Bank+InsuranceHybridCapital Briefing

The 2023 Regulatory Angle: EBA, ECB and SRB on their supervisory priorities

The European Banking Authority, European Central Bank and Single Resolution Board shared insights into their latest work and priorities in a Crédit Agricole CIB web conference ahead of the new year. *Neil Day* reports their views on the macro outlook, funding conditions, and capital framework, followed by comprehensive details of the regulators' presentations by Crédit Agricole CIB DCM Solutions.

Delphine Reymondon, head of liquidity, leverage, loss absorbency and capital unit at the European Banking Authority (EBA), kicked off the three presentations by saying that while European banks are generally robust in terms of profitability, capital, and liquidity, they face a macroeconomic outlook that is increasingly uncertain — with regard to energy supplies, geopolitics, inflation, monetary policy and a "high risk of recession".

"The first downside risks are materialising," she said, with banks reporting the first signs of a deterioration in asset quality, notably in relation to SMEs, consumer credit and energy-intensive sectors.

Along with Reymondon, Korbinian Ibel, director general, universal and diversified institutions, European Central Bank (ECB), flagged a first increase in Stage 2 loans.

"It's not yet super-worrying," he said, "but it's something we are looking at very carefully. As we all know, when interest rates go up, the first thing that comes for most banks is that interest income increases, but the defaults that might follow the interest rate increases come much later, which is why we look at Stage 2 loans as a leading indicator.

"We believe there is a risk — let's hope it's not going to be realised — that a scenario will develop which leads to a much worse cost of risk in the future. This is why you see us giving so many warnings."

While the regulators noted some parallels between the risks of the pandemic and those faced today, Ibel said there is a big difference between the Covid crisis and the Russia-Ukraine crisis.

"During the coronavirus (Covid-19) pandemic, basically everyone assumed

Korbinian Ibel, ECB, Delphine Reymondon, EBA and Sebastiano Laviola, SRB

a very, very dire scenario," he said, "and then quarter by quarter you saw improvements in the forecasts because it didn't turn out to be so bad — fiscal, monetary and supervisory measures were successful, and the economy stabilised much quicker than everybody had anticipated.

"Regarding the current crisis, in 2022 everybody assumed that it was going to be bad economically, but not *so* bad, and then quarter by quarter, with the energy crisis and the supply chain crisis coming in, the forecasts got worse and worse. This should be kept in mind."

Banks should not expect a repeat of pandemic support measures, Ibel stressed.

"When we talk to bankers that we supervise, we sometimes have the feeling that they believe they navigated one of the deepest crises of the past decades without any scratches because everything is so great in banking," he said. "Bankers did an excellent job, of course, and we fully appreciate and acknowledge that, but what should not be forgotten is that many of the positive developments were based on a lot of supervisory support.

"So bankers should not base their modelling on those times."

In light of these considerations, the ECB has been looking anew at banks' capital planning and Ibel said that supervisors will challenge management actions to ensure an appropriate level of conservatism.

He noted that dividend restrictions were a price paid for pandemic support measures, but that the ECB has not asked for an extension of its supervisory powers in this respect, judging its current powers to have proven sufficient. However, during a Q&A session, Ibel again advised prudence in respect of dividends.

"If you see an environment in which you will not only most probably observe a deterioration of the economy, but, on top of that, you know that the forecasts might not be 100% accurate, and they are going in a direction that is getting worse and worse, then what is the right reaction for a bank?

"In that situation, it must be to say,

KEY TAKEAWAYS

- There will be no change to AT1 & T2 criteria any time soon. All focus is on Basel IV implementation (and ESG regulation)
  - AT1/T2 may have lower loss absorbency quality than CET1 but they have their defined role to play and regulators accept that
  - AT1 non-calls and interest cancellation would be welcomed by regulators as this strengthens the loss absorbency argument in favour of AT1s
- We are moving towards an environment with a positive neutral Countercyclical Buffer rate (e.g. 1%-2% as default position rather than 0% as pre-Covid) – this will result in further increase in the capital requirements
- SLBs for MREL/Own Funds purposes – little progress since late 2021 observations from the EBA. Regulators are still in idea generation and evaluation mode
- CMDI (new BRRD/DGSD) proposal to come potentially in Q1 2023 – may include general depositor preference
- ESG capital charges under the current regulatory framework: other than P2R/P2G charges linked to a complete lack of governance under the 2022 ECB Climate Stress Test and Deep Dive in respect of Climate & Environmental risks, P2R and P2G charges linked to C&E risks can become more applicable upon the next C&E Stress Test by the ECB
- Deposit flight from European banks seen as a possible risk in the context of increasing rates that could be destabilising for the European banking sector. But this risk may not eventuate
- Funding risk is a major focus of the ECB in 2023 for banks with large dependence on Central Bank funding and limited market access
- Not calling senior MREL eligible instruments may provide banks with benefits in respect of the resolvability assessment and in respect of the NCWO criterion

