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Title: Proportionating Rules on Bank Crisis Prevention and Management to the Case of Retail Banks: An Analysis on the European and National Legal Framework (Pro. Re. Ba.)

Policy Report

Executive Summary

The European crisis management and deposit insurance framework (CMDI) represents the core of the Banking Union's architecture for handling bank distress. However, the experience of the past decade has revealed structural inconsistencies, particularly regarding the treatment of small and medium-sized banks. While the regulatory framework formally applies to all institutions, in practice resolution tools have primarily been used for large banks, while smaller institutions have often been managed...

The report analyses the CMDI framework through the lens of proportionality. Proportionality should not be understood merely as a limit on regulatory intervention, but as a structural principle guiding the design and application of crisis-management tools. A proportionate framework ensures that resolution planning, funding requirements, supervisory intervention, and depositor protection mechanisms correspond to the size, complexity, funding structure, and systemic relevance of different institutions.

The report highlights several structural tensions within the current regime. These include the restrictive interpretation of the public-interest test, the funding challenges associated with MREL requirements for smaller and deposit-funded banks, inconsistencies between State aid rules and resolution mechanisms, and the limited operational role of deposit guarantee schemes (DGSs) in crisis prevention. The report also examines the lessons emerging from recent banking crises and their implications...

The CMDI reform represents an attempt to address these weaknesses by expanding the practical scope of resolution, improving the usability of DGS interventions, and enhancing coordination between resolution and insolvency regimes. However, several structural challenges remain. Achieving a truly proportionate crisis-management framework will require further reforms in areas such as public-interest assessment, funding arrangements, preventive intervention of DGSs and governance arrangements.

Policy Recommendations

1. Clarify and broaden the public-interest assessment to ensure that resolution tools can be applied to a wider range of banks.

2. Strengthen the role of transfer tools, including sale-of-business and bridge-bank strategies, particularly for smaller institutions.
3. Introduce greater flexibility in MREL calibration to reflect differences in business models and funding structures.
4. Reconsider the application of the 8% TLOF threshold for banks with deposit-based funding models.
5. Enhance the role of DGSs in preventive interventions and transfer operations.
6. Revise the least-cost test so that it can account for indirect financial-stability costs.
7. Super-priority status for deposits should be eliminated to ensure that DGSs can operate more effectively, both in a preventive capacity and in the context of resolution.
8. Clarify the legal treatment of DGS resources to reduce uncertainty in their interaction with State aid rules.
9. Improve coordination between resolution authorities, supervisory authorities, and DGS governance structures.
10. Develop clearer criteria for evaluating systemic relevance beyond simple size thresholds.
11. Promote institutional diversity within the European banking system to enhance resilience.
12. Strengthen early-intervention mechanisms to address deteriorating bank conditions at an earlier stage.
13. Improve transparency and reasoning in resolution-planning decisions, including MREL calibration.
14. Align State aid rules more closely with the resolution framework to reduce regulatory inconsistencies.
15. Encourage greater harmonisation of national bank-insolvency regimes within the Banking Union.
16. Ensure that creditor-protection mechanisms such as the NCWO principle remain robust and credible.

Analytical Pills

The following analytical pills summarise the main structural features of the CMDI framework and the proportionality challenges identified in this report. They provide a concise overview of the policy issues discussed in the analytical sections.

I. Foundations

Pill 1 — Proportionality as the organising principle of the CMDI framework

Proportionality should function as the organising principle of the entire crisis-management architecture. It should guide the choice between prevention, early intervention, resolution, and liquidation, as well as funding. A proportionate regime does not mean lighter regulation; it means that the tools and procedures applied correspond to the size, complexity, funding structure and systemic relevance of each institution.

Pill 2 — Structural imbalance in the original CMDI framework

The CMDI was largely designed for institutions considered too big or too complex to fail. In practice, however, most banking crises concern smaller or medium-sized institutions. These banks are often excluded from effective resolution and instead directed toward national insolvency procedures, creating an imbalance that weakens proportionality.

