30 August 2016
EBF_022512E

EBF response to EBA report on implementation and design of the MREL framework (EBA/OP/2016/12)

Key points:

- EBF supports the EBA proposal to align the MREL denominator with TLAC i.e. determining MREL as a percentage of RWA and maintaining the leverage exposure as a backstop. To achieve comparability and market transparency between EU and non-EU banks, the EBF believes that EU should not use a MREL ratio expressed as a percentage of total liabilities and own funds.
- The EBA should be mindful of the impact on the MREL calibration arising from potential increases in RWAs under the capital standards recently proposed by the Basel Committee.
- Clarity and consistency across Member States should be ensured with regard to the stacking of CET1 buffers for all banks, including G-SIBs.
- A breach of MREL should not be an automatic indication of failing or likely to fail. A MREL breach should not automatically trigger consequences. Rather the consequences of a breach should be assessed on a case-by-case basis and tailored to accommodate the nature of the breach.
- In the case of G-SIBs, the TLAC requirement should be the reference point.
- The MREL calibration should be closely linked to the resolution strategy for the specific institution, including resolution actions, defined by the resolution authority (there should be no standard/uniform MREL-minimum). If buffers sit on top of the MREL requirement, it would follow, that buffer requirements should not form part of the MREL requirement.
- The application of the RTS should not automatically lead to a higher MREL requirement due to higher capital requirements (e.g. Systemic Risk Buffer or O-SII buffer). The 8% Total Liabilities should not be envisaged as a floor for calibrating the MREL, in particular since this 8% consists of an amount of own funds and liabilities to be bailed-in which is broader than MREL eligible instruments.
- In the case of D-SIBs and other banks a MREL requirement should be set no higher than the TLAC standard requirement based on the bank’s resolution strategy.
- Concerning internal MREL, we call for the introduction of an element of materiality rather than requiring MREL for each subsidiary. Supervisory scope and cooperation between jurisdictions should also be considered for groups operating in the single market or in the banking union.
- Mandatory subordination for G-SIBs should only be required to meet the minimum non-firm specific MREL requirement (subject to the TLAC term sheet exemptions especially the 2.5/3.5% exemption).
- Any decisions about eligibility criteria and/or subordination requirement should duly inform the calibration discussion.

- ◆ The requirement to impose contractual recognition clauses in agreements subject to the laws of a third country should be restricted to agreements which establish liabilities which are eligible for MREL (exclusion of non-MREL-eligible liabilities).

General Remarks

Reference base for MREL requirement

- For the sake of clarity and comparability, both for banks and investors, **the EBF supports the EBA proposal to align the MREL denominator with TLAC i.e. determining MREL as a percentage of RWA with the leverage exposure as a backstop[1]. This would reduce complexity and ensure a more linear and transparent management of the loss absorption requirements across jurisdictions.**
- **However, attention should be paid to the potential impact on the MREL calibration arising from increases in RWAs under the capital standards recently proposed by the Basel Committee.** Furthermore, should the MREL denominator be based upon RWAs, resolution authorities should positively take into account whether banks' assets are oriented to the financing the real economy.
- We agree with the EBA that there is a need for clarification of the total liabilities and own funds used as denominator in various articles of BRRD and in any case for the determination of the 8% bail-in before drawing down the SRF. In this context, as envisaged by the EBA, the EBF supports the full contractual netting option as defined in section 4.1.3 in relation to derivative liabilities and netting rights.

