BRIEFING

European Parliament

Public hearing with Elke König, Chair of the Single Resolution Board

Banking Union scrutiny

ECON on 30 November 2022

This note is prepared in view of a public hearing with the Chair of the Single Resolution Board (SRB), Elke König, scheduled for 30 November 2022.

This briefing addresses:

- the SRB's first public assessment of banks' resolvability,
- an overview of the SRB's ongoing work,
- the status quo of the Single Resolution Fund,
- the status quo of MREL,
- the planned reform of the crisis management and deposit guarantee framework, and
- the SRB work programme for 2023.

This briefing also includes summaries of two external studies about the "retail challenge", i.e. the practical challenges to bail-in certain bank debt, and of three briefings on evolving risks in the banking sector that are specifically relevant for the SRB.

1. SRB's first public assessment of banks' resolvability

In July 2022, more than **seven years after its inception, the SRB has for the first time published a report** with its **assessment of bank resolvability**, itself calling that process "*a marathon, not a sprint*". That report incorporates the information available to the SRB until end-September 2021.

The Resolvability report essentially aims to clearly **identify the residual gaps** in relation to one of the SRB's key objectives, i.e. to achieve the full resolvability of all banks under its remit by the end of 2023.

The Resolvability report highlights of those banks under the SRB's remit, **82% are earmarked for resolution** (accounting for 97% of total exposure at risk), while according to the resolution plans **18% are earmarked for liquidation** (accounting for 3% of total exposure at risk), those entities usually public development banks or smaller banks with a specific business model. One may note in this context that **in practice**, referring to the recent resolution case of Sberbank Europe AG, the relative share of **entities liquidated**

Economic Governance Support Unit (EGOV)
Authors: Kai Gereon SPITZER, Marcel MAGNUS, Kristina GRIGAITĖ
Directorate-General for Internal Policies
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versus those resolve (i.e. sold to other banks) was **significantly higher** than 18% (see previous EGOV briefing for more details).

As regards residual gaps, the SRB states that it requests banks to **address any significant shortcomings within 12 months**. The SRB states that it would start a formal procedure and ask banks to take the necessary remedial actions where substantial shortcomings would lead to a substantive impediment to resolvability.

In practical terms, the Resolvability report also mentions that in order to support the **operational execution of the bail-in tool**, all banks have developed **"playbooks"** describing the steps they would undertake to effectively execute bail-in at short notice, including how their governance and communication arrangements can be activated at short notice[1]. However, according to the SRB, one of the main areas that remains to be further documented in the banks' playbooks relates to **internal loss transfer mechanisms**.

The related risk to resolvability features in the SRB's overall assessment ("heatmap") in the category of low risks ("*Substantial progress where immaterial impediments to resolvability may be identified*"). In contrast, we note that other authors see the underlying legal challenges for reliable internal loss transfer mechanisms as a **topical key risk**; see in particular the briefing of Munoz and Lamandini 2022 (section 8).

2. SRB's ongoing work - overview

You can find a recent documentation of the SRB's work in the note that the SRB shared for the Eurogroup meeting on November 7. This section provides a condensed overview:

On its 2022 **resolution planning** cycle, the SRB reports that it has updated banks' resolution plans as planned and that the results are currently under review internally and by the ECB. On **banks' resolvability**, the SRB has published a first annual assessment of banks' resolvability in July, which portrays **progress and shortcomings by end-2021** against the background of the "expectations for banks" formulated in 2021. (*See Section 1 above*). Considering that **2023 is the final year of the phase-in** of these "expectations for banks", the SRB has recently sent letters to individual banks identifying the remaining working priorities for ensuring banks' resolvability.

