EBA EUROPEAN BANKING AUTHORITY

EBA BANKING STAKEHOLDER GROUP

EBA Consultation Paper - EBA/CP/2020/18

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As per BRRD2 Art 45f(1) all institutions are subject to MREL requirements, and resolution authorities may also set iMREL to financial institutions, financial holding companies and parent financial holding companies. BRRD2 Art 45f[1] (3) and (4) provide for possibilities of waivers.

Q1. Do you have any views on the merits of the approach analysed by the EBA to implement the mandate or regarding other options considered under paragraph 14?

Deduction method and the principle of proportionality

The EBA examined three possible types of deduction: the **partial regulatory-based deduction method** (option 1.1.), the **full regulatory-based deduction method** (option 1.2.) and the **full holding-based deduction method** (1.3.).

While some BSG members acknowledge that the option 1.1. (partial regulatory deduction method) presents some limits not ensuring that own funds and eligible liabilities fully play their loss absorption and recapitalisation role at each level of the chain of ownership, they consider the choice of the option 1.3. (full holding-based deduction method) instead of option 1.2. (full regulatory-based deduction method) not fully justified in terms of cost-benefit analysis. Along this view, in par. 45 of the draft cost-benefit analysis the EBA accepts that option 1.2. can ensure the smooth implementation of the resolution group strategy calibrated by the MREL, "as losses are absorbed up to the LLA and recapitalisation of material subsidiaries up to the RCA is ensured".

Other BSG members however believe that option 1.3 is the most suited to ensure the availability of MREL in its entirety and would therefore discourage daisy-chains.

[1] It was noted by some members that: It is not obvious from the Level 1 text that Art. 45k BRRD II could not be invoked to require sub-consolidation if the group turns out not to be resolvable – emphasising that the interpretation given by the EBA in the CP may be overly conservative and has not been tested yet by the resolution authorities.

The EBA has chosen option 1.3. (because it requires the intermediate subsidiary to deduct a higher amount of iMREL instruments than under the option 1.2.), as admitted in par. 48 of the same document, because it provides a conceptually simpler approach; indeed, this approach equals to a direct subscription of all instruments of subsidiaries by the resolution entity (including those in excess of the iMREL requirement), while the approach under Option 1.2 would be equal to a direct subscription of an amount of instruments that – albeit possibly smaller than those considered in Option 1.3 – could nevertheless be sufficient to ensure compliance with the Level 1 text's mandate of ensuring "the proper transfer of losses to the resolution entity and the proper transfer of capital from the resolution entity to entities that are part of the resolution group but not themselves resolution entities".

Under the cost-benefit analysis this choice has been justified considering that "during a preliminary assessment of EU resolution groups few daisy chains would be identified, which would lead to the assumption that the potential higher economic costs of Option 1.3. are limited".

Some members of the BSG think that the latter reason, i.e. the limited number of groups to which this rule will apply when the new RTS will entry into force, does not consider possible future developments of the EU banking groups structures (e.g where consolidation projects will be carried out in Europe).

Inconsistency with the capital framework

Some members of the BSG note that the EBA draft imposing the deductions of own funds for MREL requirements in the context of indirect subscription is inconsistent with the general framework for capital requirements. They argue that CRR art. 49(2), which relates to the treatment of own funds of an entity subject to supervision on an individual basis and the investments in financial sector subsidiaries, indicates that such investments shall not be deducted. They argue further that a deduction regime specifically for MREL purposes should avoid leading to different amounts for own funds, RWA and Leverage Ratio Exposure for MREL purposes vis-à-vis own funds and own funds requirements. The figures disclosed by institutions to the public should remain comparable because it will be difficult for users to comprehend the nuances of the capital and resolution frameworks causing these differences.

.Other members are of the view that it is not compliant with principle 10 of the FSB's 'TLAC Principles and Term Sheet' and the level 1 text. The objective of Article 45f(6) BRRD2, and the mandate to EBA, is to devise a mechanism that ensures that loss absorption capacity, which includes both own funds and eligible liabilities, is adequate at each intermediary level of the

chain of ownership. Deductions that are made in accordance with this RTS should be recognised in disclosures at the relevant intermediate levels to provide accurate and transparent information on the loss absorption capacity and resilience of the relevant entity or sub-group.

These members believe that the mandate issued by the legislator to EBA is clear and limited to defining a method of deduction of iMREL, they do not consider it part of this mandate to opine on the consistency of level 1 legislation.

Deduction vs inclusion in RWA or LRE

For own funds instruments and items this is fully considered under the current regulatory framework, in CRR article 151(1), 113(1) and 429(6). The draft RTS rightfully proposes to extend this principle to RWA for deducted eligible liability instruments. However, the draft RTS fails to extend this principle to the Leverage Ratio Exposure for eligible liability instruments deducted from MREL. As a result, under the RTS as currently drafted, the intermediate entity will be required to both deduct an eligible liability instrument it holds from a subsidiary and include it in its Leverage Ratio Exposure.

Similarly, it is unclear how article 2(3) of the draft RTS interacts with these principles. The competent authority should not have the mandate to require RWA for an instrument that is already deducted from the MREL capacity.

Application of Art 45k BRRD2

Some BSG members emphasise that resolution authorities should be reminded explicitly in the RTS of their right to apply measures in accordance with Art 45k BRRD2 if the complexity of a banking group's structure and/or its arrangements regarding the subscription of internal MREL is such that the intended loss absorption and recapitalisation of MREL at each level of the chain of ownership cannot be assured, creating a potential impediment to resolvability. The approach recommended by EBA in section 17 of the Discussion Paper could be incorporated into the recitals of the Delegated Regulation. They believe that the imposition of an obligation for the banking group to sub-consolidate at the resolution group level is covered by the powers granted to resolution authorities by Art 45k BRRD, in case of breaches of the minimum requirement for own funds and eligible liabilities, and proportionate to the potential risk to financial stability resulting from the disorderly failure of the institution or group.