Relationship with regulatory requirements

- **With respect to stacking of CET1 buffers, clarity and consistency across Member States should be ensured regardless of the option for stacking of buffers ultimately adopted, and applied to all banks, including G-SIBs.**
- To bring clarity and certainty for investors as well as banks, the EBF advocates inserting MREL requirements within a different section of CRR than the one concerning 'own funds requirements'. We recommend option a) in the EBF report (section 5.1) this will help avoid misinterpretation with the concept of MDA restrictions.
- EBF suggests that it be made explicitly clear in the report, that if buffers sit on top of the MREL requirement, it would follow, that buffers are not part of the MREL loss absorption amount (i.e. a change in the RTS on MREL is required).
- Furthermore, a resolution authority, when setting the MREL requirement, should not include buffers in the recapitalisation amount. If a bank is allowed to use buffers in times of stress, this should lead to the conclusion that the buffers do not need to be recapitalised immediately if a resolution process is initiated during a financial crisis.
- The EBF does not believe that buffers should operate in such a way that using part of a buffer to satisfy MREL should trigger a buffer breach, and thus set off MDA restrictions, if the bank would otherwise continue to satisfy its capital requirements. Creating MDA restrictions when a bank satisfies its capital requirements, but may need to issue more MREL-eligible debt, is simply counter-productive. Indeed, we do not agree that: "*Stacking capital buffers on top of MREL (i.e. not counting MREL instruments towards the buffers) could mean that a CBR [Combined Buffer Requirement] breach, de facto triggering the application of automatic restrictions on distributions, could in some circumstances happen at high levels of capital. This would be the case when banks choose to meet a significant part of their MREL requirements through own funds rather than eligible liabilities.*" (EBA

[1] Regarding this backstop, we support the EBA proposal to assess the impact of introducing a binding leverage ratio on the level of MREL (p. 38).

interim report, p. 43 sq.). In our view, it is the other way around: stacking capital buffers on top of MREL means not counting the buffers towards the MREL instruments, and not counting MREL instruments towards the buffers. Hence, a bank complying with both capital requirements and MREL whose RWA increases could incur a breach of MREL, but not a breach of the capital conservation buffer (set at 2.5%). Therefore, we agree that: *"The interaction between the stacking of capital buffers and MREL on the one hand, and the rules surrounding MDA restrictions on the other, therefore needs to be carefully considered" (EBA interim report, p. 44),* as, in our view, there should be no interaction. Such automaticity could prove to be highly dangerous and should be eliminated. The EBF can see two ways in which this could be achieved:

A. One approach would be to disconnect MREL from MDA, by stating that buffers are not part of the MREL requirement and that CET 1 used for buffers cannot count towards MREL (which requires a change of the RTS on MREL):
    a. In this way CET 1 in buffers does not 'drop down' to cover MREL requirements, and MDA restrictions would only arise when there was a true shortfall of CET 1.
    b. MREL breaches generated by a lack of eligible liabilities would be clearly identified.
B. An alternative approach would be to state that a breach of buffers due to the use of buffers to meet the MREL requirement should not trigger the same implications as a breach of buffers in order to satisfy capital requirements and should be treated separately in the level 1 text. In particular Article 141 of CRD should not apply in that case.

In addition, examples of the fulfilment of capital and MREL requirements would be very helpful. The EBF sees also scope for improving clarity in the area of setting targets and decision making (e.g. annual decisions of SREP and resolution colleges should be aligned).

Breach of MREL

- Because of the very different purposes they are intended to serve, MREL breaches should not be treated in the same manner as breaches of regulatory capital.
- **A breach of MREL should not be an automatic indication of failing or likely to fail. For example, a bank may be temporarily in breach of its MREL requirement due to a failure to rollover eligible liabilities under stressed market conditions but otherwise be well capitalised, profitable and very liquid.**
- **It follows that a breach of MREL requirements should not automatically trigger consequences. Rather, the consequences should be determined on a case by case basis and tailored to address the specifics of each case. In this regard, it could be helpful to distinguish between the following three types of breaches**:
    - A MREL breach only affecting the minimum level of eligible liabilities for the purposes of a recapitalisation in the event of a resolution without effects on regulatory capital.
    - A MREL breach affecting the regulatory capital (i.e. loss absorbing capacity).
    - A MREL breach affecting both capital requirements (loss absorbing capacity) and the minimum level of eligible liabilities for the purposes of a recapitalisation in the event of a resolution.
- Having made this analysis should help clarify which authority (i.e. supervisory or resolution authority) has the responsibility to intervene.
    - In the first case, this should be an issue primarily for the resolution authority, which would require the institution to develop a plan to re-establish the required MREL-levels). However, this should be done carefully so that the market does not get an impression that the institution would be failing or is close to resolution.
    - In the latter two cases, a capital breach exists, and primary responsibility should lie with the supervisory authorities to engage with the bank and to ensure an action plan to restore the required capital levels.
    - In any case we would welcome a close coordination and cooperation of the supervisory and resolution authorities in monitoring and restoring capital and MREL requirements.