The SRB notes that it sees **2023 as a *"decisive, but also transitional year"*** in which it will **shift focus** from basic resolution preparations to *"even more"* targeted bank monitoring. The SRB also announces future attention to making preferred strategies work - on its own part and on the side of banks - and to possible alternative strategies. (*See Section 6 for a brief review of the SRB's 2023 work program and Section 8, which discusses the external papers on risks and priorities for the SRB going forward).*

The SRB finds that **most banks already meet the final 2024 targets for minimum requirements for own funds and eligible liabilities**. That said, it finds among the remaining banks a total shortfall of EUR 32.2 bn per mid-2022. It does not further elaborate on the perspectives for closing that gap in time in the current more difficult market environment, a concern raised in one of our external papers (*see Section 8 on Gortsos*). The SRB however notes that gross issuance of the relevant instruments in the second quarter of this year is broadly in line with the level of the same period last year. (*See Section 4 for additional info and Section 7, in which we review the external papers on the "retail challenge" for bail-in*).

In May, the SRB has adopted the calculation of this year's **ex-ante contributions to the Single Resolution Fund**, following stakeholder consultation. After those contributions, the SRB reports the fund now at EUR

[1] In the same vein, one may note that Jens Henriksson, CEO of Swedbank, cautioned in his keynote speech at the SRB annual conference in September 2022 about putting a plan on the same level as subsequent action, reminding that "*resolution plans must not only put in place but also tested and evaluated on a regular basis*".

66 bn and projected to reach EUR 80 bn at the end of the build-up period in 2023, when contributions could "level-off". The SRB recalls in this context the importance of **finalising the backstop** to the Single Resolution Fund; announced by the Eurogroup for beginning 2022, its ratification is still pending. *See Section 3 for additional info.*

The SRB also suggests some **policy lessons** from its work:

First, it refers to the **Sberbank resolution** case. For background, the SRB has published sanitised versions of the valuations and its resolution decisions. The SRB reports that it has applied a moratorium - a suspension of certain obligations - for the first time. It considers that the instrument proved "vital", but that the time limit in law - essentially, one full business day - is too short. Then, the SRB finds that cooperation of EU authorities worked *"excellently"*, but the process was *"convoluted"* - which leads it to recommend that, even though apparently not pertinent in the case at hand, the two decisions that the Commission has to take when SRF funds are used - on the resolution and on state aid - should be taken at the same time. Finally, the SRB points out that the originally planned single-point of entry resolution was not carried through because of the special circumstances of a Russian parent, but that not doing so does not per se invalidate single-point of entry resolution strategies.

Second, the SRB welcomes the First Instance court's dismissal of the appeals against the **Banco Popular** resolution decision, calling it a confirmation of the EU legislation and application by the SRB.

Finally, the SRB comments on its expectations for the **reform of the crisis management and deposit guarantee framework**, which the Commission plans to propose in early 2023. It expresses a preference for less national differences and broader possibilities to use the funds of deposit guarantee schemes in resolution. See Section 5 for more information on the reform of the framework.

3. Status Quo of the Single Resolution Fund

On 8 July, the SRB issued a press release about the amount of contributions made to the Single Resolution Fund. The contributions for 2022 add EUR 13.7 billion to the fund, reaching EUR 66 billion in total. The fund is expected **to end up at around EUR 80 billion by the end of 2023**, taking into account the assessment base (1% of covered deposits) and the expected growth in covered deposits. All contributions come from approximately 2900 credit institutions and investment firms in the EU's 21 Banking Union countries and are initially allocated to **national compartments** that are **step-wise mutualised** (by now, more than 90% of the funds are already mutualised).

The SRB also mentions in the press release that "*The Fund will see its effective capacity approximately doubled when the* ***public Backstop*** *to the SRF is introduced.*" (own emphasis)

The introduction of the public backstop will come with the agreed amendment of the Treaty establishing the European Stability Mechanism (ESM); the **ratification** of that agreement is not yet finalised in all Member States (still pending in Germany and Italy, see Council tracker).

4. Status Quo of MREL

The term minimum requirement for own funds and eligible liabilities (MREL) essentially describes the minimum amount of equity and unsecured debt that a bank must hold to help:

- carry out an effective resolution,
- recapitalise a bank,
- and absorb losses.

