F. Resolution

While the banking sector has withstood the crises and shocks of recent years relatively well and continues to fulfil its role of financing the economy, significant changes in the macroeconomic environment and the associated uncertainties have made it more necessary than ever to strengthen the second pillar of the banking union so as to be able to resolve potential crises affecting a European banking group in an orderly manner. The resolution of the Slovenian and Croatian subsidiaries of the Sberbank group in February 2022 demonstrated that the resolution framework is both robust and sufficiently flexible to deal effectively with the failure of a small group. However, it is important not to rest on this success and to continue to develop the resolution framework further, to ensure that it can cope with more complex resolution cases.

Developments are mainly focused in three areas. First, during the year under review, legislative changes were initiated or finalised to strengthen the resolution framework. To this end, lessons were drawn from the first years of application of the framework, and its scope was extended from credit institutions and investment firms to other financial actors such as central counterparties and insurance and reinsurance undertakings. Second and in parallel, the resolution authorities of the banking union defined, under the auspices of the Single Resolution Board (SRB), a programme to be followed by each European banking group in order to achieve a minimum level of resolvability by the end of 2023. Finally, 2023 is also the last year of the transition period for the establishment of the Single Resolution Fund. These projects and achievements demonstrate the progress that has already been made, but highlight the work

that remains to be done to ensure the resolvability of the European financial sector.

1. Statutory and regulatory framework

1.1 Credit institutions and stockbroking firms

Resolution framework

After several months of negotiations, Eurogroup finance ministers agreed in June 2022 on a plan for the future of the banking union. While the creation of the banking union in 2014 was a powerful response to the financial crisis, it remains incomplete to date. Recognising this, the Eurogroup decided, as a first step towards final completion of the banking union, to strengthen the framework for crisis management and national deposit guarantee schemes. This first step includes four main elements.

First, the public interest assessment should be clarified and harmonised across the European Union. The public interest assessment determines whether an institution that is failing or likely to fail can be exempted from the normal insolvency proceedings by applying resolution tools. Although the Bank Recovery and Resolution Directive (BRRD)[1] sets out the main factors to be considered by resolution authorities when carrying out this assessment, it was found that resolution authorities across the EU are applying differing practices. Consequently, it is necessary to further clarify and harmonise this assessment so that similar credit institutions are treated in a consistent manner across the EU.

Secondly, some of the clarifications to be made to the public interest assessment should lead to a broader application of resolution tools, including to smaller and medium-sized banks. Such broadening is desirable, as it will allow the failure of a larger number of credit institutions to be resolved within the existing banking union framework, led by the SRB. However, this raises the question of how resolution should be financed. The Eurogroup has identified two possible sources of funding, namely credit institutions' own resources, through the Minimum Requirement for Own Funds and Eligible Liabilities (MREL), and industry resources, such as industry-funded schemes.

Thirdly, the Eurogroup calls for harmonisation of the use of national deposit guarantee schemes in the event of a crisis. Currently, the Deposit Guarantee Schemes Directive (DGSD)[2] allows Member States to authorise their national deposit guarantee schemes to intervene pre-emptively to prevent the failure of a credit institution, provided that such intervention would not be more costly than paying out deposits. A number of Member States, including Belgium, have not made use of this option, which means such intervention is not possible in every Member State. The aim of harmonisation is to make such intervention more consistent, credible and predictable.

The fourth element identified by the Eurogroup concerns the harmonisation of certain features of national insolvency regimes, to make them more consistent with the principles of the resolution framework. In particular, the ranking of deposits in the hierarchy of creditors should be harmonised.

The above aspects should be implemented through amendments to the BRRD and the DGSD, for which the European Commission will present a proposal in the first quarter of 2023.

As regards implementation of the resolution framework, the EBA published new guidelines on improving resolvability in January 2022.[3] These guidelines, which apply to both institutions and resolution authorities, cover operational continuity, access to financial market infrastructures, funding and liquidity in resolution, bail-in execution, business reorganisation and communication. The EBA guidelines, which will enter into force on 1 January 2024, were transposed by the Bank in its circular on the EBA guidelines on crisis management.[4]

1 Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012 of the European Parliament and of the Council.

2 Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes.