'I will keep my capital a bit higher. If I pay out now and later face a difficult situation… We saw after the great financial crisis how difficult it is to raise additional fresh capital. If the environment turns out to be very good, and much better than feared at this point in time, I can still pay out later.'

"That is why we like Common Equity Tier 1 (CET1) capital."

Funding and interest rates: banks must tackle challenges

Reymondon at the EBA warned that the development of interest rates also means a worsening of funding market conditions, just as banks are replacing TLTRO funding. She also elaborated in detail on a specific area of scrutiny for the EBA being the management by banks of the interest rate in the banking book (for example in terms of modifications of assumptions underlying modelling of IRRBB risks, changes in hedging strategies, business model changes if any) and more generally the impact of the increase of interest rates on several prudential aspects.

"Servicing debt will be more costly," she said, "and we are working on this, running some simulations, also to measure the impact on liquidity ratios in particular.

"There will be the need to substitute in particular this central bank funding with market funding," added Reymondon, "and we have of course already seen a widening of spreads in wholesale markets, meaning that as some banks still need to reach final MREL targets arriving in 2024, there might be some more difficulties for banks especially of a smaller size and in certain jurisdictions."

Sebastiano Laviola, director of resolution strategy and cooperation and board member at the Single Resolution Board (SRB), said such a scenario was foreseeable.

"For all the banks that essentially have resolution as a strategy, we always told them to exploit the period when the sun was shining to issue," he said. "Some did. Others did less.

"We are closely monitoring the development of the markets and the funding plans of the banks," added Laviola. "In a period of extreme uncertainty, for lesser known names and those with weaker ratings, it is clearly more difficult to issue, even at higher prices. Notwithstanding that, some banks of this type have issued recently — albeit certainly at higher prices."

In addition to the issue of funding, Ibel at the ECB said the development of deposits and in particular greater deposit outflows is a key question. He noted that deposits are typically invested on the basis of non-maturing deposit models, calibrated in a period in which interest rates were falling or stable.

"Many of these models do not even have the interest rate as an explanatory factor," he said, "meaning that interest rates are not assumed to play a role, which is a very brave assumption for banks to make.

"My biggest concern — which is a scenario that banks should at least consider — would be if interest rates rise further and we suddenly see more and new market entrants with big platforms who see a chance to collect deposits for very low fees and invest them risk-free at a much higher rate. Banks which have invested deposits long term on the basis of their models have no way to counter this, because the assets they have invested in over recent years have relatively low yields.

"It's not clear whether this will hap-

Crédit Agricole CIB hosts Michael Benyaya, co-head of DCM solutions and advisory, Doncho Donchev, DCM solutions, and Gwenaëlle Lereste, senior credit analyst, bank analyst.

pen," added Ibel. "The complexity of the regulatory framework, which is mostly seen as a burden by bankers, also gives the system strong protection. But there may be a trigger point where the benefits of entering the market for new players are very large and this is not included in the multi-year business plans of banks, so we have already had this in focus and will keep a close eye on any such developments in future."

Capital framework: handle with care

While acknowledging that the capital framework for banks has become very complex, Reymondon at the EBA said it is not the time to be making changes to it.

"Some work is being done at the Basel table in terms of buffer usability, the role of AT1 and these types of aspects, and we are also doing some work there, but with a different perspective," she said. "Our perspective is more to gain a better understanding of how all the different bricks in this framework are working together, and we are making some comparisons between different international frameworks to see what could be learned to maybe one day simplify the framework.

"But not today. When we replied to the Commission call for advice on reflections to amend the macro-prudential framework, our view was that we should not do it now. The current framework was not properly tested even during the Covid-19 pandemic, particularly in view of all the government support measures, and it is not even fully implemented yet.

"Simplifying the framework would also involve big hurdles," added Reymondon. "Since it's so complex, if you wanted to simplify it, you would need to restart from… I wouldn't say zero, but it's really difficult to just touch some bits and pieces — it would be quite long term work. Stability in the regulatory framework is also key from an EBA perspective."

Ibel echoed Reymondon's sentiments, while highlighting that, in its response to the European Commission's call for advice, the ECB had recommended other changes.

"The most important thing, and a lesson from the pandemic, is that it would be beneficial to have more macroprudential policy space via larger releasable capital buffers," he said. "When we entered the pandemic, the buffer that was supposed to do that was the countercyclical buffer (CCyB), but there was not enough capital in the CCyB to be really impactful. This is why we had to use other measures, but that was a patch and not an optimal solution.

"There are different policy options to do this. You could have a fully or partially releasable capital conservation buffer. You could have a higher CCyB in normal times, so basically a positive neutral rate. Or you could have a core rate for the systemic risk buffer."

Ibel then turned to the revised Capital Requirements Regulation (CRR3), reiterating the ECB's opposition — shared by the EBA — to proposed deviations from Basel III.

"There is an international standard," he said. "It was negotiated with the Europeans in the room — I'm the representative of European banking supervision at the Basel table — and this was already a compromise. Deviating from it now will most probably just lead to scepticism among international investors about the viability of European banks and whether or not they can trust the numbers — which is, of course, the worst thing we can do, because in the end it will increase funding costs and just make European banks less investible.

"So, from a bankers' perspective, one might consider it a little bit short-sighted — all this lobbying to deviate here and there and get a little relief on different aspects. International investors are fully aware that Europe was and is materially non-compliant with the Basel framework. So please understand the importance of deviating as little as possible — it's an issue that's really dear to our hearts." ●

EU capital framework

- The ECB presented briefly the framework below and did state that in order to invest and understand the risks, one has to be an expert in this matter, e.g. interactions between CET1, AT1, T2 and what kind of restrictions can be triggered (MDA framework)

- The ECB also referred to its answer to the Commission's Call for Advice on the Macroprudential framework:
  - It agreed with the EBA that the framework has become highly complex and that it may need to be reviewed at some stage in the future, not now (long term project)
  - The most important aspect for the ECB, as a take-away lesson from the Covid crisis, is to create more "macroprudential policy space":
    - The ECB has here in mind foremost a **positive neutral Countercyclical Buffer (CCyB) rate** (e.g. 1%-2% versus 0% pre-pandemic) which can be activated based on more indicators than currently in the framework and with a shorter delay than the current 12 months
      - The ECB did also mention a positive rate Systemic Risk Buffer or releasable Capital Conservation Buffer
    - The ECB did not ask for additional legal powers to curb dividend payments, having been satisfied with the following of the dividend ban during the pandemic

- The ECB also addressed the final Basel 3 (aka Basel IV)/CRR - here the ECB reminded that it is for full, timely and faithful implementation of the Basel accord, so as to avoid Europe being labelled materially non-compliant:
  - European banks must avoid a situation where international investors do not trust the numbers of European banks anymore as this would result in higher funding costs

ECB supervisory priorities

- The ECB presented the supervisory priorities for 2022-2024 as presented in Dec 2021
- The ECB supervisory priorities for 2023-2025 were published on 12 Dec 2022 (main themes and priorities for the ECB's banking supervision for 2023-2025 (and here))
- In a nutshell, among the priorities that could impact bank resilience in the short term, the ECB now focuses on exposures to energy-intensive sectors, as opposed to Leveraged Finance and interest rate exposures in the banking and trading book (work continues here, but also EBA priority now) and funding risks (higher TLTRO dependence for funding and more difficult markets, focus on subset of banks that are particularly impacted). Longer term, strategic priorities, such as digitisation, governance, cyber security and C&E risk management remain the same as in 2022-2024.

The current EU capital framework (simplified)

Source: ECB

ESG

- Two exercises by the ECB on Climate and Environmental (C&E) risks – ECB Thematic Deep Dive on C&E risk management and ECB Climate Risk Stress Test