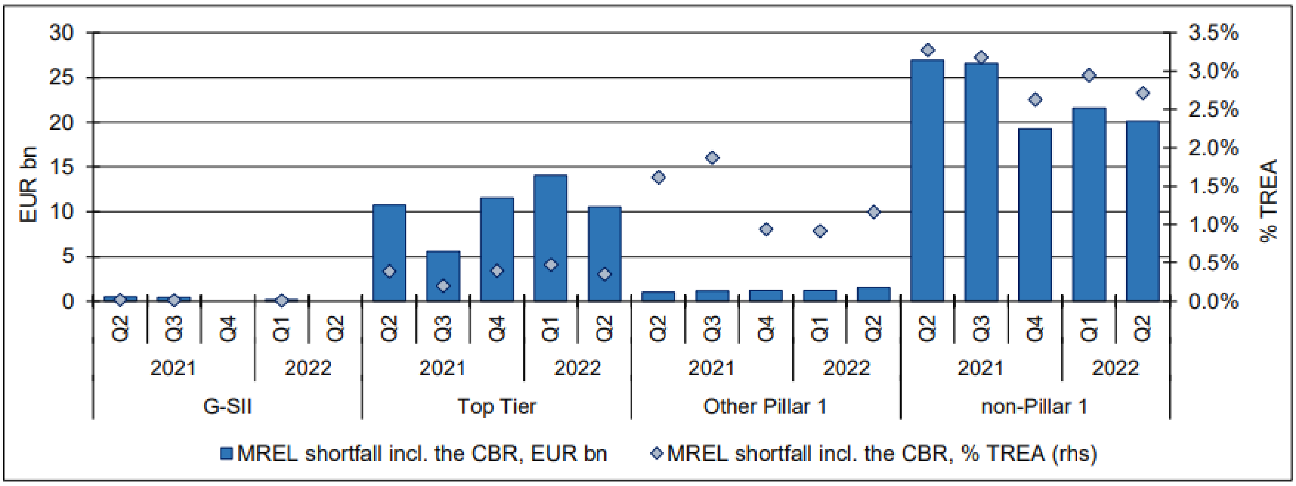
Since the second quarter of 2020, the SRB regularly publishes an overview ("*MREL dashboard*"), based on bank data reported to the SRB, which inter alia compares the banks' target levels and actual levels of MREL held and thereby indicates respective shortfalls.

The latest edition of that [MREL dashboard], referring to the second quarter of 2022, was published on 4 November.

In the Banking Union, it is the SRB that prescribes the required minimum amount of equity and unsecured debt, both for significant institutions (SIs) and less significant institutions (LSIs). MREL needs to be tailored to bank-specific features, including its size, business model, funding model, risk profile and the needs identified to implement the resolution strategy. A **comparison of final MREL targets** is hence more useful if grouped by bank size (chart 2 in the SRB publication) or by preferred resolution strategy (chart 3 of the SRB publication), rather than by geography (chart 1 in the SRB publication), as the place where a bank is headquartered should not matter for setting specific MREL targets.

The group of banks that has the **largest relative shortfall** of actual MREL versus target level MREL are **small banks** ("non-Pillar 1 banks") in the population (see figure 1); the SRB publication notes that around half of those small banks managed to issue MREL-eligible debt during the analysed period, the second quarter of 2022 (that observation leaves the question open whether the other non-Pillar 1 banks, those not issuing MREL-eligible debt, didn't do so in view of the recently deteriorated market funding conditions, or rather due to a more general lack of market access).

Figure 1: MREL shortfall against final targets of resolution entities by bank category



Source: SRB MREL Dashboard – Q2.2022; TREA: Total Risk Exposure Amount (approximately comparable to risk-weighted assets)

5. Reform of the crisis management and deposit guarantee framework

The Council Conclusions of 17 June 2016 set out a **roadmap to complete the Banking Union**. This roadmap consisted of 4 steps:

1) a proposal by the Commission to enhance prudential standards, which has been adopted in the meantime;
2) a "backstop" to the single resolution fund, which has been agreed and is awaiting ratification (see above);
3) "possible next steps" on the regulatory treatment of sovereign exposures; and
4) technical work on EDIS, and political negotiations about it when "sufficient progress on risk reduction measures" has been made.

