**The Slovak Banking Association**

**Comments and answers to the**

**Draft Regulatory Technical Standards on criteria for determining the minimum requirement for own funds and eligible liabilities (MREL) under Directive 2014/59/EU (BRRD)**

The application of the MREL RTS must not lead to banks having to issue MREL eligible debt instruments where unnecessary or inconsistent with the likely resolution plan. That could force those banks to artificially expand their balance sheets, which is not the intention of a crisis prevention and management related regulatory standard. Instead the supervisor should be given the possibility to adapt the requirement for banks in a way so that the end levels of the MREL requirement ensures a level playing field amongst different categories of banks. Such an adjustment or waiver could be applied e.g. if a systemically important bank funds itself only with retail deposits or covered bonds, but has sufficient capital to cover the MREL requirement up to a level that is equivalent from a financial stability perspective to that of similar banks as regards to size, risk profile and systemic importance etc. but with a different business model and a different funding model. This also reinforces our position on the need for the MREL amount (and the loss absorption amount if the two-step method is retained) to be driven from minimum capital requirements and not from actual levels including buffers and Pillar 2 requirements.

We are of the opinion that assessment study should be performed on local levels (all institutions included), because the overall shortfall of eligible liabilities could be misleading. The impact assessment attached to the RTS was done in a simplified way, which disregards vast differences existing among jurisdictions. These large differences relate to the capital requirements imposed by local supervisory authorities, balance sheet structure and source of financing, the size of MREL eligible liabilities relative to equity instruments in the respective countries and also the stage of the development and depth of the markets with MREL eligible instruments.

The Slovak banking sector is one of the examples of the misinterpretation in the impact assessment. Only 2 Slovak banks were included in the study, however the shortfall of the Slovak banking sector is **€1.845bn**[[1]](#footnote-1)[[2]](#footnote-2). In comparison to its asset volume it is a considerable amount (**3.74%**).

The business model of Slovak banks is very conservative. The banking system is financed mainly by primary deposits, which cover 73% of sector assets. Sector is stable and in very good conditions, banks are highly capitalized (Tier 1 capital ratio 16.17% in September 2014). Slovak banks and building societies operate with a liquidity surplus, loan to deposit ratio (L/D ratio) in September was 88%[[3]](#footnote-3). Slovak banks have not been affected by the financial crises and did not use public funds for recapitalization. Capital buffers are high and banks were generally well prepared for the new European regulatory rules CRR/CRD IV.

In this situation, EBA’s draft of MREL RTS is a regulatory threat to the Slovak banking sector. The proposal does not consider the different banking business models and worsen economic conditions especially for big retail banks financed by primary deposits.

The draft MREL RTS indicates that the MREL limit for O-SII or other locally important banks shall be set up at the level of doubled capital requirements. These are actually higher for Slovak banks due to higher capitalization than riskiness of the Slovak banking sector. Combination of higher capital requirements and financing mostly by primary deposits illogically mean the worst conditions for compliance with the draft MREL RTS.

Requirements of the MREL RTS for the Slovak O-SII would result in undesirable changes in balance sheet structure, funding costs and riskiness of the portfolio of assets which go against the sense of prudential regulation.

**Question 1:**

*The draft text describes comprehensively capital requirements under the CRR/CRD IV framework, which includes minimum CET1, AT1 and total capital requirements, capital buffers required by CRD IV, Pillar 2 capital requirements set on a case-by-case basis, and alternative backstop capital measures. The EBA is seeking comments on whether all elements of these capital requirements should be considered for the assessment of the loss absorption amount. Do you consider that any of these components of the overall capital requirement (other than the minimum CET1 requirement) are not appropriate indicators of loss in resolution, and if so why?*