3 Guidelines EBA/GL/2022/01 of 13 January 2022 on improving resolvability for institutions and resolution authorities.

4 Circular NBB_2022_11 – EBA guidelines on crisis management.

MREL

In 2022, work continued on the gradual implementation of the MREL framework introduced by the BRRD2,[1] with which credit institutions must comply fully from 1 January 2024. However, the European legislature also wished to clarify certain details of this framework during the year under review, by means of a regulation.[2] This regulation provides two clarifications, mainly related to the CRR.[3] The first clarification concerns the calculation of the total loss absorbing capacity (TLAC) of global systemically important institutions. For instruments issued by subsidiaries that do not belong to the same resolution group as the resolution entity, a distinction will be made between issuances governed by the law of a country that has a legally enforceable resolution framework and those governed by the law of a third country with no such framework. The second clarification concerns the treatment of instruments eligible for internal MREL that are indirectly subscribed by the resolution entity, where both the resolution entity and the subsidiary through which the subscription takes place belong to the same resolution group. From 2024 onwards, these instruments must be deducted from the stock of internal MREL eligible instruments of the subsidiary that subscribed to them. This deduction ensures that the same internal MREL eligible instruments are not used by multiple entities in a resolution group to comply with the MREL.

It is important that the internal MREL of systemically important subsidiaries be calibrated with a buffer to ensure market confidence. While eliminating the double counting of internal MREL eligible instruments is crucial for the implementation of single point of entry (SPE) strategies, it is also essential that internal MREL is calibrated correctly. Indeed, under-calibration of this requirement could jeopardise the implementation of the SPE strategy, by preventing the full flow of losses from the subsidiary to its parent company. Conversely, over-calibration could be viewed as a source of inefficiency. In this context, the Bank considers it important that the internal MREL of subsidiaries qualified as systemically important be calibrated with a buffer to ensure market confidence, in line with the BRRD. This is not necessarily allowed in the SRB's MREL policy.

Furthermore, to strengthen the credibility of the SPE strategy, the SRB launched a project during the year under review to test the strategy and identify potential obstacles to its implementation. Although the SPE strategy is explicitly set out in the statutory resolution framework, there is a possibility that it could favour a group over its constituent legal entities. As a result, the strategy could conflict with legal principles on preserving the corporate interest of the companies forming a group or with the principle that no creditor should incur more losses than it would have to bear in the event of liquidation under normal insolvency proceedings, taking into account that liquidation also occurs at the level of individual legal entities. The SRB's project is not only crucial for the Single Resolution Mechanism (SRM), given that the SPE strategy is the resolution strategy applied to 80 % of banking groups under the SRB's jurisdiction, but also essential for the Belgian banking sector, which includes several European banking groups operating via subsidiaries.

Finally, since the entry into force of the second Single Resolution Mechanism Regulation (SRMR2)[4] at the end of 2020, the Bank has the possibility to ask the SRB to apply the MREL regime for top-tier institutions to certain non-top tier resolution entities (the fishing option). During the year under review, the Bank informed the industry, through a circular issued by its Resolution Board,[5] of the latter's methodology and the assessment criteria it systematically considers and applies each time it makes use of this option. In particular, the circular describes how the Resolution Board has so far assessed whether an institution meets the conditions to exercise the fishing option and how it assesses the proportionality of its decisions in this regard.

1 Directive (EU) 2019/879 of the European Parliament and of the Council of 20 May 2019 amending Directive 2014/59/EU as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms and Directive 98/26/EC (BRRD2).

2 Regulation (EU) 2022/2036 of the European Parliament and of the Council of 19 October 2022 amending Regulation (EU) No 575/2013 and Directive 2014/59/EU as regards the prudential treatment of global systemically important institutions with a multiple-point-of-entry resolution strategy and methods for the indirect subscription of instruments eligible for meeting the minimum requirement for own funds and eligible liabilities.

3 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

4 Regulation (EU) 2019/877 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 806/2014 as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms.

5 Circular of the Resolution College of the National Bank of Belgium of 19 September 2022 specifying the methodology followed and assessment criteria considered when deciding whether to apply the MREL for top-tier institutions to a non-top tier institution.

1.2 Insurance and reinsurance undertakings

The year under review saw further negotiations on the European Commission's Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of insurance and reinsurance undertakings (hereinafter referred to as the IRRD proposal).[1] The proposal does not cover two issues which the Bank considers important: the need for a financing mechanism and the arrangements for cooperation between authorities in cases involving financial conglomerates.

