Svenska Bankföreningen
Swedish Bankers' Association

FINANSRÅDET

Association of Latvian Commercial Banks

FFI | Federation of Finnish Financial Services

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# Joint consultation response on the EBA draft regulatory standard on minimum requirements for own funds and eligible liabilities (MREL) – EBA/CP/2014/41

The Nordic / Baltic banking associations as displayed above support the messages outlined in the European Banking Federation's response to the EBA consultation on criteria for determining the MREL. However, there are some additional points that we want to stress, that are of particular importance to the Nordic/Baltic banking sector.

**The ambition to implement TLAC-features in MREL creates an RTS that goes beyond the EBA mandate**

The EBA is seeking to set a regulatory standard that does not only define the criteria for setting the MREL, but also takes into account the proposed new global standard on total loss absorbing capacity from the FSB, TLAC. In doing so, the EBA includes features in the RTS, that do not follow from the mandate in the BRRD, and that would normally only be implemented in the EU through the usual regulatory process in the Council and the European Parliament. One such feature of the proposed RTS, is that the default loss absorption amount includes a component based on the leverage ratio.

The leverage ratio is under review in the Basel Committee and its implementation in the EU demands a separate regulatory process. Therefore it is entirely inappropriate to refer to the leverage ratio in the MREL RTS at this stage.

In addition, as also explained in the Nordic/Baltic banking associations' response to the TLAC consultation, the leverage ratio as such would lead to significant problems for universal banks with a high proportion of low risk assets on the balance sheet.

The leverage ratio, when first proposed by the Basel Committee, was designed to serve as a backstop for the risk weighting used in the capital requirement regulation,

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but was never intended to become the primary binding requirement for a significant number of banks. A doubled leverage ratio overriding the RWA based capital requirements incentivizes banks, with relatively large balance sheets relative to their RWA, to reduce the amount of low risk assets on the balance sheet rather than carefully assessing its risk and pricing them correctly. Therefore, the approach will favour banking models largely built on asset securitization, as opposed to those models where low risk assets are kept on the balance sheet of the bank. This is not a positive feature when it comes to securing global financial stability.

If the reference to the leverage ratio is maintained in the MREL RTS, we recommend that it be made explicit in the standard text that the national regulatory authorities should have the possibility to disregard entirely any leverage ratio requirement for the purpose of calculating MREL, at least until the EU has fully implemented the leverage ratio requirement through common legislation.

**The EBA MREL should not go beyond the FSB TLAC**
As stated in the EBA consultation document, the proposed RTS are expected to be compatible with the proposed FSB term sheet for TLAC. However, the proposed EBA RTS for MREL calculation is different from the proposed FSB TLAC calculation and the EBA goes beyond the FSB.

The proposed EBA recapitalization amount for Global and Other Systemically Important Institutions is the capital requirement, or the higher of any other regulatory capital constraints. The proposed amount is higher than the equivalent of the proposed TLAC of 8-12% of RWAs (subtracting the minimum capital requirement of 8% of RWA from the 16-20% of RWA minimum TLAC requirement). This is particularly the case for larger banks in the EU Member States with very high Pillar 2 capital requirements as well as buffer requirements, as is the case in several of the Nordic Baltic countries. Although the theory of capital buffers and Pillar 2 requirements may be that they are representative of additional risks and additional losses, the reality of their application within the European single market does not bear out this theory. In many cases, they are more an expression of macro-prudential concerns than a reasoned appreciation of potential losses not covered elsewhere in the capital framework.

The existing inconsistencies in introduction of capital buffers and also in determination of additional capital add-ons under the SREP in individual Member States shall not be transferred into determination of LAA. To ensure the compatibility with the FSB TLAC requirement, we recommend the EBA to disregard the Pillar 2 capital requirements and combined buffer requirements when calculating the MREL, particularly as regards the recapitalisation amount.