This year on June 16, the Eurogroup released a statement on the **future of the Banking Union**. As to the EDIS and sovereign exposures, the two open issues from the roadmap, the Eurogroup merely notes that it has *"explored ways"* to create a more robust common protection for depositors and to encourage greater diversification of banks' sovereign bond holdings in the EU. Meanwhile, in 2021, the Council had discussed, in some detail, the idea of a **"hybrid" EDIS** providing, as a first step, liquidity support to national deposit guarantee schemes from a central fund and from other national schemes. As to **sovereign exposures**, those discussions reflected on taking account of them in banks' contributions towards deposit guarantee schemes. Neither of these ideas is pursued in the statement of June.

Bruegel: ambitions for the Banking Union

A fresh paper from Bruegel identifies three levels of ambition for the way forward: an 'incremental deal', insufficient but achievable in the current EU parliamentary term, a 'real deal' that the authors strongly advocate and a 'cosmic deal' considered aspirational for the foreseeable future:

The **'incremental deal'** of the authors aims at broadening the scope for private-sector burden-sharing in future cases of bank failures and is **intended to "explicitly match" the Eurogroup statement** (see main text of this briefing). We still feel that the differences between the authors and the Eurogroup go beyond nuances - where the former speak of **eliminating the option of normal insolvency** for banks, the latter want to apply resolution more widely. Also for instance the idea of treating institutional protection schemes as 'conglomerates' (inverted commas in the original) does not appear in the Eurogroup statement.

The **'real deal'** aims at breaking the bank-sovereign link. Here, the authors envisage a **single European resolution agency** that assumes the functions or SRB, national resolution authorities and deposit guarantee schemes and ensures an "impartial enforcement". This would go together with a common financial backstop and a **mandatory European deposit guarantee scheme**. The authors believe that Treaty change is not necessary for this way forward. They nevertheless consider it desirable to provide the resolution authority with more leeway for decision making, considering the implications of the *Meroni doctrine*.

Finally, the authors' **'cosmic deal'** aims at a "single, seamlessly integrated banking market". To achieve this goal, the authors believe also **a single system of bank taxation, for corporate and personal insolvency and for housing finance and mortgages** are necessary.

Instead, the **Eurogroup invited legislative proposals from the Commission in order to reform the crisis management and deposit guarantee framework**.

The Eurogroup supports clarifying and harmonising the **public interest assessment**, which is the trigger for resolving a bank under European law rather than subjecting it to national insolvency proceedings. Consequently, the Eurogroup expects **resolution to apply more widely**, including to smaller and medium-sized banks, where sufficient MREL and *"industry-funded safety nets"* are available. Nevertheless, the Eurogroup wishes to also have appropriate **flexibility for market exit** of failing banks in a manner that preserves the value of the bank's assets. The statement does not explain where to draw the line between market exit and wider application of resolution, and how asset values are meant to be *"preserved"* in a process leading to market exit. The Eurogroup wants to ensure the availability of *"industry funded safety nets"* by **harmonising the use of national deposit guarantee schemes** in resolution. One element would be a **harmonised least-cost test**, i.e. a test that ensures that the deposit guarantee scheme supports resolution to the extent it can save money by doing so instead of reimbursing depositors and becoming a creditor in an insolvency procedure. Interestingly, the **Eurogroup insists on national authorities to make the least**

cost test, which we understand to mean they do including when the resolution and the relevant asset valuations are done by the SRB. Finally, the Eurogroup supports **limited harmonisation of national bank insolvency laws**.

Note that the Commission published an inception impact assessment for a review of the crisis management and deposit guarantee framework already in November 2020. This was followed by a public consultation in February 2021 and a legislative proposal was announced for the fourth quarter 2021. In a recent speech, Commissioner McGuinness did announce the Commission will answer to the Eurogroup's invitation, but did not give a date.

