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FBF RESPONSE TO EBA INTERIM REPORT ON IMPLEMENTATION AND DESIGN OF THE MREL FRAMEWORK

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorized as banks and doing business in France, i.e. more than 390 commercial, cooperative and mutual banks. FBF member banks have more than 38,000 permanent branches in France. They employ 370,000 people in France and around the world, and service 48 million customers.

The FBF welcomes the opportunity to share its comment on the EBA's interim report relative to the implementation and design of the MREL framework. It should be noted that future changes in the hierarchy of banks creditors may affect or address certain issues raised in this response. Please find our key comments below on issues related to the MREL implementation, notably on the 5 provisional recommendations, as well as on others topics which are not specifically addressed in the draft interim report and our answers to the questions raised in the document.

1. Reference base for MREL requirement

- For the sake of clarity and comparability, both for banks and investors, **the FBF supports the EBA proposal to align the MREL's denominator metrics to the TLAC ones i.e. determining MREL as a percentage of RWA with the leverage exposure as a backstop[1].**
- 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 FBF supports the full contractual netting option as defined in section 4.1.3 in relation to derivative liabilities and netting rights**.

[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).

2. <u>Relationship with regulatory requirements</u>

- **Again, to bring clarity and certainty for investors as well as for banks, the FBF advocates to insert MREL requirement within the CRR into a different section than the one regarding "Own fund requirements".** This should permit to avoid any misinterpretation with the concept of maximum distribution amount (MDA) restrictions on voluntary distributions.

- 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.

3. <u>Breach of MREL</u>

<u>"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."</u>

The FBF believes that the action of the authority should be proportionate to the situation.

- **The treatment of an MREL breach should be tailored to accommodate to the 3 following situations**:

  - A MREL breach through non-capital breach (i.e. through a shortfall of MREL eligible debts). This will be evidenced by a breach of MREL, with no breach of capital;
  - An MREL breach through a capital breach;
  - An MREL breach through both capital and eligible debt shortfalls.

- Having made this analysis should allow clarification of which authority (i.e. supervisory or resolution authority) has to intervene:
  - In the first case, this should be an issue primarily for the Resolution authority;
  - In the second and third cases, a capital breach exists, and primary responsibility should lie with the Supervisory authorities.

- As a third step, proportionality of supervisory or resolution authority measures shall be characterised upon the nature of the breach.
  Whereas the breach of capital levels must be considered very seriously and is already addressed in CRR/CRD4, the breach of eligible debts (without a breach of capital levels) should, in first instance, result in a discussion between the bank and the authority upon the means to remedy the shortfall (the bank could be required to draw an action plan). But, absent other indication that the situation is critical, it is not an emergency situation requiring specific powers for authorities (given that eligible debts are only gone concern elements).
  Moreover, the minimum 12 months remaining maturity for MREL instruments should provide the authorities with a "maturity buffer" during which the MREL position can be restored. Indeed, in the event of a breach of eligible debts, it is likely that there will be a significant amount of liabilities with a maturity of less than 12 months but which are otherwise eligible for MREL.

- **Thus, in the case of an MREL breach through a shortfall of eligible debt, the FBF recommends that the regulation introduce a "grace period" of 6 months, renewable once to cope with temporary closing of financial markets that may prevent a bank to renew its eligible debt instruments.**
  As a consequence, we oppose the EBA proposal that any breach of MREL should result systematically in an assessment of whether the PONV is reached. It is hardly credible to carry out a PONV assessment on a bank that has not breached capital requirements.

- 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 if this redemption is not causing a MREL breach. This aspect has been extensively discussed at the FSB level during the course of the TLAC discussion and eventually agreed upon in the final version of the TLAC Term sheet. The FBF is therefore in favour of the last option proposed by the EBA (see page 51).

4. Adequacy and calibration

- **The FBF welcomes the EBA proposal to closely link the MREL calibration to the resolution strategy, including resolution actions, defined by the Resolution authority.**

- **As far as the calibration is concerned, we consider that the TLAC requirement should be considered as the reference point for G-SIBs,** given that it has benefited from extensive and comprehensive quantitative impact studies - that have demonstrated that it was enough to both encompass loss absorbing capacity as well as recapitalisation amount - as well as G20 political endorsement.
  Any further requirement should be duly justified by the Resolution authority on the sole basis of major and factual impediments to the resolution. And 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.

- **The FBF supports the EBA view that the 8% consists only of an amount of 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.**

Internal MREL

The FBF would like to bring further clarification over the calibration issue for subsidiaries:

- If a floor was to be set upon 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, and within Europe, at least in the Eurozone where there is a single supervisory authority and a single resolution authority**. 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 uncollateralized 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.
- Regarding third country recognition of resolution powers, the FBF strongly recommends to follow the EBA third option to limit the scope of article 55 to instruments which are eligible for MREL.

5. Eligibility

"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."

- **As far as subordination is concerned, the FBF advocates for a mandatory subordination 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 FBF agrees with the EBA that, as long as clarity is given both to resolution authority as well as investors, subordination can take several legal forms (structural, statutory or contractual) that should be equally allowed by authorities.

- **As far as the optional preference to be given to deposits (other than covered and preferred), the FBF is strongly opposed to such idea**. Indeed, without bringing strong benefit from an economic stand point, this preference would bring further volatility into liability management of banks 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 were 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 of the availability of MREL, or the capacity of banks to renew maturing MREL qualifying debt.

- **The FBF 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 a funding costs. It would therefore require modifications of the calculation methodology set out in the RTS on MREL.

- Regarding disclosures, while the FBF agrees upon the need of transparency about creditor hierarchies towards investors, it would suggest the EBA not to pre-empt the ongoing BCBS work on that field.

6. Third country recognition

"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."

- While the preferred path supported by the FSB is a statutory recognition of foreign resolution by G20 jurisdictions, we agree that the contractual recognition can ensure smooth cross border resolution in the meantime. Nevertheless the scope of article 55 is too broad and we fully support the recommendation of the EBA to narrow the scope in the level one text to debts eligible to MREL. In particular, notwithstanding the spirit and goal of the bail-in tool, and the position of the Financial Stability Board (FSB) in this matter[3], the current drafting of article 55 may be interpreted as an obligation to include the contractual recognition clause in every contract creating any kind of liability for the European institution, and not only in debt instruments
- **Accordingly, the FBF supports EBA's view that some reduction of the burden of compliance with article 55 is necessary.** The scope should be reduced to exclude debts where the absence of clause would not reduce the resolvability of the banks or which bail-in would have unintended effects, e.g., non EU CCP, trade finance contracts or contingent liabilities. In addition, **we agree with EBA that authorities should have a power to grant waivers where the absence of clause does not create an impediment to the retained resolution strategy.**

7. Other- topics

- **Prudential treatment of MREL instrument holdings:** the FBF has responded to the BCBS consultation on TLAC holdings, highlighting that the retained framework should not prevent the development of a broad market for TLAC instruments while ensuring a limit on contagion effects. As such, TLAC holdings should only deducted from TLAC issuances (not from Tier 2) above a threshold. TLAC holdings should only be deductible for G SIBs as provided by the FSB. On top of this, MREL holdings treatment should be considered carefully to avoid unintended effects on market depth and liquidity. Like TLAC, MREL debts are touched by bail-in only after all own funds have been written down/converted, and as such bear a lower risk which should be reflected in the prudential treatment.

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3 Please see page 7 of the Financial Stability Board's principles for cross-border effectiveness of resolution actions dated of 3 November 2015, available at http://www.financialstabilityboard.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf