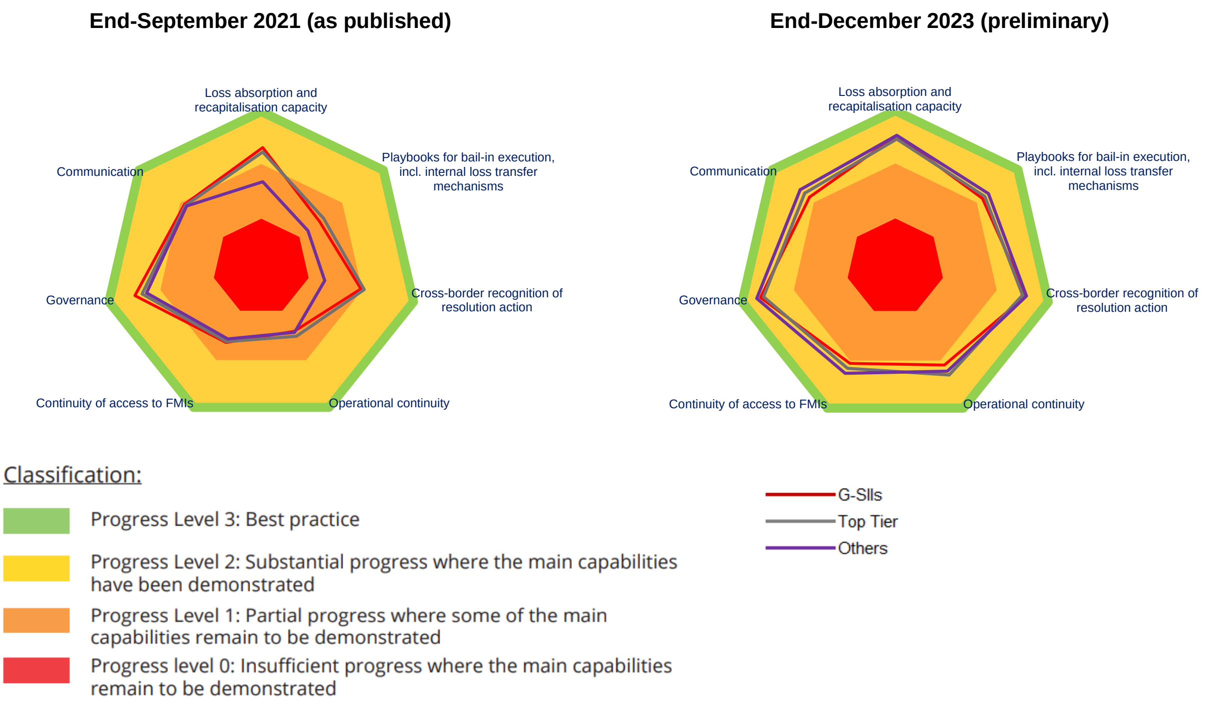
b. Resolvability progress

MREL compliance is not the only criterion with which the SRB assesses whether a bank is resolvable. Banks' progress is monitored through an annual resolvability assessment. Banks' capabilities are benchmarked against a set of resolvability conditions defined in the SRB's Expectations for Banks[3]. The results are summarised in the heatmap charts below for 2021 and 2023.

Although the 2023 Resolvability heatmap results are still preliminary and will be published in their final state in the course of this year, our analysis shows that, overall, banks have matched the expected level of progress set by the SRB until the end of that year. The 2023 Resolvability Assessment exercise preliminary results show that banks have developed key capabilities to support the successful execution of a resolution action in all areas of the Expectations for Banks.

Figure 2 shows that, compared to the end-September 2021 Resolvability Assessment results, where the focus was on banks' ability to swiftly mobilise MREL and to apply the bail-in tool, substantial work has been done to meet the SRB's Expectations.

Figure 2 - Heatmap - Progress made by type of bank on the main prioritised resolvability conditions until the end of 2023



It is clear that banks have come a long way in all the relevant dimensions. At this point, banks' capabilities are at a sufficiently mature stage to allow us to start systematically testing them. This testing will be carried out in accordance with a multi-annual testing programme (see also section 2 below). The regular testing will allow

[3] See SRB's Expectations for banks

the SRB to verify that the banks' capabilities remain operationally ready over time and to support the effective execution of a resolution action in any scenario.