- As a third step, the supervisory or resolution authority measures shall be chosen which are commensurate with the nature of the breach, i.e. the consequences to be drawn from any MREL-breach should be proportionate to the nature of the breach and its effect on the institution and stability and resolvability. The competent authorities is already provided with a broad array of powers to address the breach but should also be afforded a wide degree of discretion if and how to use these powers in order to address the specific situation. In this context, any regulatory measures triggered or enacted under regulatory requirements other than the recovery and resolution regime, in particular under capital requirements, would of course need to be taken into account. In the case of breaches concerning capital requirements, the remedies and powers afforded to the supervisory authorities will generally be the most appropriate and should also generally be considered to be sufficient by themselves. Consequently, we strongly believe that MREL-breaches should not automatically trigger consequences.
- With regard to an MREL breach through a shortfall of eligible debt, the EBF fully agrees with the need to accommodate the proposed concept of "grace period" on page 48. The EBF recommends that such a period should be determined on case by case basis, with a minimum timeframe of 6 months, which should be renewed if market-wide disturbances prevent the rollover of maturing debt or if there would be any other systemic implications.
- We oppose the proposal that any breach of MREL should result systematically in an assessment of whether the PONV is reached, in particular where there has not been any breach of capital requirements.

Adequacy and calibration

- **The EBF welcomes the EBA proposal to closely link the MREL calibration to the resolution strategy, including resolution actions, defined by the resolution authority in respect of the specific institutions as opposed to a standard/uniform MREL-requirement.**
- **In respect of G-SIBs, the TLAC requirement should be considered as the reference point for the calibration** given that quantitative impact studies have demonstrated that it was enough to both encompass the loss absorbing capacity as well as the recapitalisation amount. Additional requirements should only be imposed in view of and proportionate to material resolution impediments.
- **In the case of D-SIBs and other banks the MREL requirements should in any case be set no higher than the TLAC standard requirement.** Other banks should have the necessary MREL levels to permit the implementation of their resolution strategies to preserve the continuity of any critical economic functions they provide. This could mean that if the failure of a bank would not invoke the use of resolution powers, its MREL would be set at the level of minimum capital requirements. Equally, when a bank provides critical economic functions - such as SME lending – then MREL should be calibrated to support the application of the resolution strategy foreseen to maintain these, but not to support the recapitalisation of other group entities, which are not deemed critical, via bail-in.
- **Any additional requirement should be duly justified by the resolution authority on the sole basis of major impediments to the resolution.** The level resulting from the direct application of the RTS on MREL should be viewed as a cap for the calibration of this possible further requirement.
- In EU Member States where higher capital requirements for systemic risk and Pillar 2 are introduced, the application of the RTS should not automatically lead to higher MREL requirements. Instead, flexibility in the RTS in relation to the parts of the higher capital requirements should be applied when setting the MREL requirement.
- **The EBF supports the EBA view that the 8% consists only of an amount of own funds and liabilities to be bailed-in in order to benefit from the access to the SRF and cannot be envisaged as a floor for calibrating the MREL.** This is further supported by the fact that otherwise MREL-requirements for non-G-SIBs could effectively be higher than the corresponding TLAC-requirements for G-SIBs. In any event, it is necessary to clearly distinguish the MREL-minimum and the 8% threshold.

- Regarding the 8% rule, the EBF agrees with EBA that the notion of *"total liabilities and own funds"* (used in particular in Articles 44 (5) and 45 (1) of the BRRD) is unclear. Consequently, the EBF supports a clarification in the BRRD itself. The definition should be clarified to the effect that derivatives are included in total liabilities for the amount after full recognition of netting rights.