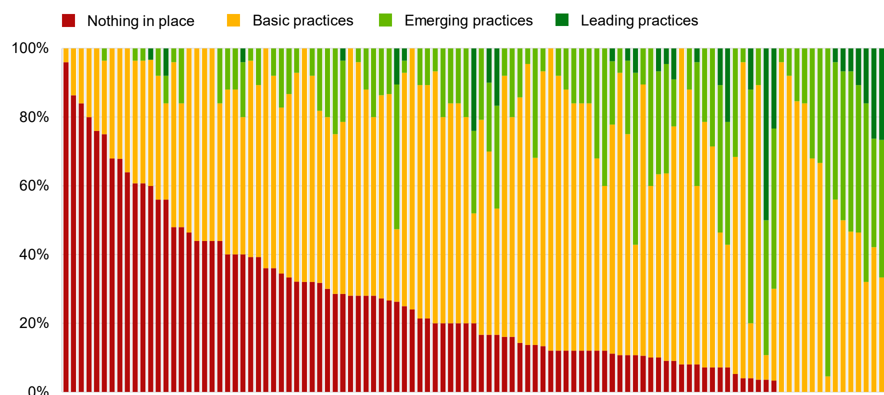
- **ECB Thematic Deep Dive on C&E risk management**
  - 186 banks (107 significant and 79 less significant institutions) covering €25tn of assets
  - However, not a single bank covers all areas of C&E risk management
  - The ECB published a Compendium of Good Practices for the banks to see in which direction the ECB expects them to go

- Results of the Thematic Deep Dive – in some cases only deep red (no idea of what C&E risks are), in some cases dark to light green (on the way to proper capture of C&E risks), with lots of yellow (basic architecture for C&E risk management being put in place):
  - Over 85% of banks have now at least basic practices in place for most of the areas addressed by the expectations
  - All 107 significant banks fail to completely correspond to the ECB's expectations in respect of (i) soundness and (ii) comprehensiveness of practices in respect of C&E risks
    - However, a few years back the shortcomings would have been complete for all banks and banks have come a long way
    - Also, Europe is seen as a leader in the context of C&E risk management

- **ECB Climate Risk Stress Test**
  - The Stress Test was a discovery exercise to see if banks can project realistic scenarios of stress due to the materialisation of C&E risks
  - Results – from 1 being Excellent to 4 Fail
    - Most banks were rated 2 and 3, with the majority in (>50 banks) scoring 3, or just a Pass mark, with also ~15 significant institutions receiving a Fail mark – overall ~65% of banks scored poorly
  - The regulator was clearly not happy with these results
  - As a remedial measure, the regulator will push banks to integrate C&E risks in the ICAAP stress testing framework
  - At this time there was no direct impact on the SREP for the banks (only indirect impact, on scores for e.g. governance), but in the future one has to expect that C&E risks will be included in the P2R and in the SREP because of the importance that this factor deserves

- Following the Deep Dive and the Stress Test, all banks have received individualised feedback telling them in which areas are the weaknesses, how this has to be improved and clear deadlines

The level of maturity of practices across areas of supervisory expectations (bank-by-bank)



Source: ECB

Q&A session

- **Structural position of the EU banks:** The last decade was spent by banks on ensuring robust through-the-cycle profitability through restructuring: build out businesses with strong market share, reinforce fee income, rationalise costs. How do you see the position of banks now? What about the challenges of digitalisation and green transition? Can we consider national and cross-border consolidation as a part of the solution?
  - If you look at RoE for European banks and their market valuation, with a P/B ratio on average below 1.0x, this limits the European banks' ability to raise equity and hinders their ability to finance the economy
  - Banks made a lot of progress in the last years and this is to be lauded, but many challenges remain. E.g. digitisation investment cannot be offset against short term cost savings, or such banks will have a difficult future
  - The European bank market is one of the biggest markets in the world, but still fragmented (banks operate mainly within national borders) and cannot realise economies of scale, for instance from digital investments (the larger the customer base, the more the IT investments are leveraged operationally)
  - Banks must continue to invest to get operationally stronger and more efficient
  - Cross-border mergers can help to leverage economies of scale
  - Strategically, it is important that banks must bear in mind that their future competitors may not be other banks, but new players or platforms

- **Capital targets & MDA buffer:** Given the cost, some banks use CET1 to cover for shortfalls in the their AT1 & Tier 2 buckets. When considering banks' capital positions, how do you take this into account? Do you prefer for banks to optimise their AT1 and T2 buckets? Would you consider a 200bp-250bp distance to MDA (this includes P2G) as sufficiently high?
  - AT1 and Tier 2 instruments are in the regulation and banks can use them. Having said that, there are doubts as to whether AT1 is really a loss absorbing instrument given that the triggers are set so low that banks would become non-viable prior to reaching them
  - A bank that elects to fill its AT1 or T2 buckets with CET1 would be supported in this decision by the ECB. From a profitability point of view, the ECB understands that banks may want to leverage their capital base with AT1/T2, but from a prudential perspective CET1 is the highest quality capital (absorbs losses on ongoing basis, if there are losses, there are no dividends)
    - AT1 coupons can in theory also be cancelled, but in reality this is much more difficult. Should a bank want to cancel AT1 coupons, it certainly will not get any restrictions from the ECB
  - Size of the management buffer:
    - Not a one-size-fits all approach
    - Many different bank business models in Europe, with different business profiles and a business environment that is changing rapidly
    - But clearly a bank with stable, predictable earnings can afford a buffer above P2G and CET1 requirements that is much smaller than for a bank with volatile results operating in a volatile part of the industry
    - There are intensive discussions with each and every bank on this question and it is always an individual decision

