European Federation of Building Societies
Fédération Européenne d'Epargne et de Crédit pour le Logement
Europäische Bausparkassenvereinigung

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European Commission wants to define new resolution framework: EFBS advocates for retaining existing principles

With its proposals of 18 April 2023, the European Commission launches the European legislative process to revise the Recovery and Resolution Framework and the Deposit Guarantee Scheme Framework, the so called CMDI package. In doing so, it is fulfilling a work mandate from the Economic and Finance Ministers from June 2022, which had set the revision of the CMDI framework as the primary work stream for completing the Banking Union. In its proposals, the European Commission also expresses its regret about the - in its view - missing third element of the Banking Union, namely the European Deposit Insurance Scheme (EDIS). It notes that its EDIS proposal from 2015 is still pending.

The European Commission emphasises that the CMDI package is not a fundamental revision of the recovery and resolution framework. At the same time, however, the proposed technical changes are so far-reaching that - if adopted unchanged by the co-legislators - significantly more small and medium-sized institutions would be resolved according to European requirements in the future instead of being sent into regular national insolvency. In addition, it should be easier in future to use the funds of the national deposit guarantee schemes (DGS) for the purposes of European resolution.

We agree with the EU Commission that existing rules already allow authorities to deal effectively with failing banks. The fact that authorities have resorted to taxpayers' money in the event of the failure of medium-sized and small banks in the EU instead of the banks' mandatory own funds or sector-funded safety nets shows that resolution strategies are not applied effectively and uniformly across Europe in all resolution cases. In our view, the binding application of the resolution regime therefore does not require a comprehensive revision of the crisis management framework, but rather a harmonised and consistent application within the existing framework. To this end, for example, the obligation of member states in Art. 32 b to ensure liquidation under national law in the absence of public interest could be strengthened, e.g. through appropriate supervision of the national resolution authorities (NRAs) as well as rights of intervention by the corresponding European bodies as warranted.

Although the European Commission emphasises that the decision as to whether resolution in accordance with European requirements or national insolvency rules is to be applied is an individual decision (case-by-case decision) of the competent authority, it proposes such a significant change in the underlying parameters that in future the competent authority will have to come to the conclusion in its assessment that European resolution is preferable to national insolvency rules. Particularly worth mentioning here are reformulations in the execution of the public interest assessment for the evaluation of the existence of a public interest for resolution. In general, the assessment of the public interest as a prerequisite for resolution in the run-up to and during an actual crisis is associated with uncertainties. The expansion of the definition of the critical function in the context of the public interest assessment to include the regional significance of an institution, which is not specified in more detail in the Commission's reform proposal, not only complicates the ex ante

analysis of the public interest, but also brings with it the risk that the assessment of the public interest will be carried out inconsistently by the national resolution authorities.

In addition, the proposed change to the creditor hierarchy will significantly influence the result of the so-called least cost test to be applied. As a result, national DGS funds would be used more frequently in the European resolution process in the future. According to the European Commission, this could result in corresponding additional funding obligations for the contributing credit institutions. However, the European Commission is not able to quantify the extent of these additional contributions in its impact assessment.

The European Federation of Building Societies is of the opinion that the general objective of the European Commission to improve the existing legal framework is to be supported. However, the current distinction between European resolution for large, systemically important institutions with cross-border business and national insolvency as a standard option for the large number of small and medium-sized institutions should be maintained.

The high regulatory requirements associated with the resolution regime could overburden small, non-complex institutions. The associated high financial costs and enormous procedural efforts weaken these institutions unduly and thus do not lead to a strengthening of the resilience of the European financial system. On the contrary, this would further reinforce the trend of consolidation of the banking sector towards ever larger institutions, the failure of which would have significant negative effects.

The EU Commission's reform proposal also does not take into account the special features of the institutions' business models and the specific national regulations that ensure effective supervision and resolution of specialised credit institutions. Due to the special, low-risk business model of building saving institutions (bausparkassen), a framework of standards has already been created with the regulations of the Building Savings Institutions Act (BauSparkG) and the Building Savings Institutions Regulation (BauSparkV). At the same time, in addition to the ongoing banking supervision, there is a special supervision established for the issues of building saving institutions, which is located at the Federal Financial Supervisory Authority (BaFin). The BaFin has decision-making authority over business model-specific supervisory decisions and thus also over the bausparkassen resolution mechanism, which has been explicitly developed for German bausparkassen.

In Germany, with the bausparkassen supervisory authority and the bausparkassen legal framework, there is thus a resolution mechanism specifically tailored to bausparkassen, so that the overriding objective of "financial stability without recourse to taxpayers' money" is ensured using this legal framework. Based on the decades of experience of supervision of building savings institutions, priority should therefore be given to these tried and tested national resolution regimes - which have so far not required recourse to taxpayers' money - over a harmonised European resolution regime for all credit institutions that is not specific to any business model. Furthermore, a multiple responsibility of different authorities with regard to resolution issues is inefficient from a risk point of view and should ideally remain where the business model-specific know-how is already located today.

In addition, a reform of the resolution regime must not lead to internally financed institutions such as building saving institutions falling under the resolution regime and, as a result, having to raise funds (senior non-preferred) that are fundamentally not needed for operations. At the same time, building saving institutions are subject to national legal requirements that result in investment

restrictions on the asset side, which only allow "counter-financing" of the relatively expensive bail-in or MREL-eligible liabilities if, in return, senior non-preferred bonds of other issuers are held on the asset side. Therefore, we propose that with regard to the resolution or liquidation of special credit institutions (e.g. building saving institutions), existing national special regulations can be used as equivalent resolution instruments and that these should have priority over the European resolution instruments.