Internal MREL

- **Concerning internal MREL, we call for the introduction of an element of materiality rather than requiring MREL for each subsidiary.**
- Further, the EBF would like to bring further clarification over the calibration issue for subsidiaries:
    - If a floor was to be set upon a business model, a reduced floor should be applied for the subsidiaries of the resolution entity that are not a point of entry (for consistency reasons with the internal TLAC where a reduction of 10-25% of the standard is proposed).
    - **The general principle should be that internal MREL is not required if there is a sufficient level of confidence between authorities: this should be the case in the same jurisdiction, such as the banking union and even within the European Union**. This would be consistent with the TLAC term sheet provisions.
    - The regulation should allow all types of internal MREL: subordinated debts, collateralised guarantees and even uncollateralised guarantees if confidence exists.
    - In case of mixed capital ownership with minority shareholders, it should be possible, but not obligatory, to issue also external MREL (to the extent of the minority interest share) provided that the conversion of this MREL does not trigger a change of control which is a condition in the TLAC term sheet.
    - In case the resolution strategy is modified (from a SPE to a MPE strategy), call on internal MREL instruments should be allowed after replacement of internal by external MREL, to reflect the new resolution strategy agreed upon.

Third country recognition/contractual recognition clauses

- We fully support the recommendation of the EBA to narrow the scope in the level one text.
- The most effective and proportionate means of reconciling the policy objectives of Article 55 with the practical compliance challenges faced by firms is to limit the scope of the requirement to liabilities eligible for MREL. We note that this would be consistent with the guidelines adopted by the Financial Stability Board and the underlying policy rationale: effective cross-border resolution. It is important for firms and their counterparties that there is clarity and transparency on what is required in this respect, with a clear rationale in terms of credible loss absorption and recapitalisation. Where necessary, the resolution authority should have a complementary power to require a firm to include a contractual recognition term in other liabilities, but only as an exception, if in aggregate this would have a significant impact on the firm's resolvability.
- The other options considered in the interim report all have significant shortcomings. The identification of additional exemptions (option i) will be challenging for the legislator and may result in uncertainty and differing interpretations by competent authorities and firms. The list of exemptions would also need to be kept under review to ensure it remains appropriate over time. A power for competent authorities to grant waivers where this will not represent an impediment to resolution (option ii) may also not be ideal unless in combination with option iii.

Practical challenges (contractual recognition)

- Some of the key practical challenges to the implementation of Article 55 in the BRRD are summarised below. It should, however, be noted that these are only a few selected examples: there will be many more cases, instruments and circumstances where the inclusion of contractual recognition clauses will be impossible, impractical or may result in unreasonable/disproportionate effects:

- Under certain circumstances and in relation to certain types of contractual arrangements it will be impossible to impose the contractual recognition clauses because the relevant third country counterparties will and/or cannot accept such contractual clauses for valid reasons (including for legal reasons as such an acceptance of unilaterally imposed rights adversely affecting the position of the counterparty may raise legal questions under local law, especially in relation to public authorities, investors/consumers or small and medium sized entities). One example are transactions of members of third country market infrastructures such as central counterparties or settlement systems which are governed by rules and regulations which cannot be unilaterally amended by a counterparty. Similar issues arise where the instruments creating the liabilities are governed by international standard market terms and practices which do not allow for the inclusion of contractual recognition clauses, or where the relevant contractual agreement is concluded by means which do not permit the inclusion of such clauses, i.e. because of the involvement of intermediaries such as trading platforms or brokers (practical examples are certificates of deposit or commercial papers).
- Some liabilities are structurally not suited for a bail-in. One case in point is contingent liabilities: Contingent liabilities only come into existence upon the occurrence of a certain future event and upon the making of the claim by the relevant beneficiary. Until such time and such making of the claim, there will simply not be any liability which could be subjected to a bail-in. Practical examples are guarantees and documentary credits (letters of credit). Here, the payment obligation only arises upon occurrence of the guarantee event or the presentation of the documents and subject to the beneficiary actually making the claim.
- In many circumstances, a bail-in may not have any net-effect since a bail-in of the liability would directly be neutralised by a corresponding reduction of a counter-claim securing the bailed-in liability. Again, a practical example are guarantees and documentary credits which are regularly covered or secured by corresponding counterclaims against a third party, often the client of the bank in question.
- In all of the above situations and cases, not entering into the relevant transaction or offering the relevant instrument and service to customers is likely to have a very significant adverse effect on the competitiveness of an institution and may also affect its core business operations and/or its access to key markets and market infrastructures.