The IRRD proposal does not include an obligation to establish a resolution fund. However, where one or more resolution instruments are applied, it is required to ensure that shareholders and/or creditors that would incur losses greater than those they would have incurred had the company been wound up under normal insolvency procedures be compensated. In order to comply with this obligation and to ensure a level playing field between the Member States, the Bank considers it important to include in the IRRD proposal an obligation to establish a funding mechanism.

Furthermore, the IRRD proposal does not pay particular attention to financial conglomerates. The BRRD, together with the SRMR, sets out a resolution framework for credit institutions and investment firms, while the IRRD proposal details a framework modelled on it for (re)insurers. The Bank is of the opinion that the potential impact of the coexistence of these two frameworks on the resolution of credit institutions, investment firms and/or (re)insurers that form part of financial conglomerates should be addressed without delay. Strong but balanced consistency between the two frameworks should be ensured from the outset. To this end, a number of guiding principles could be included in the IRRD proposal. For example, the respective resolution authorities of (re)insurers, on the one hand, and credit institutions and investment firms, on the other, should have autonomous decision-making powers to be exercised on equal footing and should cooperate in good faith. They should also exchange all relevant information necessary for the performance of their respective tasks. To this end, they could, for example, be granted observer status in resolution colleges. Finally, the functioning of the resolution framework should be reassessed after some time. To this end, the proposal should include a review clause.

1 Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of insurance and reinsurance undertakings and amending Directives 2002/47/EC, 2004/25/EC, 2009/138/EC (EU), 2017/1132 and Regulations (EU) No 1094/2010 and (EU) No 648/2012, see also section 1.3 of part E "Resolution" of the 2021 annual report.

BOX 12

Resolution of Sberbank Europe AG

The crisis that affected the European branch of the Russian Sberbank group, in the wake of the sanctions imposed in response to Russia's invasion of Ukraine, was a further test of the resolution rules applicable at European level. Several of the group's institutions were subject to resolution proceedings in the course of 2022.

The Sberbank group, which has a Russian parent company, was present in Europe through its Austrian subsidiary, Sberbank Europe AG, which acted as the parent company for the group's European branches. Sberbank Europe AG (with a balance sheet total of € 3.6 billion on an individual basis) operated in Germany through a branch office and had seven subsidiaries, four of which were located in the EU,

specifically in Slovenia (balance sheet total of € 1.8 billion), Croatia (balance sheet total of € 1.5 billion), Hungary (balance sheet total of € 1.4 billion) and the Czech Republic (balance sheet total of € 3.4 billion). Of the remaining three subsidiaries, two were located in Bosnia (balance sheet total of € 0.8 and € 0.5 billion) and one in Serbia (balance sheet total of € 1.3 billion).

As a result of the intensification of geopolitical tensions between Russia and Ukraine starting in November 2021 and culminating in Russia's invasion of Ukraine on 24 February 2022, the European Union and the United States announced sanctions against Russia. These sanctions and the resulting reputational damage had an immediate impact on the liquidity of the European operations of the Sberbank group.

On 27 February 2022, having regard to the precariousness of their liquidity position, the ECB deemed the Austrian parent company and its Croatian and Slovenian subsidiaries failing or likely to fail. That same day, the three institutions were placed under a moratorium by the competent resolution authorities further to the instructions of the SRB. The moratorium, which involved the suspension of certain contractual obligations for a period of up to two working days, was intended to allow the SRB to assess whether resolution actions against the three institutions were required in the public interest and, if so, to choose the most appropriate resolution tool and prepare for its implementation.

On 1 March 2022, the SRB decided that the Austrian parent company did not meet the public interest test and that it should therefore be liquidated in accordance with the normal national insolvency procedure. As regards the Croatian and Slovenian subsidiaries, the SRB found that they did meet the public interest test. Both subsidiaries were thus resolved by means of the sale of business tool, pursuant to which they were transferred to the Hrvatska Postanska Banka in Croatia and the Nova Ljubljanska Banka in Slovenia, respectively. As regards the Hungarian and Czech subsidiaries, the competent national resolution authorities considered that they did not meet the public interest test. These institutions therefore also had to be liquidated under the normal national insolvency regimes.

