KEYNOTE SPEECH

International Workshop on Financial System Architecture and Stability

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The European crisis management framework and the recent banking crisis: is there space for improvement?

Introduction

Thank you for inviting me to deliver this speech.

The crisis events in the first quarter of 2023 have certainly represented an important testing moment of the regulatory framework in place since the global financial crisis. While those bank failures happened outside of the EU and were driven by different risk factors, they resulted in a crisis of confidence in banking systems globally and required significant public intervention.

Questions are now being asked on whether the current EU crisis management framework is appropriate to deal with similar situations and whether potential changes could be required. It is on this topic therefore that I would like to focus my intervention today.

In my view, let me be clear upfront, a lot of progress has been made to enhance our resolution framework in the last decade. The EU already has strong rules and tools to deal with bank crises in an effective way.

Sure, improvements can be made and should be made. The current framework will benefit and further improve in some aspects through the implementation of the recent

Commission proposals contained in the crisis management and deposit insurance (CMDI) package.

I think we should be careful not falling into the trap of overcomplicating the rulebook unless there is a real need to do so and not just for the sake of covering all the different crisis situations. In my opinion, the crisis has exposed more the need of being ready to effectively implement the framework rather than faults in the regulatory framework itself. So no need in my view to re-invent the wheel!

While remaining confident on the European crisis management framework, the recent crises remind us of the need not to be complacent and the importance of continuing to critically review the framework on the basis of the experience gained through the planning and implementation in crisis. Importantly the crisis cases also remind us of the ultimate important goal of completing the Banking Union in particular the importance of establishing a European Deposit Insurance Scheme (EDIS) as this is an essential step to reduce fragmentation and divergences across the Banking Union.

Today I want to start first focusing on some preliminary reflections that are emerging from the recent events from a crisis management perspective and why in my view those events point more to concerns in effective implementation rather than fundamental issues in the regulatory framework. I will then mention EBA's early thinking on how to embed those preliminary takeaways from the crisis into its work priorities. I will also highlight the benefits of CMDI proposals in refining the framework in particular in relation to the recent crisis events. Lastly, I will conclude emphasizing why it is important to complete the Banking Union to better protect us against similar issues and risk of contagion in the future.

Reflections on the recent crisis cases

As an EU regulator also for crisis management and resolution times the EBA has always granted high importance to the lessons learned process following crisis events. In the aftermath of the Spring crisis, the EBA started discussions with its constituencies in order to (i) identify the issues exposed by recent crisis events and (ii) assess if potential supervisory and regulatory changes more specific to the EU framework should be considered. These discussions are taking place in close coordination with the discussions being held in various fora including FSB and BCBS to which we are also contributing.

Overall, those discussions point to the fact that recent crisis cases have further emphasized the importance of a strong, effective supervisory and crisis management framework to maintain trust in the system and avert contagion.

With regard to the crisis management framework, I would like to reflect on the aspects emerging from the initial assessment and discussions of recent crisis cases. Those could be summarised as follows:

(i) **Liquidity and funding in resolution:** recent events have highlighted the importance of being able to access appropriately funded public backstop facilities in resolution as essential to restore public trust and confidence. We knew that this is an open issue in the current EU framework and the recent crisis has made it even more obvious. In addition the speed of deposit withdrawals fuelled by digitalisation and social media pointed to the need of having those facilities readily/rapidly available for use.

(ii) **Flexibility while implementing resolution**: it came out evident from the crisis that, during their planning, resolution authorities should consider and develop different options to be ready to adopt the strategy most appropriate to the crisis scenario and its evolution. During the recent crisis, in some cases we have seen authorities changing their final strategy as opposed to their preferred one in planning. In my view, a wrong conclusion would be to conclude that the change in final strategy indicates the lack of use of resolution planning. Clearly this outcome would have not been possible without appropriate preparation during resolution planning.

(iii) **Operationalisation of resolution strategies**: in order for the resolution strategies to be implementable, it is essential that they have been fully operationalized to identify and mitigate/overcome potential legal and operational obstacles that could ultimately impede the choice of the preferred action. To do this, it is crucial to clearly identify the operational steps required and make extensive use of testing and crisis simulations exercises. The recent bank failures demonstrated for example the need of operational preparation to implement a transfer strategy including in terms of availability of information and perimeters of separation.

