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Mrs de Lange
Member of the European Parliament
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Re: Your question to the Chair of the SRB, Ms Elke König

Honourable Member of the European parliament, dear Mrs de Lange,

At the hearing in the European Parliament on 5 December 2016, you asked how the SRB would reduce firm's MREL to take into account the amount by which a deposit guarantee scheme ("DGS") is expected to contribute to the financing of the preferred resolution strategy. You further asked how the SRB would provide compensation to a DGS, were such a scheme required to contribute to resolution.

The Commission Delegated Regulation (EU) 2016/1450 on MREL, sets out how the SRB may apply this reduction. Article 6 (2) of the Delegated Regulation notes that *"the size of any such reduction shall be based on a credible assessment of the potential contribution from the deposit guarantee scheme"'* and that the reduction shall *inter alia* at least be less than a prudent estimate of the losses the DGS would have had to bear in insolvency, taking into account its priority ranking, and the limit on DGS contributions noted in Article 109(5) of the BRRD (i.e. 50% of the DGS target level, as also reflected in Article 79(5) SRMR).

In this context, it is useful to recall that DGSs only insure covered deposits. Article 108 of the BRRD harmonises the treatment of covered deposits in insolvency across the EU by making them senior to uninsured deposits (including uninsured deposits by natural persons and SMEs, which in turn rank higher than ordinary unsecured, non-preferred creditors). DGSs subrogating to the rights and obligations of covered deposits in insolvency have the same high priority ranking. Therefore, DGSs could only be expected to make a contribution in resolution after all more junior ranking liabilities of an institution (including uninsured deposits by natural persons and SMEs) have either been fully written down (in case of the bail-in tool), or are not expected to be transferred in full to a purchaser or bridge entity in resolution.

As such, the use of the DGS in resolution is less likely for banks which have a greater number of liabilities ranking junior to the DGS. The reduction might therefore only be applied for a certain set of firms, which have balance sheets which make the use of the DGS in resolution credible. For example, where the liabilities side of a firm's balance sheet is relatively simple and is primarily made up of covered deposits, then it would be more likely that this adjustment might be applied.

As regards the mechanism for compensation of a DGS, the SRB is currently undertaking broader work on how shareholders and creditors might be compensated in the event of a bank resolution if, following the ex-post valuation, it is concluded that they have incurred greater losses than they would have incurred in an insolvency scenario. This work will develop in greater detail the operational mechanics around how shareholders and creditors would be compensated, taking into account the relevant legal and operational factors. This may provide significant assistance in developing a mechanism for providing compensation to DGSs, where these contribute to the costs of resolution, if such compensation proved necessary.

Yours sincerely,
[signed]

Elke König

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