This approach deviated from the resolution strategy foreseen in the Sberbank group's resolution plan which provided for the application of the bail-in tool at the level of the Austrian parent company and was therefore based on a single point of entry (SPE) resolution strategy. However, as the SPE strategy was insufficient to contain the rapidly spreading liquidity crisis, the SRB was forced to derogate from it and to take resolution actions at the level of the Slovenian and Croatian subsidiaries. The SRB thus applied a multiple point of entry (MPE) resolution strategy.[1]

The approach adopted in the context of the management of the Sberbank group's liquidity crisis demonstrates that the strategy set out in the resolution plan remains indicative and leaves room to take into account the concrete circumstances of an effective crisis. For these reasons, the Bank considers it important to carefully examine the intrinsic limitations of the SPE strategy, from both a legal and operational perspective. It is imperative that these limitations are taken into account in the resolution planning phase so that options can be kept open, insofar as possible, in the event of an effective crisis.

1 See Recital (4) to the BRRD2: "In the single entry point resolution strategy, only one entity of the group (typically the parent undertaking) is subject to resolution proceedings. Other group entities (typically operating subsidiaries) are not placed in resolution, but transfer their losses and recapitalisation needs to the entity to be resolved. In the multiple entry point resolution strategy, several entities in the group could be subject to resolution."

2. Resolvability of credit institutions and stockbroking firms

2.1 Institutions falling directly under the Bank's authority

As a resolution authority, the Bank is directly responsible for less significant institutions (LSIs). The Bank draws up resolution plans for these institutions, on which MREL decisions are based after a decision by the Bank's Resolution Board. In 2022, the Bank adopted two formal MREL decisions, based on resolution plans that had been updated in previous resolution cycles. Resolution plans for 13 LSIs were updated in the 2022 resolution cycle. Of these, 11 were developed on the basis of simplified obligations and are therefore based on a two-year cycle. Since a resolution cycle does not coincide with the calendar year but rather runs from May to April, formal MREL decisions for the 2022 resolution cycle will only be adopted in 2023.

For institutions for which it is directly responsible, the Bank is required to follow the SRB's LSI guidelines. This resulted in two new developments for the 2022 resolution cycle. First, the assessment of the resolvability of institutions whose resolution plan states that the public interest test is met in the event of failure has been harmonised using the so-called "heatmap" tool. To this end, for each principle set out in the SRB Expectations for Banks,[1] a score ranging from low to high is given for the importance of the principle in question and a score ranging from zero to three is given for the extent to which the institution meets the principle. Second, a more harmonised approach is used to assess the impact of a systemic crisis on financial stability. The preservation of financial stability is indeed the second resolution objective pursued in the analysis of whether the public interest test is met. However, these two developments have not had a major impact on the resolution strategies of institutions for which the Bank is directly responsible.

In Belgium, LSIs are divided into three categories, each of which is subject to a different MREL calibration methodology. The first category includes institutions whose failure is not likely to be detrimental to the stability of the financial system in Belgium and which can therefore be wound up under normal insolvency proceedings. This category is subject to MREL equivalent to the amount needed to absorb the institution's losses. In other words, the MREL of these institutions corresponds to their capital requirements.

The second category comprises institutions whose resolution plan provides that they are likely to be able to be wound up under normal insolvency proceedings but whose failure could, in certain specific circumstances, notably in the context of a systemic crisis, impact the stability of the Belgian financial system, for example due to their links with the Belgian real economy and their level of (covered) deposits. For this category, the amount needed to cover loss absorption was adjusted upwards, so that their MREL exceeds their capital requirements. However, this upward revision was calibrated in accordance with the limits imposed by regulations and the SRB, meaning the MREL remains lower than for institutions in the third category.

The third category includes institutions whose resolution plan provides that the public interest test will be met in the event of a failure. In such cases, the resolution tools and powers should be used. In this context, the MREL incorporates not only an amount necessary to absorb losses but also an amount to ensure recapitalisation and market confidence at the end of the resolution process.

The Bank's Resolution Board decided in December 2021 to also monitor, as from 2022, the MREL capacity of institutions in the second category based on half-year reporting. The latter is a simplified version of the mandatory MREL and TLAC reporting for institutions whose MREL consists of a loss-absorption amount and an amount intended to ensure recapitalisation. This allows for smoother and more accurate monitoring of MREL for smaller institutions. For LSIs whose MREL is limited to a loss-absorption amount, this additional reporting is not necessary, as they meet the MREL through the own fund instruments, which are monitored through supervisory reporting.