- **Bank resilience and payouts:** Eurozone banks remain resilient in terms of profitability, capital and liquidity. However, the ECB recommends banks to preserve capital as the economy slows and restrict payouts. In your view, are the banks sufficiently robust to the risks in the real economy and why do they need to exercise caution on payouts?
  - Whilst in the Covid 19 crisis, there was an initial shock and then projections only got better, in the current situation the forecasts keep getting worse and there is a lot of uncertainty
  - In such a context it is better to have the banks keep capital at somewhat higher levels and then to have a catch-up later in terms of dividends and share buybacks (another reason why the ECB likes CET1 is this capacity to time pay-outs in line with the prevailing macro environment)
    - On the other hand, if a bank pays out now, then there is a crisis and the bank is short of capital, it is much more difficult to raise equity then rather than to preserve it now
  - One has to find balance between the two alternatives above. The pendulum is now swinging towards capital preservation which may have been different if there were no Russian invasion and jump in energy costs

- **C&E risks and P2R/P2G charges:** Could P2R/P2G charges be imposed on banks with C&E risk management shortcomings?
  - It was not part of the 2022 C&E Stress Test, but could be part of the next C&E Stress Test/Deep Dive (will be a bit further in the future, with the generic EBA Stress Test taking place in 2023)

- **Deposits situation:** Can we see deposit outflows in the changed interest rate environment?
  - Banks' models of non-maturing/transactional deposits have been calibrated during a long period of low, stable interest rates – these models do not reflect a period of increasing interest rates and some of these models do not even have interest rates as an explanatory factor – hence, the regulator is concerned about these models and their outputs and makes appropriate inquiries
  - When the interest rates increase further, will there be new players/platforms that could collect deposits at a cheap cost and invest them in higher yielding assets with low risks, thereby putting the stability of the whole banking system at risk? It is not a scenario that will happen, but something that can happen
  - On the other hand, the complex regulatory requirements also act as a barrier to entry and thereby (partially) protect the banking system. However, there could come a trigger point where external players could consider that the regulatory investment/cost is worth it, given the size of potential returns
  - Also, banks could not respond in a cost-covering manner as over the last years they have invested in low yielding long term assets
  - So the deposit question could become a liquidity and solvency question (banks can always keep the deposits if they pay enough (above what they earn, if necessary), but so far not something that is reflected in the banks' models)
  - Thus, the ECB is very focused on this question

For more on the latest ESG trends, see our recent special report, *Greening the Business Model*

Sebastiano Laviola, Single Resolution Board

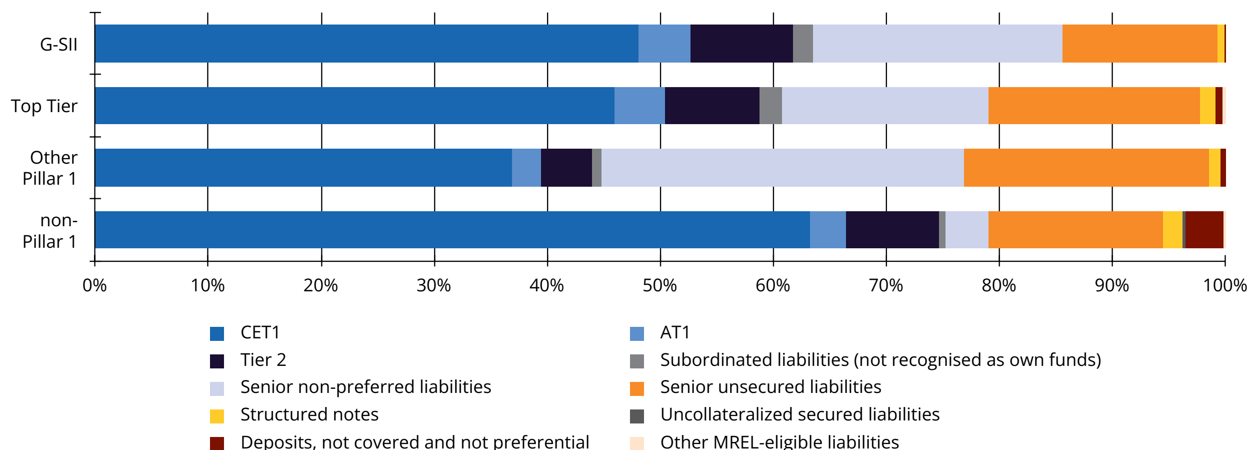
SRB priorities for 2022 & 2023

- The SRB's overarching priority remains to make banks fully resolvable by end-2023
  - Here the focus is on three common priorities: (i) liquidity and funding in resolution (mobilisation of collateral, sources of funding), (ii) work on a Separability Analysis Report (SAR/transfer playbook) when the strategy envisages a transfer tool, and on reorganisation capabilities when the strategy is bail-in, and (iii) IT capabilities for valuation and bail-in execution
  - Complemented by bank-specific priorities to ensure resolvability (e.g. build up MREL for certain banks). SRB subjecting the banks to more targeted monitoring (e.g. onsite visits, dry runs)
  - MREL: (i) end of LR transitional measures, (ii) internal MREL and MPE MREL computation of surpluses in other resolution entities, (iii) more dynamic subordinated MREL policy (evolution of balance sheet prior to resolution taken into account)
    - MPE resolution strategies: capital surpluses in third country subsidiaries no longer recognised as TLAC/MREL resources unless there is a resolution regime in place recognised as equivalent by the EU authorities – transitional period applies
    - Internal MREL: holdings of MREL instruments issued indirectly to the resolution entity shall be deducted fully from the intermediate entity's internal MREL capacity – from 1 Jan 2024
  - Monitoring of eligibility of MREL instruments reported to be further strengthened – sign-off by Senior Management of bank, eligibility checklist, SRB to strengthen monitoring
  - Prior permission regime for redemptions – where redemption without replacement, there must be a sufficient Margin on top of MREL + CBR. The amount allowed under the prior permission regime must be deducted (the Pre-Determined Amount). The SRB policy now is that the Margin will be equal to the lower of the Pre-Determined Amount and Pillar 2 Guidance.

MREL state of play (levels, shortfalls, cost of funding)

- The Single Resolution Board published the MREL Dashboard for Q2, 2022 *(link here – see also chart below)*:
  - **Final targets:** The average final 2024 MREL target for resolution entities under the SRB's remit was 23.2% of the Total Risk Exposure Amount (TREA) (€1,736bn) and 26.4% (€1,970bn) including the Combined Buffer Requirement (CBR). Both were stable from Q1. The average final subordination target was 19.1% (€1,431bn), down marginally from 19.4% (€1,442bn) in Q1.
  - **Intermediate targets:** The average 2022 intermediate target was 21.9% TREA (25.1% including CBR), 18.1% subordinated.
  - **MREL stock:** The MREL stock was broadly stable from Q1, up 1.7% (€38.3bn). The subordinated MREL stock was also broadly stable, up 1.5% (€29.2bn) in the quarter.
  - **Shortfalls:** The shortfall against final 2024 targets was 0.2% TREA (€18.3bn), 0.4% (€32.2bn) including the CBR. The 10 Other Pillar 1 banks (i.e. banks with less than €100bn Balance Sheet, yet subject to full MREL rules, including MREL subordination, typically located in the Benelux,

