

Addendum to the Public Interest Assessment: SRB Approach¹

31 May 2021

The SRB has revised its approach to the Public Interest Assessment policy (PIA) in resolution planning to take into account that a bank's failure may take place not only under an idiosyncratic scenario, but also under broader financial instability or system-wide events (SWE). This consideration strengthens the choice of the best resolution strategy in order to safeguard the resolution objectives.

SRB APPROACH TO THE PUBLIC INTEREST ASSESSMENT

As described in the SRB's Approach to the Public Interest Assessment (PIA)², the identification of public interest is a necessary pre-condition for taking resolution action when a bank fails. The PIA is updated annually in resolution planning, and also when a bank is declared failing or likely to fail, to reflect the circumstances at that point in time.

The PIA assesses whether resolution is necessary and proportionate to achieve one or more of the five resolution objectives (as stated in the BRRD2 and SRMR³), and winding up the institution under normal insolvency proceedings would not meet those objectives to the same extent⁴. All resolution objectives have equal importance and are assessed when developing the resolution strategy. The assessment takes into account the circumstances at the time the bank is failing, and such a test may give different results if the bank fails under normal market circumstances or during system-wide events.

The SRB has updated its approach on how to conduct the PIA, in order to consider potential system-wide events when identifying the preferred resolution strategy and tools in the resolution plan⁵. The rationale of the revision is to ensure, already at the resolution planning stage, that the best strategy is chosen.

SYSTEM-WIDE EVENTS IN THE PUBLIC INTEREST ASSESSMENT

The updated approach to the PIA in resolution planning consists of a single assessment and a single conclusion, under which two sets of circumstances are considered: normal market conditions and system wide events.

The SRB takes into account system-wide events in resolution planning by assuming that the failure of a bank takes place in a situation where the rest of the banking system is affected by an adverse scenario,

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² https://srb.europa.eu/sites/default/files/2019-06-28_draft_pia_paper_v12.pdf

³ Article 14(2) Single Resolution Mechanism Regulation (SRMR) and Article 31(2) Bank Recovery and Resolution Directive (BRRD).

⁴ Article 18(5) SRMR; Article 32(5) BRRD.

⁵ As stated in art. 8(6) SRMR and art. 10(3) BRRD, "The resolution plan shall take into consideration relevant scenarios including that the event of failure may be idiosyncratic or may occur at a time of broader financial instability or system wide events".

such as that underlying the EU-wide stress test performed by the relevant authorities. The estimated impact on banks' capital reflects the effects of an underlying extreme but plausible macroeconomic deterioration affecting all banks simultaneously. After having weakened the rest of the banking system with a depletion of CET1 in line with the outcome of the stress test, the PIA takes into account the direct and indirect contagion effects caused by the failing bank.

It assesses whether the resolution objectives are fulfilled under such scenario to the same extent by the preferred resolution strategy – liquidation or resolution – under normal market circumstances. As a result of this assessment, it is possible that the strategy changes from liquidation to resolution. If a resolution strategy was already adopted under normal market circumstances, it has to be decided whether to confirm the same resolution tool or adopt another one.

This PIA policy enhancement is being implemented in the current resolution planning cycle. The consideration of SWE takes place according to the following successive steps, alongside those described in the existing PIA framework:

- ▶ Assessing the impact on the five resolution objectives of a bank's failure under normal insolvency proceedings in normal market circumstances and under a scenario where the rest of the banks are weakened by a system-wide event.
- ▶ Selecting the preferred and variant resolution strategies. If resolution objectives are at risk, internal resolution teams (IRTs) should assess the feasibility of the preferred resolution strategy under a system-wide event.
- ▶ Assessing whether winding up the bank under normal insolvency proceedings meets the resolution objectives to the same extent as resolution, also under system-wide event. If this is not the case or there is a doubt, the IRT should consider resolution as the preferred strategy and prepare the resolution strategy consistently with existing SRB policies.

When performing the assessment of the impact on each resolution objective, the SRB relies on both qualitative and quantitative information. The qualitative assessment takes into account how bank and country specific factors increase or reduce financial stability risk due to the failure of the bank under the SWE scenario. The quantitative assessment is conducted using the same methodology as for the PIA analysis under the assumption of a bank's failure under normal market circumstances, however in a context where the rest of the banking system has been affected by an adverse scenario, as described above.

Moving forward, the SRB is considering whether further enhancements to its PIA framework are needed. Areas of consideration, among other technical improvements, concern the protection of covered deposits and the scope of critical functions⁶.

⁶ See the S. Laviola blog 'System-wide events in the Public Interest Assessment', published in the SRB website.