As far as LSIs are concerned, in 2022, all NRAs applied the SRB resolvability assessment policy in a proportionate way. This work continued in the 2023 cycle, and further progress is expected in the 2024 cycle.

In October 2023, the SRB published for the first time its LSI Report, which examined key developments in the LSI sector and gave an account of NRAs' resolution planning and crisis management activities in 2022 and 2023[4].

c. Single Resolution Fund (SRF)

Since its inception in 2015, the SRB also had relevant capacity building to perform. One of the main efforts was the collection of banks' contributions to build the Single Resolution Fund (SRF). The SRF is an emergency fund that can be called upon in times of crisis to finance the resolution of a bank. As of 31 December 2023, the SRF was fully funded and mutualised. This year, the SRB is not planning to ask for ex ante contributions from banks.

In fact, as of that date, the available financial means of the SRF, represented by cash balances, assets and irrevocable payment commitments, amounted to more than EUR 78 bn or 1.047 % of the total amount of covered deposits in the Banking Union – slightly above its 1% final target level, also because of the good returns on the investment portfolio.

Finally, until the end of 2023, the Loan Facility Agreements (LFAs) between the SRF and Member States have provided the possibility of bridge financing and support to the national compartments of the Single Resolution Fund in case of need. As of this year, these agreements have expired.

2. SRM Vision 2028 – the new strategy of the Single Resolution Mechanism (SRM)

Building on the achievements of its first eight years, the SRB has now become a mature organisation – exiting a build-up phase to enter a new steady state. This is why, in 2023, the SRB launched a strategic review to define its long-term goals, to address new challenges, and collaborate better to strengthen the work with the other organisations in the SRM.

The strategic review, among other things, involved in-depth consultations with SRB staff, the other institutions of the Single Resolution Mechanism (SRM) and the industry. The strategic review culminated with the publication of SRM Vision 2028[5] last February, which sets out our direction for the coming five years. The SRM Vision 2028 has three main areas:

- **On the SRB's core business**, now that banks have made good progress in their capacity building (see section 1 of this report), the SRB's focus will shift to crisis preparedness. The SRB will concentrate on the operational aspects of crisis management and on testing banks capabilities, through fire-drills, deep-dives and on-site inspections. The SRB will streamline the annual Resolution Planning Cycle (RPC) to ensure that it is increasingly efficient. This review will introduce a modular approach for updating resolution plans, a potential reduction of their length and an increased focus on operational aspects. Plans will also take into consideration new options, such as combination of resolution tools. A new testing framework will include dynamic elements, factoring in emerging risks and lessons learned from capabilities testing and crisis cases.

- On **governance, tools and organisational matters**, the SRB is striving to simplify its processes and to enhance its transparency, in particular towards the industry. Another key element is building a

[4] See also SRB LSI report

[5] See also SRM Vision 2028

common culture withing the SRM, reinforcing our integration with the NRAs. This process has already started, as shown by the recent MREL policy consultation and the publication of a list of core policies and guidance documents for consultation in 2024. Digital transformation and innovation in the SRM, with the help of a dedicated new data management unit, is also a key driver for the new strategy.

- Finally, on **human resources**, the SRM Vision 2028 aims to harness the potential of our pool of talent by ensuring better training, more mobility and career development opportunities. The SRB is also already working on improving gender balance, diversity and inclusion.

The SRB is now implementing this new strategy. Detailed activities have been outlined in the multi-annual plan 2024-2028. The SRB has established a monitoring and reporting system which will allow for a detailed progress monitoring over the coming months and years.

To be clear, this new vision has a long time-span and will take time to implement and bear fruit. This said, the work is already well under way.

3. Important legislative files and emerging risks

There are a number of legislative files, some currently under debate and some not yet, that have the potential to enrich the crisis management toolkit. If and when adopted, they will help us dealing with constantly evolving risks.

a. ESM treaty revision, liquidity in resolution and EDIS

The availability of large amounts of liquidity is critical for a successful crisis management. The SRB is working intensively with the banks under its remit to develop their capabilities to generate liquidity. Beyond that, in case of need, the Single Resolution Fund, is there to help. However, our toolkit should be backed up by effective liquidity provisions to ensure the successful resolution of any crisis.