MREL composition by bank category as of 30 June 2022



Source: SRB

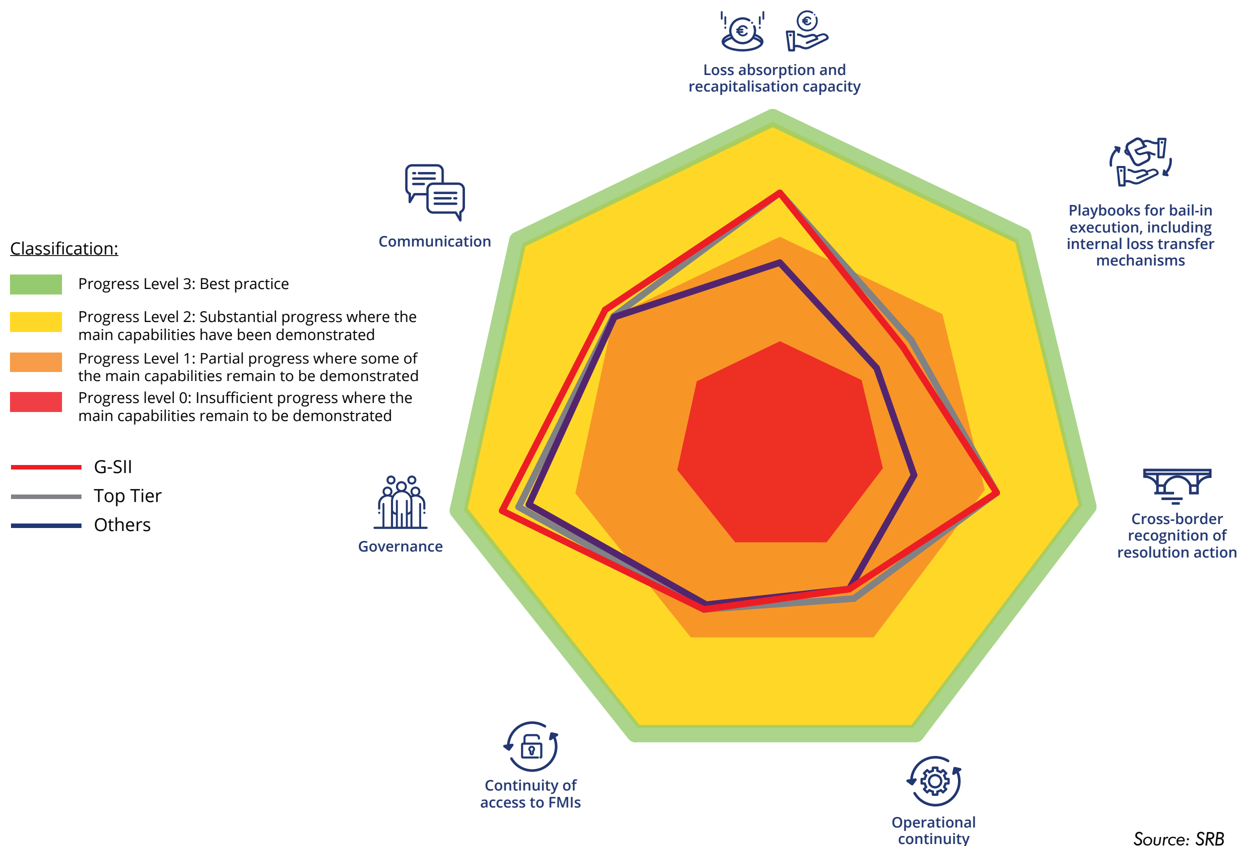
Austria, Germany and Finland/some CEE countries) were the only category to show an overall increase in shortfall (including CBR) during the quarter; their targets are in most cases almost fully subordinated due to the 8% TLOF adjustment and lower risk density.

- **Issuance:** MREL issuance was €67.3bn (0.9% TREA) in Q2, around 20% lowered than in Q1, but broadly stable with respect to the same period of 2021. 41% of total issuances were senior preferred and 31% SNP, a shift towards the former since Q1.
- **MREL stock composition:** Senior non-preferred (SNP) liabilities made up 19% of MREL resources for banks in scope, with substantial variation between categories of bank. Senior bonds made up 16% of the MREL stock, ranging from 14% for global systemically important institutions (G-SIIs) to 22% for Other Pillar 1 banks.
- **Maturity profile:** Around 49% of MREL-eligible instruments were perpetual, around 7% had residual maturities of more than 10 years, 37% of 2-10 years, and 7% of 1-2 years. The proportion of instruments with residual maturities of 1-2 years ranged from 5% for non-Pillar 1 banks to 9% for Top Tier and Other Pillar 1 banks.
- **Governing law:** Of the overall MREL stock, around 18.5% was made up of instruments issued under non-EU law, of which 95% were governed by either US or UK law. From securities under foreign law, 20% were Tier 2 and 10% AT1 (both mostly under UK and US law), with remainder senior instruments (70%).
- **By resolution strategy:** Banks under a Single Point of Entry (SPE) resolution strategy had an average target of 25.8% TREA, compared to 29.9% for those under a Multiple Point of Entry (MPE) strategy, due to the add-ons required for the latter. Banks under the bail-in tool averaged a target of 26.5% TREA and those under a transfer tool 23.5%, due to the potentially lower need for recapitalisation.