We recall that shortly after the Commission's consultation in May 2021, the SRB published a ***"blueprint for the CMDI (crisis management and deposit insurances, ed.) framework review"***:

First, the SRB called for EDIS, which should transition from a hybrid version to *"full mutualistation"* over 5 years. The SRB hoped that **EDIS would significantly increase the combined *"firepower"*** (sic) for dealing with ailing banks, together with the Single Resolution Fund.

Second, the SRB called for some changes to the crisis management framework. It would like to see **less restrictive conditions for the use of deposit guarantee funds in resolution**. In particular, the SRB suggested that a general depositor preference should replace any special insolvency creditor ranking priority of the deposit guarantee scheme, subordinating all other senior debt to deposits. Thus, it argued, the least cost test (see above) could be fulfilled more easily. The SRB favoured also limited harmonisation of bank insolvency proceedings. However, it cautioned that improving national insolvency should not *"perpertuate the national management of banking crisis"*. The SRB suggested this could be avoided when **harmonising insolvency proceedings and centralising deposit guarantee funding and governance at the same time** - something that is not envisaged by the Eurogroup. Also as regards the use of DGS in resolution, the SRB wished for a **joint governance by SRB and national authorities** - in contrast to the Europgroup's plans.

Finally, the SRB had called for an **update of the Commission's banking Communication**, which deals with the conditions of state aid for banks; specifically, the SRB expressed the concern that the current version provides wrong incentives and escape avenues. The Commission is carrying out an evaluation and appears set to put forward revisions in 2023,[2] but has not given clues as to content.

6. SRB Work Programme for 2023

On 17 November, the SRB published its annual work programme for 2023, writing that it is committed to ensuring banks make themselves fully resolvable by the end of the coming year.

In the foreword of that work programme, Elke König writes "*The coming twelve months will see the **SRB's focus** moving from the more general phases of drafting and fine-tuning of resolution plans towards ensuring that each plan and preferred resolution strategy for each bank is implementable at short notice. This **means more testing** and deeper analysis of existing resolution plans, as well as further developing sound quality control measures for resolution plans across the Banking Union.*" (own emphasis)

The work programme sets out that testing shall be carried out in form of *"centrally coordinated dry-runs"*. The SRB plans to carry out just two such dry-runs in 2023 (one fully-fledged simulation exercise and one technical exercise). At least **in quantitative terms** that target does not suggest that the SRB would do *"more testing"*

[2] See page 109 in https://www.eurofi.net/wp-content/uploads/2021/04/views-the-eurofi-magazine_lisbon_april-2021.pdf

in 2023, the **number of planned dry-runs is virtually the same** as in the baseline date (2021). Apart thereof, the question of how many resolution plans would actually need to be tested in form of dry-runs requires a qualitative judgement, which essentially depends on the shortfalls identified and lessons learned from previous exercises.

On a different note, the work programme mentions that in 2023 the SRB will "***start exploring crypto finance*** *and decentralised finances as a potential source of direct and/or indirect contagion in the event of a bank failure, with the aim of reflecting these channels of contagion in resolution planning and execution in the future.*" (own emphasis)

Finally, the work programme also mentions that the SRB, drawing from the experience made in recent crisis cases, intends to initiate a dialogue with the Commission on the possibility of **extending the length of the moratorium tool**.

7. External papers on the "retail challenge"

Bail-in of bank debt held by small creditors particular can be particularly challenging since it may impose or may be seen to impose undue hardship on households and small businesses. Nevertheless, the BRRD envisages in principle that also such *"retail debt"* can be bailed in and that it qualifies, to a certain degree, as eligible liabilities for banks' minimum requirement for own funds and eligible liabilities. This raises two questions: **First, how difficult is it in practice to bail in different forms of retail debt? And second, how much does the BRRD framework rely in practice on the ability to bail-in retail debt?** Or put differently, what is the share of bail-inable debt and of debt qualifying for MREL requirements that is held by small creditors? These two questions frame what can be referred to as the **"retail challenge"** for bank resolution. In the following, we review the two external contributions that have been received on the topic following the request by the ECON Committee.