The SRB's liquidity firepower in resolution could be immediately boosted by ratifying the ESM treaty revision. The so-called common backstop would add up to EUR 68 billion to the SRB's available means, covering the possible liquidity needs of most banks in the SRB's remit.

In addition, available studies and the evidence from recent crisis cases in the US and Switzerland have shown how the current resolution liquidity facilities (i.e., the SRF and the common backstop when it is in place) may need additional support in the case of the failure of a global bank (G-SIB) or of several medium-sized banks failing at the same time. This is a tail-risk but should not be ignored.

Providing enough liquidity in resolution is an effective way to protect taxpayers' money. With adequate liquidity provisions, meaning short-term loans which will be quickly and fully repaid[6], authorities can foster trust in the successful implementation of their resolution decisions, as opposed to the expensive bail-outs of the past.

Furthermore, it would be good that Council re-tables the completion of the Banking Union, now that risk reduction has well advanced. In this sense, the SRB welcomes the renewed efforts of the European Parliament's ECON committee on EDIS. Although, this proposal is not as ambitious as the SRB would like. The SRB hopes that, during the next legislature, the Council will decide to re-start discussions on EDIS in a less polarised way, looking at the completion of the Banking Union from the global competitiveness angle. Pooling resources together, even if just starting with liquidity support, is not something that weakens individual members, but rather makes the overall Union less vulnerable and, as a consequence, more competitive.

[6] In the case of UBS / Credit Suisse, the liquidity assistance program was initiated in March and terminated in August 2023. The Swiss National Bank was repaid in full.

b. Crisis Management and Deposit Insurance proposal (CMDI)

After the European Parliament agreed a negotiating position on the Crisis Management and Deposit Insurance proposal (CMDI), the SRB hopes that the Council will also achieve compromises on this file soon. This way, CMDI may be finalised shortly after the beginning of the new legislature.

CMDI contains several pragmatic improvements to the crisis management continuum in the EU, which would complement the SRB's toolkit. CMDI should deliver sufficient certainty on the amounts of the funding to support the sale of smaller banks will be there if and when necessary. To recall, according to the proposed rules, this funding will be provided by deposit guarantee schemes (DGS) only after the depletion of the bank's MREL capacity and then, if need be, complemented by the SRF. The only way to enable sufficient and reliable funding, if legislators move away from a single-tier hierarchy, is to modify the least cost test (LCT) by law in a sufficiently harmonised way.

If discretion over funding is left at national level, the risk is that when trying to sell an ailing bank, the SRB will be confronted with uncertainty on whether and to what extent the national DGS could support the sale. In addition, the lack of harmonisation would ultimately link the degree of protection of deposits to the national DGS' willingness to pay. This fragmentation could hamper the Banking Union and, ultimately, the Single Market. This is why the SRB recommends that the LCT is harmonised as much as possible in the level 1 legislation.

c. Capital Markets Union (CMU)

The SRB welcomes the Eurogroup statement relaunching the Capital Markets Union. The CMU is important from the SRB's perspective because deep capital markets are critical to reduce our banks' dependence on foreign markets to issue MREL securities. In addition, a European securitisation market could help banks to have slimmer balance sheets.

d. New risks

Risks to financial stability evolve quickly and do not emerge only from the banking business. The SRB considers that risks stemming from non-bank financial institutions (NBFIs) and cyber risks can threaten financial stability. Appropriate regulations should help dealing with these risks. More precisely, on cyber-security, the SRB is increasing internal awareness and knowledge, and preparing to implement the new (DORA) rules on digital operational resilience for banks and their crisis management.

4. Conclusions

The SRB, together with the whole SRM, is working hard to be ready to deal with any emerging threat. However, authorities can only work within the boundaries of their legal framework. This is why it is critical that the crisis management legal framework, underpinning our toolkit, is kept up-to-date.

Now that the Great Financial Crisis is 15 years in the past, the attention on these topics risks to fade. However, the 2023 bank turmoil was a stark reminder that bank crises are not a thing of the past. It is not the time for complacency.