**The Proposal for MREL floor at 8% of total liabilities incl. own funds is not justified**

As mentioned above, there is a possibility in BRRD for the resolution authorities to use the resolution funds to absorb losses in bail-in/resolution. This possibility can be used only if the losses amounting to 8% of a bank's total liabilities incl. own funds have been absorbed by the bank's shareholders and some debtholders. Alternatively, the resolution funds can be used if the losses amounting to 20% of a bank's RWA have been absorbed, provided that the resolution funds are well-financed (>3% of covered deposits).

Losses amounting to 8% of total liabilities incl. own funds or 20% of RWA will be absorbed by all liabilities that are bail-inable in bail-in/resolution. Although some of the liabilities are excluded from bail-in and the resolution authorities may exclude more liabilities from bail-in, the liabilities subject to bail-in will be much more than 8% of banks' total liabilities incl. own funds. Consequently, 8% threshold will always be fulfilled in bail-in/resolution for most the business models.

Introducing a floor for MREL at 8% of total liabilities including own funds is therefore not justified. We suggest that it should be deleted or significantly reduced.

**The possibility to bail in a smaller portion of the balance sheet before the resolution fund can be used, must be secured**

In the case of Sweden capital that has been built up in funds to ensure financial stability will be partly transferred into a resolution fund. The Swedish financing arrangements that can be drawn on in the event of a crisis amount to almost 7 per cent of guaranteed deposits (DGS, stability fund and resolution fund in total). In the BRRD there are provisions that Member States with resolution funds corresponding to 3 % of guaranteed deposits may choose to bail in only 20 % of RWA instead of 8% of total liabilities, before the resolution fund can be drawn upon in the event of a crisis. This possibility in the BRRD is especially tailored towards countries with large amounts of ex ante financed funds paid up by banks. It is of utmost importance that the MREL RTS does not in any way limit the possibility of the resolution authority to decide to bail in less than 8% of total liabilities. This should be made explicit at least in the recitals of the RTS.

**The de minimis derogation of 10 percent for liabilities that are potentially excluded from bail in may trigger extra MREL requirements**

Another feature of the proposed RTS which raises concern is the proposed de minimis derogation of 10 percent for liabilities that are potentially excluded from bail in.

The intention of the BRRD is that the assessment of which eligible liabilities are likely to be excluded in a bail in situation is to be made entirely by the resolution authority

on a case by case basis, reflecting the unique situation of the bank in question, at the point in time where resolution occurs. Article 45(6)c, stipulates that the resolution authority must ensure that losses can be absorbed even when there is a likeliness that certain classes of eligible liabilities that qualify for bail-in may be excluded, referring to to 44(3). Article 44(3) regulating the exclusion of eligible liabilities is in turn, intended to guide the resolution authority in ”exceptional circumstances, when the bail-in tool is applied”. We therefore suggest that article 5 in the RTS shall only refer to 44(3), and the reference to 44(2) should be deleted. In this context we would also like to point out that according to article 44 (4) the resolution fund may be used to cover the losses that the liabilities excluded according to 44(3) would have covered. To our understanding, it is therefore not the intention that exclusions made on the basis of 44(3), when the bail in tool is applied, affect the level of MREL decided ex ante, under “normal” circumstances.

In any case, it must be clarified that the 10 percent threshold is intended to cover only liabilities that are potentially excluded by the resolution authority, i.e., liabilities referred to in Article 44(3) in BRRD at the point in time when the bail-in tool is applied, and *not* also the liabilities that shall be excluded from bail-in ex ante, i.e., Article 44(2) in BRRD. [We note that in Article 5 of the EBA proposal, both Article 44(3) and 44(2) are mentioned.] Even so, the de minimis threshold of 10 per cent is very low and should be raised substantially.

If the intention is that the threshold should cover liabilities referred to in both Article 44(2) and 44 (3) it should be deleted entirely.

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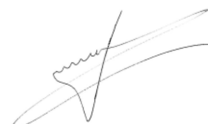

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