A. Enria on the "retail challenge"

In January 2021, the Chair of the ECB Supervisory Board, Andrea Enria, warned: *"An excessive reliance on non-preferred and subordinated instruments placed in the portfolio of captive retail customers could also jeopardise the resolvability of a bank, as the ability to allocate losses to these retail investors in a crisis situation could prove highly questionable."* In 2017, Andrea Enria had already mentioned in a speech, held in his capacity as Chair of the EBA, that *"The common practice of placing eligible debt with retail investors may pose serious challenges to (...) the bail-in procedure. This is what I call the 'retail challenge' to banks' resolvability. (...) Data available for the euro area confirms that retail investors still hold an important share of EU debt securities issued by financial institutions".*

SAFE: Some "red flags" from selected holdings data and a lack of transparency

Using anecdotal evidence from bank failures in one Member State, the authors show that debt held by retail creditors **does complicate bail-in in practice**. To gauge the size of the retail challenge today, the authors systematically review how useful the different available data sources are. In this regard, they conclude that **public access to data on ownership of bail-in debt is basically inexistent**. But beyond the issue of public access, they find that **even supervisory and resolution authorities do not have unimpeded access** to vital data. For example, they report that the SRB does not have direct access to ECB data on ownership of traded debt securities.

Against this background of data limitations, the authors derive their main conclusions on the size of the retail challenge from German SSM banks' data. To this end, they look at the retail ownership of claims against each bank in their sample. They think that there is no retail challenge considering the average across all banks. **However, 10% of the banks in their sample have more than 35% of bail-inable debt held by retail investors.** The authors also consider whether there could be a "bank challenge" in the sense that banks borrow to often from other banks. They fear a resolution authority might hesitate to impose losses on other banks since doing so might endanger financial stability. In this regard, they point out that on average, **40% of bail-inable debt of their sample banks is held by other banks**. We would add that this raises the follow-up question as to how concentrated such debt holdings are in the balance sheets of the lending banks. This would be a key determinant for the ability of the lending banks to absorb bail-in losses and consequently, for the risk of systemic contagion. Supervisory large exposure data could inform a judgement, but is not publicly available - and we do not know if resolution authorities use it in resolution planning. The authors of the paper recommend imposing **concentration limits for banks investing in bail-inable debt**.

Against the background of their assessment of data availability, the authors recommend that **ownership data on bail-inable debt should be fully disclosed**. They suggest a Europe-wide effort to standardize, collect, and fully disclose the holding statistics for each individual banks in a single data repository and that supervisory agencies, resolution agencies and central banks should all have unrestricted real time access to bail-inable debt holding data.

The authors are also concerned with **making more evident to investors whether debt can be bailed in or not**. They recommend that all bail-inable debt instruments should be visibly flagged to all investors. Furthermore, the ambiguity with respect to wholesale deposits and other debt instruments not covered by deposit insurance, i.e. that they may or may not be subject to bail-in, should be eliminated. Finally, to reduce the retail challenge, the authors advocate that **minimum denomination requirements for MREL eligible instruments** should become mandatory.

Note: SAFE ("Sustainable Architecture for Finance in Europe") is the Leibniz-Institut für Finanzmarktforschung. The authors of the paper are Tatiana FARINA, Jan Pieter KRAHNEN, Irene MECATTI, Loriana PELIZZON, Jonas SCHLEGEL and Tobias H. TRÖGER.

Jakob De Haan: large retail debt at Eurozone banks and several policy recommendations

De Haan points to the same anecdotal evidence as the SAFE paper to demonstrate the complexities of retail debt bail-in. As to the size of the retail issue, the author uses ECB data on the ownership of traded debt securities at country-aggregate level. He concludes that **Italy, Germany, France and Austria have large retail investors' exposure to bank securities** ranging from 12% to 37% of total bank debt. Furthermore, the author reckons that for most countries, the **amounts of bank debt securities held by retail investors are fairly stable over time**.