**Answer:**

We are of the opinion that the combination of both Pillar 1 and Pillar 2 capital requirements (SREP requirements) and buffers could overestimate the loss absorption amount (LAA) leading to an unwarranted increase in MREL levels. We recommend the total loss absorption amount to be set as a default based on own funds requirements pursuant Article 92 of Regulation (EU) No 575/2013. The inclusion of other elements of capital requirements shall be subject to evaluation of the resolution authority based on the resolvability assessment, business model, funding sources and the risk profile of an institution (including the assessment of its historical losses) which would help to eliminate different phase-in period for implementation of capital buffers by individual Member States and also to assess whether for each entity in particular Pillar 2 and buffer requirements should be added, under exceptional conditions, or not, to the LAA. The existing inconsistencies in introduction of capital buffers and also in determination of additional capital buffers under SREP in individual Member States shall not be transferred into determination of LAA.

In addition, we think the use of the leverage ratio in the MREL measure should at a minimum await the EBA’s assessment on the appropriateness of this measure as mandated by BRRD Article 45(20)(b) and be introduced no sooner as it has become a Pillar 1 requirement in the European law.

**Question 2:**

*Should the resolution authority be allowed to adjust downwards? What are the specific circumstances under which resolution authorities should allow a smaller need to be able to absorb losses before entry into resolution and in the resolution process than indicated by the capital requirements?*

**Answer:**

We suppose the national resolution authority should have the sufficient flexibility to adjust MREL both ways, upwards and downwards as well, regarding additional information and specificities on each individual bank or characteristics of local banking sectors/models (the option to decrease the LAA for a purpose of elimination of national discretions and for a purpose of normalisation and standardisation of Pillar 2 add-ons. This would ensure a level playing field among entities that are similar but are in different jurisdictions.

In some cases, high capital requirements (for instance systemic risk buffers and countercyclical buffers) are rather an expression of high risk aversion or macro prudential tools used to counter the build-up of systemic risk, and are not an indication of potential loss levels for a particular institution or banking system. These are not appropriate to be used as a default loss absorption amount.

**Question 3:**

*Should any additional benchmarks be used to assess the necessary degree of loss absorbency? If yes, how should these be defined and how should they be used in combination with the capital requirements benchmark? Should such benchmarks also allow for a decrease of the loss absorption amount compared to the institution’s capital requirements?*

**Answer:**

We do not deny the right for the resolution authority to adjust LAA upwards, but we are concerned about the potential source of conflict of interests between competent authorities and resolution authorities, since the higher level of LAA should represent the risks not included in standard components of LAA (but we do not see any other risks that could influence loss absorbency and would not be incorporated in own funds requirements and relevant capital buffers, which are based on Supervisory Review and Evaluation Process taken by competent authority). Moreover, if there is a possible impediment to resolvability, it should not be incorporated in loss absorbency, but in recapitalization amount.

**Question 4:**

*Do you consider that any of these components of the overall capital requirement are not appropriate indicators of the capital required after resolution, and if so why?*

**Answer:**

After the resolution institution should fulfill only minimum own funds requirements set according to CRR (Articles 92 and 458). Potentially, all other risks (not incorporated in CRR; in terms of Articles 104 (1a) and 139 of Capital Requirements Directive IV) should be part of recapitalization amount. But these capital buffers should be based on situation after the resolution, not before, because these capital buffers, after the resolution, may not be relevant for the bank any more. Capital conservation buffer, countercyclical buffer, buffer for G-SII/O-SII and Basel I floor are not risk covering, but since they help to restore the market/bank confidence they should be part of recapitalization amount in longer-term horizon. Since the capital accumulation for fulfilling the combined capital buffer requirement will speed up after the resolution (due to restrictions in dividend policies via the Maximum Distributable Amount (MDA)), there is no need to include all capital buffers into recapitalization amount.