Further considerations (contractual recognition)

- For the purposes of the above, we have assumed that the obligations under BRRD Article 55 only apply to contractual agreements, which have the purpose of establishing a payment obligation, and consequently, do not apply to contingent liabilities which may arise incidentally, i.e. because of a breach of contractual obligations. Otherwise, the already very broad scope of obligations covered would be practically limitless, as it would cover practically any contractual arrangement the institution is party to.
- Article 55 should not be an end in itself but needs to be seen in the context of its underlying purpose, namely the facilitation of a bail-in. A failure to include contractual recognition clauses in some cases or circumstances or vis-à-vis certain types of counterparties should therefore be addressed as an issue of the resolvability of an institution and only to the extent there is an adverse impact on its resolvability. It should also be noted that the BRRD does not provide for any specific legal or regulatory consequences in the event of a failure to impose contractual recognition clauses in all contractual arrangements falling within the scope of the obligation, other than that these liabilities cannot be counted towards MREL (see Article 45 (5) of the BRRD).
- Since institutions have a vested interest in ensuring a sufficient basis of MREL-eligible liabilities in order to reach the applicable MREL requirements, and in view of the broad and far reaching powers granted to regulatory and resolution authorities to address any impediments to resolvability, institutions have no incentive to avoid the implementation of Article 55 wherever such implementation is possible and practical.

Eligibility/subordination

- We welcome the EBA's approach regarding subordination that is focusing on the desired outcome rather than the legal means of achieving it. All three methods of subordination – contractual, statutory and structural - should be available to firms.
- **As far as subordination is concerned, the EBF advocates for a mandatory subordination for G-SIBs to be only required to meet the minimum non-firm specific MREL requirement (subject to the TLAC term sheet exemptions especially the 2.5/3.5% exemption). The EBF opposes the optional preference to be given to deposits (other than covered and preferred). Indeed, without bringing strong benefit from an economic stand point, this preference would bring further volatility into liability management of bank**s **and would raise moral hazard issues. Indeed, large corporate or financial institutions may choose** to arbitrage between debt instruments and term deposits when investing their non-operational cash. Indiscriminate depositor preference may also encourage the placement of deposits with more risky banks offering higher returns, given the protection offered by total depositor preference. In addition, the creation of depositor preference also takes the financial system further away from the objectives of resolution, which is to ensure that bank stakeholders share the effects of resolution. Every time that a category of creditors is exempted, via preference, from this effort, resolution risk is concentrated on an ever smaller population of investors. This is dangerous for financial stability, as any withdrawal or reduction in risk appetite from such investors will have immediate effects on the availability of MREL, or the capacity of banks to renew maturing MREL qualifying debt.
- **The EBF recalls that any decisions about eligibility criteria and/or subordination requirement should duly inform the calibration discussion** given the magnitude of impacts both in term of volume of issuance required as well as funding costs. It would therefore require modifications of the calculation methodology set out in the RTS on criteria for determining.

Findings (p. 16 et seq.)

- We note the findings on deposit funded banks that deposit funded banks with limited financial market access might face difficulties in meeting MREL-requirements. However, this finding does not take into account the effects of deposit guarantee schemes (notwithstanding the fact that this issue is addressed in Article 6 of the final Regulatory Technical Standards on criteria for determining the minimum requirement for own funds and eligible liabilities under Directive 2014/59/EU.

Disclosure

- Regarding disclosures, while the EBF agrees upon the need of transparency about creditor hierarchies towards investors, it would suggest to the EBA not to pre-empt the ongoing BCBS work on that field.
- At this early stage, the MREL requirement process is not yet sufficiently stabilised and its disclosure can lead to market volatility and uncertainty. Despite the need that the MREL disclosure process follows the same pules that will be required for SREP requirements, the additional risk related with depositors behavioural and market liquidity needs to be duly considered when it comes to MREL disclosure. In our opinion a transitional period should be set to ensure that the different stakeholders get familiar with the MREL process, allowing that in a future moment, any disclosure is made without generating excessive volatility or risk of bank runs. A description of the bank's liability structure according to its bail-in ability would be sufficient during that transitional period.
- In addition, any disclosure requirement could only have the desired effect of giving the investors an overview over his/her position as at the time of the report, if there was a unified reporting/disclosure standard. Without such standardisation, the information may actually increase misunderstandings.