(iv) **Credible restructuring plan post-stabilisation**: recent events highlight that resolution does not stop at the stabilisation phase or the resolution weekend. Without a credible, clear and quickly implementable business reorganisation plan, authorities will find difficult to effectively implement their resolution action and restore trust and confidence in the viability of the institution post stabilisation. For example the use of the bail in tool could restore the capitalisation of the bank but it will have a limited impact on its business viability unless effective restructuring actions are planned and announced.

(v) **Communication in crisis and resolution planning**: a major observation to emerge from the crisis has been the importance of a clear and timely external communication as an essential condition to restore trust and confidence in the effectiveness of the chosen strategy to restore viability of the institution. While it is true that the final messages will need to be tailored to the specific events, no doubt of the need to include key content of communication as a crucial aspect of the operationalisation of strategy.

Linked to this, the crisis demonstrated that confidence and trust increases when there is clarity and predictability on the potential actions. The recent failures showed clearly that market panic can spread easily when the rules that are followed are not clear and predictable. Essential therefore that in peace times resolution authorities work more on familiarising the market on the key aspects of the general resolution framework. In the same vein, more institution specific transparency on key aspects of resolution planning including resolvability could help in enhancing public and investor confidence on level of preparedness of institutions and authorities to crisis events.

(vi) **Effective coordination in crisis**: recent events also raise the importance of close coordination across authorities to make sure that actions are well understood and appropriately coordinated. In crisis for example it is important that the aspect of coordination of communication across authorities is also carefully considered to ensure alignment of messages and effective time sequencing in intervention.

Resolution colleges and CMG for cross-border banking groups are primarily established for the purpose of effective coordination in the EU and global resolution frameworks. Proper functioning of those fora in the planning phase but also during execution is essential to ensure proper flow of information and timely consultation/discussion including with ministries of finance and DGS. In addition these fora are fundamental in creating relationships across authorities and build up trust which are crucial when executing resolution.

Implications on EBA crisis management work and priorities

While reflecting on the crisis and its preliminary takeaways, EBA has also been exploring the potential implications on its work areas and priorities to understand whether some reprioritisation and adjustments to the current work would be necessary or to consider new areas for potential work initiatives.

These discussions are on-going but today I would like to indicate to you some of the options that are emerging.

EREP

Currently the EBA performs its monitoring role mainly through its European Resolution Examination Programme (EREP) which stresses for the whole European Union the particular points of attention under the annual cycle of examination for the Resolution authorities. This annual effort is guided by risk analysis as well as the necessity to converge upon the regulatory implementation requirements. Presently for the 2023 exercise it is recommended to Resolution authorities to more specifically monitor adequate progress of resolution planning and resolvability. A first report summarising main findings has been recently published highlighting that overall, resolution authorities incorporated the work priorities set by the EBA, with MREL monitoring being a key focus.

From the issues emerged from the crisis so far, for example the aspects of liquidity needs in resolution and assessment of resolvability capabilities have emerged as crucial. While those are, to some extent, already included in our programme, surely they will remain in need of close assessment.

Crisis simulation exercises

A key additional aspect of monitoring where the EBA is already intensifying its work is on crisis simulation exercises which are essential to test planning. The crisis events have shown that effective implementation is key and to be ready, it is essential that the processes and operational steps identified in planning are tested to check their effectiveness and fix the potential issues that emerge and adjust to the actual circumstances.

After various years of resolution planning development, real progress could be achieved in resolvability through appropriate testing and the EBA has already dedicated specific guidance to authorities and institutions on this aspect in its resolvability testing guidelines.

To further progress, the EBA is now conducting a stock take of the testing exercises so far conducted by authorities to identify best practices in order to contributing to make those simulation exercises more effective. The EBA is going to maintain high priority on this work on EU simulation exercises as it believes that testing of the planning is essential to improve operationalisation of resolution strategies as also clearly emerged from recent crisis cases and it aligns with an active role on simulation exercises already envisaged for the EBA by the recent CMDI proposal.

Review of relevant regulatory products

The EBA believes that initial lessons learned from recent crisis add momentum to a critical review and update of some relevant regulatory products.

With the majority of this regulation issued at the time of adoption of the BRRD, the EBA believes that, while no fundamental changes to the rules are needed, some practical amendments in some specific aspects are necessary to reflect the experience acquired during the last years.