Pill 3 — Proportionality across the crisis continuum

Proportionality should apply across the entire crisis continuum. Early intervention, resolution planning, MREL calibration, funding arrangements and insolvency alternatives must operate coherently. If planning is based on one strategy but crises are handled through another, regulatory obligations may become disproportionate and ineffective.

Pill 4 — Institutional proportionality

Proportionality concerns not only substantive rules but also institutional design. The allocation of powers among supervisory authorities, resolution authorities, European institutions and national bodies affects the speed and legitimacy of crisis decisions. Efficient coordination and clear responsibilities are essential for proportionate crisis management.

Pill 5 — CMDI reform as structural rebalancing

The reform of the CMDI framework seeks to rebalance the system by making resolution more usable for smaller banks, improving the interaction between resolution and insolvency regimes, and strengthening the role of DGSs as crisis-management tools.

II. Smaller Banks and Economic Relevance

Pill 6 — Smaller banks and the real economy

Smaller and regional banks play an essential role in financing small and medium-sized enterprises and maintaining access to financial services in local communities. A crisis-management regime that indirectly favours only large banking groups risks weakening financial inclusion and regional economic stability.

Pill 7 — Concentration and systemic risk

The consolidation of the banking sector may improve efficiency but can also increase systemic concentration. If the financial system becomes dominated only by a small number of very large banks, the risks associated with institutions that are too big to fail may intensify.

Pill 8 — Institutional diversity as stability factor

A resilient banking ecosystem requires diversity in ownership structures, business models and institutional profiles. Cooperative banks, regional banks and mutual structures contribute to systemic resilience and support local economic development.

Pill 9 — Limits of size-based classification

Asset size alone is not a sufficient indicator of systemic relevance. Funding structure, depositor composition and economic interconnectedness may be equally important in determining the potential impact of a bank failure.

III. Public Interest Assessment

Pill 10 — Central role of the public-interest test

The public-interest assessment determines whether a failing bank will enter resolution or be handled through national insolvency proceedings. This decision strongly influences the allocation of losses and the continuity of banking functions.

Pill 11 — Narrow interpretation of public interest

In practice, the public-interest requirement has often been interpreted restrictively, limiting the use of resolution tools. As a result, many bank failures have been managed through national procedures instead of European resolution mechanisms.

Pill 12 — Predictability and proportionality

A proportionate framework requires that market participants can anticipate how crises will be handled. Clearer criteria for the public-interest assessment would enhance legal certainty and market discipline.

Pill 13 — Lessons from the Veneto banks

Cases such as the Veneto banks illustrate the difficulty of applying the public-interest test. Although resolution was not applied, significant public intervention was ultimately required to manage the liquidation and preserve financial stability. It is therefore essential that there be no double assessment of the public interest; if this requirement is not met for the application of the resolution, it cannot be met for the granting of liquidation aid.

Pill 14 — Liquidation may still involve public interest

Even when authorities choose insolvency proceedings, the broader economic impact of a bank failure may still require measures aimed at protecting depositors, maintaining credit flows and preserving financial stability.

Pill 15 — CMDI reform and broader resolution scope

The CMDI reform aims to make resolution a realistic option for a larger number of banks by clarifying the public-interest assessment and improving the interaction between resolution and insolvency frameworks.

Pill 16 — Limits of reform

Despite these reforms, political considerations and national preferences may still influence the choice between resolution and liquidation, potentially limiting the effectiveness of the revised framework.

IV. Resolution Planning and MREL

Pill 17 — Role of MREL

The Minimum Requirement for Own Funds and Eligible Liabilities ensures that banks maintain sufficient loss-absorbing capacity to support orderly resolution without relying on taxpayers.

Pill 18 — Funding-structure asymmetries

Banks that rely heavily on deposits may find it difficult to issue sufficient bail-inable instruments to meet MREL requirements, creating structural asymmetries within the framework.