Redemptions

- We are firmly opposed to any systematic requirement for approval for early redemption of MREL eligible liabilities. This aspect has been extensively discussed at the FSB level during the course of the TLAC discussion and eventually agreed upon the final version of the TLAC term sheet. The EBF is therefore in favour of the last option proposed by the EBA (see page 51).

- In order to allow a smooth and efficient liability management, early redemption of MREL-eligible liabilities should be allowed without the prior approval from the resolution authority provided that this redemption will not cause an MREL breach. The approval process will be too long and burdensome and as a result banks will not be able to use bond buy-backs as a liability management tool or possibly to give a positive signal to the markets in times of turmoil.
- Prior approval would be totally unworkable for banks with a significant amount of MREL eligible liabilities in the form of corporate term deposits. In such cases having to ask for an approval of redemption of any MREL liability would significantly worsen the flexibility towards clients and limit interest rate and liquidity management.
- In particular, prior approval would become very complicated for an institution to be a market maker for the eligible instruments that it has issued although this is essential for liquidity purposes.
- Further, with regard to extending approval for redemption to internal TLAC/MREL we recommend also not to include an obligatory approval of the redemption for internal MREL targets by the competent authority. Internal targets may often be fulfilled by internal deals which may flexibly react to different situations. Obligatory approvals decrease the flexibility and independence of institutions and significantly limit interest rate and liquidity management.
- We agree that the resolution authority should monitor the maturity structure and potentially make recommendations. However, we do not agree with the proposal that the resolution authority might enforce the maturity structure. MREL eligible liabilities are an important part of the funding structure of the bank and help to manage its interest rate and liquidity position. Resolution authority decisions might not be sufficiently rapid or sensitive and might potentially harm the bank. In addition, there is no legal requirement for a particular term structure of MREL, i.e. the only requirement is that maturities are in excess of one year. Giving the resolution authority the right to impose a maturity structure could contradict recommendations made by competent authorities, and would present an unnecessary interference in the management of the bank, and should be avoided.

Transitional period

- We recommend to increase the power of the resolution authority in order to adjust the transitional period both ways. It should be clear that the transitional period starts after the resolution authority announces the targeted MREL.
- We agree that the resolution authority should consider to increase the transitional period in case there are obvious reasons for it such as limited market access to acquire funding.
- We would also envisage the need of a longer transition period if certain liabilities need to be subordinated as only a few countries have introduced the necessary subordination legislation so far and this itself is a process which would in some countries take more than 12 months.

Quantitative impact analyses

- There are some assumptions or simplifications that (admittedly) influence the outcomes. In particular:
  - Only external MREL at the parent level is considered, but the denominators are at group level. This may be appropriate for SPE resolution strategies, but certainly is not for MPE banking groups with subsidiaries that issue important amounts "locally". While the EBA states that the denominator cannot be corrected due to the absence of data, we wonder if the EBA ran an additional exercise considering all external MREL how this would change the outcomes.
  - Static balance sheet: the recapitalisation requirement is based on the assumption that the bank after resolution has the same risks and balance sheet size. This is overly conservative and real gaps should be lower in reality. The EBA Report states that for smaller banks, a 50% recapitalisation instead of 100% would lower the gaps by EUR 31-47bn (pp. 23, 30). It would be informative to understand the impact of a 75% recapitalisation for the bigger banks.