Progress on resolvability

- Results from Sep 2021 (can have improved in the meanwhile) – Most progress has been achieved on the resolvability conditions related to loss-absorbing capacity, bail-in recognition, governance and communication. G-SIBs more resolvable than other types of banks
- *See chart below*
- By the time the assessment took place (Q3 2021), most banks still needed to complete the work on the quantification of their liquidity needs in resolution and a self-assessment of the capabilities to produce the datasets for valuation or for bail-in execution

Progress made by type of bank on the resolvability conditions prioritised by the SRB



Source: SRB

Q&A

- SRF completed by end-2023 – Is there any other contribution expected from banks after that date? Can we consider that EDIS will never happen and that developing something else would be a good idea?
  - SRF transition period ends 2023YE. Now SRF at €66bn, target ~€80bn by 2023YE. But legislation requires the SRF to correspond to 1% of covered deposits – so it is a dynamic threshold that must be maintained. Hence, contributions will depend on covered deposits developments and also if there is no utilisation of the SRF, e.g in the context of a failing bank
  - On EDIS – the SRB strongly disagrees that EDIS has been abandoned, there has not been any official communication to this extent. Instead, the focus is on making use of the available resources in the SRF and DGSs more efficient in the context of resolution
    - CMDI legislative project (BRRD3 and new DGSD) to be presented in Q1 2023 by the European Commission
  - Why is EDIS needed?
    - To avoid further fragmentation in the Banking Union
    - To treat all depositors of a cross border bank in the same way
    - To finally cap the sovereign-bank feedback loop (if DGS insufficient, the State has to step in to reimburse covered deposits up to €100k)
  - Beyond this, in the medium term, the SRF and EDIS should be merged and the system should become more similar to the US FDIC system
    - There is no distinction in the US between usage of funds for depositor reimbursement and resolution/liquidation funding, the FDIC chooses the most cost-efficient route

- For banks with difficulties accessing the wholesale debt markets, could a lowering of the MREL requirements be a solution?
  - The SRB was encouraging the concerned banks to come to the market when the "sun was shining" – some did and others did not
  - The impacted banks are mostly banks with less than €100bn B/S size (i.e. banks already subject to lighter MREL requirements) and with limited domestic capital markets base
  - The SRB already provided relief – by e.g. deciding on transitioning periods for 13 banks for final MREL compliance beyond 1 Jan 2024
  - The SRB follows the funding plans and market conditions very closely – for unknown issuers and for lower ratings, market access is more difficult, but has improved as of late
    - The higher cost of funding is an issue, but these banks will also earn more money from higher rates (however, this needs to be monitored closely because the profitability improvement may not be long-lasting)

- What about lowering MREL requirements for smaller banks via greater role for DGS resources? Clearly, under the condition of necessary legislative changes
  - The SRB reminded that one of the thoughts behind the CMDI project of the Commission is to push more banks into resolution rather than liquidation strategies (lower disruption, lower costs to the whole system)
  - However, these banks would have to have MREL resources in place and there is unwillingness to lower the 8% TLOF condition for access to the SRF – hence, the DGS could act as a "bridge" between available MREL resources and the SRF
  - To enable the intervention of the DGS, then there are a couple of reforms needed:
    - Harmonisation of the Least Cost test (cost of paying out all covered depositors and then recuperating funding from bank liquidation versus "alternative" measures, such as financing resolution)
    - All depositors to rank pari passu: DGS only covers the most senior depositor layer, which makes intervention in a resolution remote or it needs the situation to worsen to such a degree that covered depositors are the only unsecured liability left -> by that time the bank is likely to be beyond the point of successful resolution
    - Introduce general depositor preference: to avoid NCWO and potential moral hazard of the DGS having to intervene to support also senior preferred holders (because of pari passu ranking and NCWO obligations)

- What, if any, are the benefits for banks of not calling Senior MREL instruments (if call is skipped, the bond is no longer included in MREL)?
  - It still remains a bail-inable resource, so it can contribute to meeting the objective of resolvability
  - Not calling a Senior (preferred) instrument can contribute to resolving a No Creditor Worse Off issue
  - Then there are liquidity and funding benefits
  - Banks must be mindful of signalling effects of not calling to the market and how they communicate
  - The biggest benefit of a non-call is clearly for AT1 instruments, as they keep their capital benefit into perpetuity versus diminishing capital/MREL content for Tier 2 and senior instruments

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