The author continues to offer a **number of conclusions for policy**. He considers that retail bail-in might be easier for the SRB than for national authorities, the latter being more exposed to domestic politics. The author is also **critical of exempting retail creditors in the course of bail-in** - and he considers that highlighting the exceptional possibility, as EBA and ESMA did in a statement, creates expectations and is not the best way to avoid ad-hoc retail exemptions. The author finds it more promising to **reduce reliance for resolution on retail-held debt**. A possibility would be to exclude retail-held debt from minimum requirements for eligible liabilities or imposing more stringent requirements on banks with important retail funding, while allowing banks most affected a transition. A second would be a ban on distributing bail-inable bank debt to retail, since political pressure to protect even well-informed retail investors may remain hard to avoid.

8. Evolving key risks in the banking sector and related priorities for the SRB

Given the uncertain risk outlook for the euro area banking sector, the ECON committee also asked for short briefings about evolving key risks in the sector, and related priorities for the SRB. In the following, we review the three external contributions that have been received on the topic following the request by the ECON Committee.

David Ramos Muñoz and Marco Lamandini: **Obstacles to implement transfer strategies**

The final paper is also available in the EP's Public Register of Documents.

The executive summary reads (emphasis added):

*"There is possibly **no greater risk** for the EU banking system **than the obstacles to implement transfer strategies** in bank crisis management. Simply put: the resilience of the EU banking system may depend less on exogenous shocks than on its ability to deal with them, and the EU can do less to prevent the shocks than to make it easier to deal with them. This will depend on the availability of strategies that allow banking groups, national authorities or the SRB to swiftly execute transfers of funds, assets, liabilities or shares (hereby called "transfer strategies").*

*The EU's single-minded focus on (i) dealing with the largest banks, and (ii) minimizing taxpayer losses has resulted in a bank crisis management **system that is skewed towards resolution and bail-in, to the neglect of transfer strategies.** Yet, national practice in different Member States, and the SRB's own experience in cases like Popular or Sberbank shows that successful bank crisis management requires transfer strategies more often than bail-in. It is necessary to acknowledge the relevance of transfer strategies, and **address the current limitations** to give them effect.*

*First, current rules lack sufficient clarity as to when **intra-group transfers** of resources, or repayment of liabilities can take place to avert the crisis of a subsidiary, or maximize its transfer value, even in a situation where the parent itself may be in financial distress. National contract, corporate or insolvency law can present obstacles, and lack certainty about how to execute the transfers.*

*Second, the current resolution framework is primarily "regulatory", while successful transfer strategies require a **more M&A-oriented approach**. Once the authorities visualize the M&A process, some limitations of the current framework become evident, including cross-border recognition, the treatment of SPVs, the coordination between authorities, or the potential liability of the transferee, or the parent company.*

*Third, successful transfers often need **funding**, and the current framework makes it difficult for the Single Resolution Fund (SRF) to adequately fulfil that role, and for national deposit Guarantee Schemes (DGS) to offer additional funding in coordination with the SRF.*

*Fourth, currently there seems to be no intention to explore the idea of an **EU-wide market of Non-Performing Loans** (NPLs) using mechanisms like securitisation, which straddle across banking and capital markets. Such mechanisms could make NPL management more efficient, improve both crisis management and the liquidity of secondary loan markets, and deepen the Capital Markets Union."*

Marco Bodellini, Willem Pieter De Groen, Rosa Lastra, Costanza Russo, Tinatin Akhvlediani, and Barbara Casu: **Geopolitical risks, tail risks, and alternatives to resolution**

The final paper is available in the EP's Public Register of Documents.