Leverage ratio back-stop

- For G-SIBs a backstop is already calibrated in the TLAC term sheet, and there is no need to deviate from this calibration for EU G-SIB's.
- However, while the EBF largely supports the general approach and findings regarding the role of RWA as relevant denominator for the purposes of MREL, the potential adverse effects need to be taken into account and addressed adequately, namely the impact of other regulatory developments on RWA.
- Against this background the proposal to include TLOF as an additional, volume based benchmark should be reviewed with the aim to fully recognise contractual netting for either type of transactions. In this context, the treatment of netting effects regarding derivatives and securities financing transactions should be reviewed.
- The determination of the backstop as described on page 36 is not appropriate. Authorities would take the euro amount for the MREL requirement (based on the methodology of loss absorption and recapitalisation, etc.) and simply divide it by the leverage ratio exposure measure, creating a new ratio (limit). Doing so, if a bank's RWA would remain constant but the leverage ratio exposure would increase, then the backstop ratio would be breached immediately. Or if the RWAs would decline with a constant balance sheet, the ratio MREL/RWA would not be the binding ratio, but immediately the MREL/exposure ratio would be the binding limit. The backstop should be set at some distance from the current level (to be a "back-stop" to the RWA calculation deficiencies as is the intention with leverage ratio in the CRR), and should probably be set at the same level for all banks, or all banks of a given type.
- To avoid those drawbacks, the EBF proposes to disregard the last step in the RTS. Instead, banks should report/disclose MREL expressed as a percentage of risk-weighted assets potentially as a percentage of leverage ratio exposure.

Use of the SRF

- In the Report there is the assumption that G-SIBs should have at least an 8% MREL so the SRF can be used: "*In particular the fact that an institution is of systemic significance and its disorderly failure would be likely to have adverse effects on financial stability will support the conclusion that the resolution fund might need to be accessed in order to resolve it*." (p. 69). This is conceptually wrong as for all banks. MREL should be set in a way that the resolution strategy can be executed (as stated more than once in the same Report). The resolution strategy cannot foresee the use of the SRF as it can only be used in exceptional circumstances if the resolution strategy cannot be executed. As such, we support the assumption on the bottom of page 69 that the MREL should rather be linked to the resolution strategy.

Answers to Questions

4 p50: The EBA invites stakeholders' comments on whether and in what circumstances a breach of MREL should result in the Competent Authority making an assessment of whether the institution is failing or likely to fail.

Breaching MREL should not be the only element serving as reason for this assessment, also other elements should be considered. The debate on failing or likely to fail is the ultimate measure to be taken but should not be the first one.

5 p61: The EBA invites stakeholders to comment on the appropriate scope of any subordination requirements. More precisely stakeholders are invited to comment on what the highest priority information and disclosure needs are, in the three areas of i) disclosure of bank balance sheet structures; ii) disclosure of banks' MREL requirements and iii) availability of standardised information on statutory creditor hierarchies.

All types of subordination should be allowed. Mandatory subordination of MREL eligible liabilities should be assessed on a case-by-case basis (e.g. banks subject to TLAC) and not imposed in general for all banks (e.g. when it is not relevant for a bank in view of its resolution strategy).

Regarding the disclosure needs, we agree that information on the three above mentioned areas should be available to creditors.

6 p62 The EBA invites stakeholders' to comment on the practical difficulties faced in implementing the recognition clauses, specifically in the field of MREL, and on alternative approaches to improve the regime without creating incentives to evade the scope of bail-in.

The mandatory inclusion of bail-in recognition clauses in agreements entailing contingent liabilities (such as guarantees, letters of intent and also trade finance agreements (letters of credit)) is counterproductive and harms the competitive position of EEA firms and credit institutions:

- The inclusion of a bail-in recognition clause in trade finance agreements leads to strong resistance from non-EU counterparties that will not accept a possible write-down or conversion of their claim.
- This will cause direct and serious competitive disadvantage for all EEA credit institutions as counterparties will choose other, non-EEA credit institutions (which do not have to include a bail-in clause in their contracts).
- Also, for the companies operating outside the EU it will cause a competitive disadvantage. If a guarantee delivered by an EU bank is refused by a non-EEA beneficiary because a bail-in clause is included, this will mean a loss of revenue for the EU company since it will not be awarded the contract.
- The wording of many trade finance agreements and certainly international bank guarantees is standardized and/or imposed by local regulations and is therefore not subject to change.
- For certain trade finance agreements, such as letters of credit (L/C's), it is not always clear which law is applicable.