Pill 19 — Discretion in MREL calibration

Resolution authorities have significant discretion when setting MREL levels. While this flexibility allows adaptation to individual institutions, it also raises questions about consistency and proportionality.

Pill 20 — Depositor-reliance classification

Deposit-based banks may depend on uninsured deposits or other fragile funding sources in order to satisfy regulatory requirements related to resolution planning. Classifying banks according to their reliance on deposits helps identify institutions that may face structural difficulties in meeting loss-absorption requirements.

Pill 21 — Strategy-sensitive calibration

MREL calibration should reflect the resolution strategy that is realistically expected to be applied to a given institution. While the existing framework has largely been designed around bail-in strategies, transfer tools are increasingly used in practice, particularly for small and

medium-sized banks. Where transfer strategies represent the most credible option, the current MREL framework may generate disproportionate requirements.

Pill 22 — Artificial intelligence and proportionality in resolution decisions

Artificial intelligence tools could support resolution authorities in assessing institutional risk profiles and calibrating regulatory requirements such as MREL. By enabling more granular analysis of bank-specific characteristics, these technologies could facilitate a more proportionate and dynamic approach to crisis-management decisions.

Pill 23 — Coherence between supervision and resolution

Divergences may arise between supervisory decisions and resolution planning, particularly in relation to waivers for capital, liquidity and internal MREL requirements. These inconsistencies can be especially relevant for banking networks and cross-border groups. A proportionate framework requires stronger alignment between supervisory and resolution perspectives, with divergences justified only where they derive from the legal distinction between going-concern supervision and gone-concern resolution scenarios.

Pill 24 - Proportionality and coherence in MREL and crisis-management decisions

MREL setting and resolution planning rely on forward-looking assessments under uncertainty, particularly complex for banking networks and groups. Inconsistencies can be found between supervisory and resolution approaches, notably in the granting of capital, liquidity, and iMREL waivers, especially for cross-border groups. A proportional framework requires greater coherence between supervision and resolution, with divergences justified only where legally mandated by differences between going-concern and resolution scenarios.

Pill 25 — Limits of the 8% TLOF benchmark

The minimum benchmark requiring creditor participation equivalent to at least 8% of Total Liabilities and Own Funds (TLOF) was primarily designed with bail-in strategies in mind. While appropriate in that context, the same threshold may prove excessive when resolution relies on transfer tools. Applying a uniform benchmark across fundamentally different resolution strategies risks limiting the effective use of market-based solutions for smaller institutions.

V. Institutional Protection Schemes and Resolution Strategy

Pill 26 — Regulatory consistency between IPSs and banking groups

Institutional Protection Schemes (IPSs) and banking groups represent distinct legal and organisational structures, yet they perform broadly comparable stabilisation functions within the banking system. The current EU prudential framework combines elements of functional alignment with persistent regulatory asymmetries, resulting in differentiated regulatory treatment that is not always justified by underlying risk considerations. A more coherent regulatory approach would enhance proportionality.

Pill 27 — Role of IPSs in resolution and public-interest assessment

In resolution planning, IPS membership is not considered on a consolidated basis but remains relevant as a factor that may reduce the likelihood that resolution becomes necessary by providing a credible private-sector stabilisation mechanism. IPSs can contribute to both failure prevention and contagion mitigation through pre-arranged support arrangements. Their stabilising role should therefore be explicitly considered in public-interest assessments and in the calibration of MREL requirements.

VI. Early Intervention

Pill 28 — Role of early intervention

Early intervention measures (EIMs) aim to restore a bank's viability before it reaches the point of failure, bridging the gap between supervision and resolution. Also in this field proportionality plays a fundamental role. The current system provides for the application of EIMs based on the combination of the principles of graduality and proportionality. It is, however, more effective to apply the principle of proportionality exclusively.

VII. Deposit Guarantee Schemes

Pill 29— Expanding functions of DGSs

Deposit guarantee schemes play a broader role in crisis management, including preventive interventions and support for transfer strategies. Both kind of interventions are essential to preserve banking functions and maintain depositor confidence.