2.2 Establishments falling under the authority of the SRB

The SRB is the competent resolution authority for significant institutions (SIs) and for cross-border LSIs.

1 See https://www.srb.europa.eu/system/files/media/document/efb_main_doc_final_web_0_0.pdf.

In addition to resolution plans, specific aspects of resolvability are further developed during each resolution planning cycle. The SRB Expectations for Banks serve as a guideline for the setting of annual priorities. The 2022 resolution planning cycle focused on three priorities, namely: (a) the identification of assets that could be used as collateral in order to obtain additional liquidity; in this context, institutions are asked to carry out an analysis of assets that are not used as collateral under normal circumstances; (b) plans to reorganise the business after application of the bail-in tool; and (c) the possibilities to split a resolution group or entity. Institutions with a bail-in strategy were also required to conduct a dry run before the end of 2022 and to use the lessons learned to make their strategy more operational. Liquidity remains a priority for the 2023 resolution cycle. Institutions have been asked to continue to work on the operationalisation of their resolution strategy. For resolution groups, this also applies to the mechanisms to transfer losses to the resolution entity and capital to subsidiaries. By the end of 2023, all institutions should meet the principles set out in the SRB Expectations for Banks.

In addition to the priorities applicable to all institutions under the SRB's authority, specific priorities can also be defined for each one. This is done on the basis of the heatmap tool mentioned above, with the understanding that each institution is checked to see whether it is on track to be resolvable by the end of 2023.

Since 1 January 2022, MREL, based on the SRMR2 rules, has been binding on all Belgian SIs. Each quarter, an analysis is carried out on the basis of the MREL and TLAC reporting in order to determine whether institutions comply with their MREL. In the course of 2022, a number of breaches were identified in this respect, which concerned both internal and external MREL and were based on both risk-weighted and non-risk-weighted MREL. However, all institutions concerned took prompt action to remedy the shortcomings identified and to adapt their risk management frameworks to prevent similar situations from arising in the future.

3. Establishment of resolution funding arrangements

The BRRD provides that a resolution fund financed by contributions from credit institutions and investment firms must be established in each Member State. By 31 December 2024, each resolution fund must reach a target level of at least 1 % of the total amount of covered deposits.

The SRMR established the Single Resolution Fund (SRF) within the banking union on 1 January 2016. The SRF replaced the national resolution funds for credit institutions, investment firms and financial institutions subject to the ECB's consolidated supervision. The SRF supports the actions taken by resolution authorities when a banking group fails. It may guarantee the assets or liabilities of a failing institution, grant loans, acquire certain of its assets, or, under specific conditions, make contributions to it. The SRF may also intervene in cases involving a bridge institution, an asset management structure or even a purchaser in the event of a sale of business. However, the resolution fund cannot directly absorb the losses of an institution under resolution.

In 2022, the institutions subject to the SRF jointly contributed € 13.7 billion (compared to € 10.4 billion in 2021). Of these contributions, € 447.6 million come from institutions subject to Belgian law, compared to € 346.9 million in 2021. This increase was mainly due to the strong rise in the volume of covered deposits, which determines the SRF's target amount. The 2022 contributions increased the SRF envelope to € 66 billion. The SRB estimates that, by the end of the transition period for establishment of the fund, which concludes in 2023, the SRF's contributions could total around € 80 billion. A further increase in covered deposits in the coming years could result in a higher amount, however.

In addition to its own resources, since the beginning of 2022, the SRF has had a revolving credit line from the European Stability Mechanism. This is an additional source of funding which can be drawn on in an emergency and which, if necessary, can double the size of the SRF. This credit line is initially fed by public funds in order to be able to immediately restore market confidence. It is financed by the Member States of the banking union and must be repaid by all institutions subject to the banking union contribution within a few years from its use.

Institutions not subject to the SRF, i.e. Belgian branches of third-country credit institutions or investment firms, as well as stockbroking firms incorporated under Belgian law that are not subject to the ECB's consolidated supervision through their parent company, are required to contribute to the national resolution fund. After payment of the 2022 contributions, the fund amounted to almost € 2.3 million. In 2023, it should reach € 2.6 million, which now constitutes the fund's target.