In order to reconcile the policy objectives of Article 55 with the practical compliance challenges faced by firms, the scope of the requirement should be limited to liabilities eligible for MREL and, when absolutely necessary, extended to other liabilities if in aggregate this would have a significant impact on the firm's resolvability. It is important for firms and their counterparties that there is clarity and transparency on what is required in this respect, with a clear rationale in terms of credible loss absorption and recapitalisation. We see two alternative approaches:

i. It is for the resolution authority to decide, on a case-by-case basis, on the bail-in of liabilities governed by a third country law, at the occasion of the drafting of the resolution plan for each institution separately. A nuanced, balanced case-by-case assessment arises, rather than a general obligation to include a bail-in recognition clause in all liabilities governed by the laws of a third country. The resolution authority should judge whether there are liabilities governed by non-EEA law where the absence of a bail-in clause would be an impediment to the resolvability of the institution.
ii. The bail-in clause should only be included in contracts governed by a third country law suitable for a rapid writing-down or conversion, for which it clear this would be impeded by the absence of such a clause (e.g. contracts related to the issuance of funding or debt instruments).

Please see also our comments in our General Remarks above.

Annex - Comments to analysis

The EBA interim report describes the sample of banks based on their size, business model and country of origin the nature of the banks in the sample. The data shows that there are completely different banking systems and potential problems with fulfilment of MREL requirement. Even though the sample is rather diversified we have several comments and recommendations to the analysis:

- Several countries do not have any bank in the survey.
- The analysis mentioned some specifics of deposit-funded banks and chose two thresholds for identification of a deposit-funded bank (30% and 40%). However, there are banks which are funded over 50% from retail deposits. Such banks were not analysed even though the 10% delta means a significant difference in the funding structure and a significant lack of MREL liabilities for such banks.
- The report shows three calibration scenarios. First and third scenarios are described as unrealistic. While we agree that the first scenario with no buffers and no Pillar 2 add-on is very optimistic, the third and "worst" scenario (double capital requirement with buffers) is a mild version of the current RTS on MREL requirement and does not fully show the worst potential impact on EU banks. The third scenario includes 2% Pillar requirements (while some regulators require higher values), no countercyclical buffer (planned >0% in several countries) and G-SIB buffer (it is not clear whether the systemic risk buffers is included - in small countries systemic risk buffer is often higher than buffers for larger G-SIBs in other countries). Thus, the study does not show the real impact of RTS on the EU banking sector.
- The analysis shows the percentage of non-compliant banks only under scenario 2. We would recommend to show the results for all scenarios (including scenario 3: "mild pessimistic RTS on MREL" impact).
- Even though the report shows more detailed results only for scenario 2 (with 50% of recapitalisation only), 31% of all banks and 42% of small banks would be currently non-compliant (if deposits were excluded even 46% of all and 55% of small banks). Are those banks also poorly capitalised? What would be the results for scenario 3 with full recapitalisation?
- What would be the results for the worst case scenarios (all buffers included and higher Pillar 2 add-on)? While it may not be the realistic scenario at the moment it is still a scenario which is possible and in line with the RTS. There should be an analysis showing the full potential impact of the RTS on MREL and also an analysis of potential holders of new debt. Who would be the investors/depositors covering potential future losses? Could they be better prepared than the sovereigns to absorb potential huge losses?
- Based on BRRD Article 45(20)(a)(i) and (ii) the report should assess the impact of the minimum requirement, and any proposed harmonised levels of the minimum requirement on: (i) financial markets in general and markets for unsecured debt and derivatives in particular; (ii) business models, and balance sheet structures of institutions, in particular the funding profile and funding strategy of institutions and risk approach models (Standardized or IRB approach), and the legal and operational structure of groups.

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The European Banking Federation is the voice of the European banking sector, uniting 32 national banking associations in Europe that together represent some 4,500 banks - large and small, wholesale and retail, local and international - employing about 2.5 million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that securely handle more than 300 million payment transactions per day. Launched in 1960, the EBF is committed to creating a single market for financial services in the European Union and to supporting policies that foster economic growth.

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For more information contact:

Timothy Buenker
Senior Policy Advisor
Banking Supervision
t.buenker@ebf.eu
+32 2 508 37 22
+32 496 50 12 56