Pill 30 — Least-cost principle

DGS interventions must respect the least-cost principle, ensuring that the cost of intervention does not exceed the cost of reimbursing depositors. However, a narrow interpretation of the least-cost principle may overlook broader economic and financial-stability costs associated with liquidation.

Pill 31 — Structural distortions

The criteria for determining the least cost should be more harmonized and take into account not only the cost of deposits net of reimbursement. To that end, the priority status that deposits hold in the hierarchy of creditors should be eliminated, as it creates obstacles to the least-cost test and thus prevents the use of preventive and alternative measures.

Pill 32 - Importance of governance and decision making autonomy

The governance structure of DGSs plays a key role in determining their effectiveness and independence. Autonomous decision-making is essential to ensure that DGS resources are used efficiently and consistently; moreover, decision-making autonomy is a prerequisite for avoiding the application of state aid rules (Tercas case).

Pill 33 — Persistent fragmentation

DGS governance remains heterogeneous across Member States, creating potential legal and operational asymmetries.

Pill 34 — Nature of DGS resources

The classification of DGS funds raises important questions about the boundary between private industry-funded mechanisms and public financial support.

Pill 35 — Limits of market-operator analogies

The activities of DGSs differ from those of private market investors because their purpose is systemic stability rather than profit generation.

IX. State Aid, Burden-Sharing and Creditor Rights

Pill 36 — Divergence between State aid burden-sharing and bail-in

State aid burden-sharing and resolution bail-in follow different legal logics and apply to different sets of liabilities, creating potential inconsistencies.

Pill 37 — Property rights and NCWO

Subordinated creditors should not receive less in economic terms than what their instrument would have been worth if no State aid were to be granted.

X. The institutional architecture of the Single Resolution Mechanism

Pill 38 — Evolution of the Meroni doctrine in bank resolution governance

The traditional Meroni doctrine limited the delegation of discretionary powers to European agencies. Recent case law of the Court of Justice has progressively adapted this doctrine to the institutional architecture of the Banking Union. Rather than prohibiting delegation, the Court now emphasises the existence of clearly circumscribed powers, institutional oversight and judicial review, reflecting the growing role of specialised agencies such as the Single Resolution Board (SRB).

Pill 39 — Legitimacy of SRB discretion in resolution procedures

The Banco Popular judgment recognised the legitimacy of discretionary powers exercised by the SRB in resolution procedures. The Court accepted that technically complex assessments can be delegated to specialised agencies, provided that the European Commission participates in the adoption of the final resolution scheme, thereby supplying an additional layer of institutional legitimacy.

Pill 40 — Limits of agency legitimacy beyond resolution decisions

The legitimacy derived from the Commission's involvement is largely confined to formal resolution decisions. It is less clearly applicable to other areas of SRB activity, such as MREL determination, instructions to national resolution authorities or the management of the Single Resolution Fund, where political oversight is more limited.

Pill 41 — Institutional proportionality in crisis-management governance

The effectiveness of crisis management also depends on the institutional architecture governing supervisory and resolution decisions. A proportionate allocation of competences between European and national authorities can improve coordination, ensure timely interventions and strengthen the overall legitimacy of Banking Union governance.

XI – Cooperative banks

Pill 42 — Financing shares as crisis-management instruments in cooperative banking

The issuance of financing shares by cooperative credit banks provides an instrument to strengthen capital positions while preserving the cooperative structure of these institutions. Within cooperative banking groups, this tool can complement solidarity mechanisms such as cross-guarantee schemes, although it may also increase the influence of financial investors in corporate governance.

Pill 43 — Governance tensions in cooperative banking recapitalisation

The increasing use of financing shares highlights the tension between prudential stability and cooperative governance. While recapitalisation instruments reinforce financial resilience, they may also marginalise cooperative members in decision-making processes, reflecting a regulatory preference for capital stability over purely mutualistic governance structures.