In particular, consensus is emerging on the need to update certain aspects of delegated regulation concerning the resolution planning. Overall the objective of this review would be to increase the 'usability' of the resolution plan in execution, making sure that it is a focused document containing core essential information, it is operational enough to allow swift implementation and it contains variant strategies to adapt to the crisis events.

Coordination/collaboration among authorities has also emerged a key issue to consider in execution. The EBA is therefore considering potential revisions to the secondary regulation governing the functioning of resolution colleges to make smoother and more effective their work both during planning and execution. The review will also take into account the practical experience gained in colleges over the past few years.

Those are some preliminary areas of action which I am highlighting but as mentioned earlier, the work that we are envisaging on the policy side would not alter or overcomplicate the framework but it could mainly refine some aspects of its implementation.

The benefits of the CMDI in relation to recent crisis events

Let's now focus on the recent CMDI proposals.

Although not prompted by the recent crisis events, the recent EC legislative proposal of the CMDI package is, in my view, crucial as it refines the framework addressing some implementations aspects that have also emerged from the recent crisis.

Let me highlight the key elements and benefits of the CMDI proposal.

The first key aspect of CMDI reform is that it will facilitate the use of crisis tools enabling wider application of the resolution framework to banks of any size facilitating in particular the application of the resolution toolbox to medium-sized and smaller banks. Past cases of implementation of the framework in the EU have shown difficulties in applying the current resolution framework to smaller banks with, as a consequence, often recourse to different insolvency regimes and often involving the use of taxpayers' money.

EU resolution authorities will therefore be better equipped to tackle situations of financial distress of mid-sized and smaller banks. Recent experience with the US bank failures has illustrated the importance of a strong and operational crisis management framework to handle in an orderly and timely manner, irrespective of the bank size or business model.

The second crucial aspect of the proposed reform is that it will make possible to unblock the use of resolution funds and national deposit guarantee schemes, when this is needed, to implement resolution complementing the loss absorption buffers accumulated within the banks. The result would be that in the EU, we would be better equipped to ensure un-interrupted access to deposits and reduce the risk of imposing losses to depositors in the handling of bank failures, in cases when this is deemed necessary to prevent contagion and financial stability risk.

US cases have clearly highlighted the risks and sensitivities of imposing losses on depositors when dealing with banks in trouble. The CMDI reform goes in the right direction as it gives the possibility for authorities to better shield all depositors from losses in case of crisis and reduce detrimental effects for financial stability and depositors' confidence.

I believe that the recent crisis makes even more compelling and pressing the need to swiftly implement the changes of the CMDI proposal to fully operationalise the framework.

Way forward

EDIS

The proposals contained in the CMDI proposal are important as they strengthen the crisis management framework and increase trust in the system. This should facilitate to move forward towards completion of the Banking Union which still misses its third pillar i.e. an EU common deposit insurance scheme (EDIS).

Why does this matter? It does because lack of a unified deposit insurance base creates market segmentation and a vicious cycle of risks between banks and sovereigns. When there is tension in the market, deposits could flow toward countries with stronger credit standing or better funded national deposit guarantee schemes potentially undermining financial stability. In addition if the failure of a cross-border banking group impacts the national deposit scheme, it is more likely that authorities will try to maintain at domestic level high levels of capital and liquidity.

That is why I hope that the strengthening of the crisis framework with the CMDI could overcome the political deadlock on EDIS and we could move forward pragmatically towards the completion of the Banking Union.

Conclusion

In conclusion, I believe that, in the aftermath of the recent crisis events in US and CH, we can remain confident in the strength of the EU crisis management framework and significant progress in resolution planning and resolvability has been made over the past few years.

However a good set of rules works well only if implemented effectively. The preliminary reflections on the recent crisis have emphasised the need of being ready and have a plan that can be effectively ‘used/implemented’ and ‘adaptable’ to the prevailing circumstances.

In my view the preliminary takeways of the current crisis make therefore even more compelling for the EBA and authorities to focus their work on fixing implementation aspects that do not appear to work as intended and that the current framework is updated with the proposals contained in the CMDI package.

Strengthening of the crisis management framework is important as it remains an essential step to progress towards completion of the BU, fostering consistency and reduce fragmentation and divergences across the Banking Union.

Thank you for your attention.