The executive summary reads (emphasis added):

*" This paper aims to identify the **evolving risks** that are likely to affect banks in the Banking Union **in the upcoming twelve months** and impact on the Single Resolution Board (SRB) and its priorities. This review excludes risks that have the potential to materialise in the near future which cannot yet be assessed adequately, such as operational risks and the longer-term risks related to digitalisation and climate change.*

*First, **geopolitical risks** are considerable at the moment, with the war in Ukraine and rising tensions between China and Taiwan. Their direct impact is likely to be limited as most banks under the remit of the SRB have no activities in any of those countries, and the banks that are owned by institutions located in the affected countries have already been liquidated, resolved, or are winding down their banking activities. For those banks with activities in Russia, the potential losses **can be absorbed with the ongoing profits or excess capital**. The main risks identified at this point in time are the indirect consequences of geopolitical tensions, such as rising inflation, increasing interest rates and economic decline.*

*Second, **shadow banking** has grown in the past few years and currently account for nearly half of all financial assets. The recent issues with UK pension funds invested in liability driven investment and crypto-asset markets show that there are risks for banks. However, given the limited available public information it is **difficult to assess** their extent. According to the ECB, crypto markets would still have to grow further to become a concern for financial stability.*

*Third, while during the critical months of the Covid-19 pandemic most governments put in place **supporting mechanisms to** avert the dire consequences of lockdowns, the majority of these measures are now being withdrawn. Consequently, the end of liquidity support might increase default rates by firms unable to repay, with potential negative outcomes on banks' credit risk, leading to increasing non-performing loans. The scale of public intervention also gives rise to significant uncertainties associated with bank credit risk.*

The risk that banks will start to fail or would become likely to fail due to these key challenges is reduced by the build-up of capital buffers and liquidity pools in response to the 2008-09 global financial crisis. Moreover, monetary authorities and governments are likely to provide support should risks acquire a systemic nature.

*Although the identification of challenges for banks under the SRB's remit is useful to be prepared for the most likely types of failures, the recent past has shown that some **risks materialise quite unexpectedly**. The crisis management framework should therefore be suitable to deal with all kinds of endogenous and exogenous shocks.*

*Nevertheless, the SRB can use data and information on expected risks to prepare and then adopt a crisis management strategy if risks materialise and one or more banks are deemed to be failing or likely to fail. The SRB can monitor more frequently the conditions laid out in the resolution plans for significant banks. The SRB might further review its activities and priorities should there be an increase in bank failures under their remit. In the public interest assessment, the SRB can further **envisage that alternatives to resolution** might result in some instances not credible and some resolution tools, such as bail-in and the sale of businesses, could become less feasible and credible."*

Christos GORTSOS: **more difficult market conditions** for issuing own funds and eligible liabilities

The final paper is available in the EP's Public Register of Documents.

Gortsos recognises a threat to banking stability since a banking sector affected by low profitability, a delayed macroeconomic recovery and elevated credit risk faces a range of new challenges. Within this context, he sees two issues for the SRB:

The first issue relates to the **ability of credit institutions to meet their requirements for own funds and eligible liabilities**. To this end, banks have to continue raising debt, which becomes more difficult because of the current high level of interest rates. The author suspects even greater difficulties for those banks that have not yet managed to fulfil their own funds and eligible liabilities targets (*cf. Section 4 of this briefing*). In addition, he points out possible profitability challenges as raising own funds and eligible liabilities gets more expensive.

The second issue concerns resolution strategies. For 82% of the banks in the SRB's remit, there is a specific resolution strategy planned in advance (*cf. Section 1 of this briefing*). The author raises the question whether there is a need to **review the preferred resolution strategies that rely on bail-in**. This may be necessary given the present market conditions that make reaching and maintaining required own funds and eligible liabilities levels more difficult. In this context, the author expects that most of the largest institutions already meet their minimum requirements and that for them, a deviation from the preferred strategy including bail-in is not probable.

For the remainder of banks, the author notes that in the past, the SRB used to prefer insolvency over resolution, and that it is not unknown whether that was also the preferred strategy ex-ante. Now, since preparation for resolution has advanced, the author finds it more likely that **the SRB would, where feasible, choose a sale-based strategy as an alternative to the bail-in resolution tool**. He would also very much be in favour of this solution, considering the negative side-effects of both winding up credit institutions under normal insolvency proceedings and applying to them the bail-in resolution tool.

Contact: egov@ep.europa.eu

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