**Question 5**

*Is it appropriate to have a single peer group of G-SIIs, or should this be subdivided by the level of the G-SII capital buffer? Should the peer group approach be extended to Other Systemically Important Institutions (O-SIIs), at the option of resolution authorities? If yes, would the appropriate peer group be the group of O-SIIs established in the same jurisdiction? Should the peer group approach be further extended to other types of institution?*

**Answer:**

We do not believe the “peer group” approach to be an appropriate mechanism for setting regulatory requirements. Regulatory standards should be set by regulators, not by observing market behavior, which can be influenced by varying factors including notably the maintenance of management buffers over and above regulatory requirements, and individual banks financial strategies.

It does not appear reasonable that an institution immediately after a resolution event that is still undergoing a restructuring program operates with capital levels at the median of its former peer group (because it is likely that the institution will no longer be a G-SII, or O-SII, or will at least have changed its “bucket” after resolution to a lower peer group). In addition, G-SIIs or O-SIIs from different jurisdictions may be subject to significantly different Pillar 2 and buffer requirements, affecting their total CET1 ratio. Therefore, we do not support the peer group approach.

However, if a peer group approach eventually should be applied, then the peer group should not be extended to O-SIIs. For these banks the level of sufficient market confidence after resolution should be derived on a case by case basis.

O-SIIs will be a combination of subsidiaries of banks classified as either G-SIIs or O-SIIs in their home countries and domestic institutions. This has potentially significant implications for capital levels, as subsidiaries of global/regional institutions may not operate with the same internal buffers as local institutions (management buffers are more likely to be held at the parent institution). In addition, buffers applied to the parent institution may be higher than those that would be applied to the subsidiary on a standalone basis (but be considered as the “combined buffer requirement” for the subsidiary institution). Both of these factors would potentially distort the sample data for the peer group.

Finally, in some jurisdictions, where the banks traditionally retain large portion of their earnings and hold significantly higher capital than prescribed by the supervisory authority, the peer group approach would actually be counterproductive in discouraging such a practice, since it would lead to a spiral increase of MREL requirements.

**Question 6:**

*The approach outlined in Articles 2 and 3 will reflect differences between consolidated and subsidiary capital requirements. Are there additional ways in which specific features of subsidiaries within a banking group should be reflected?*

**Answer:**

There is no information in either Article 2 or 3 as to how differences between consolidated and subsidiary capital requirements would be reflected. It is actually not entirely clear to us what is meant by the statement that ‘differences in capital requirements’ will be reflected, as the RTS should address how MREL requirements will be differentiated between subsidiary and consolidated levels. As far as capital requirements are concerned, these are generally available at both consolidated and subsidiary level, so we would assume the methodology outlined in the RTS to be applied based on the relevant requirements. If this is not the intended approach, this should be further clarified.

The RTS should contain explicit and detailed specifications as to how MREL requirements should be set at subsidiary, parent and consolidated level respectively. At a minimum, the assessment should consider the following aspects:

• Strategy (i.e. SPE vs. MPE) and whether or not the entity for which MREL is being set is a ‘resolution entity’.

• Treatment of intercompany exposures in subsidiary assessments.

• Cross guarantee and institutional protection schemes or other intragroup support arrangements.

**Question 7:**

*Do you agree that there should be a de minimis derogation from this provision for excluded liabilities which account for less than 10% of a given insolvency class?*

**Answer:**

In our view, a specific threshold should not be explicitly set in advance. *A de minimis derogation from the provision for excluded liabilities* should be evaluate case-by-case by the resolution authority after the individual NCWOL test.

**Question 8**

*Do you agree that resolution authorities should seek to ensure that systemic institutions have sufficient MREL to make it possible to access resolution funds for the full range of financing purposes specified in the BRRD?*

**Answer:**

We agree with the proposal of the draft RTS that systemic relevant institutions should have sufficient MREL. However, we strongly recommend deriving the MREL minimum for all institutions from the resolution plan. This should be done on an individual basis and not by a uniform approach like a minimum level for systemic relevant institutions. This would allow the EBA to reinforce the principle of proportionality by ensuring that MREL requirements are suited to the particular characteristics of each bank.

A uniform minimum would not adequately reflect the different business models, risk profiles and diversification effects of the institutions (retail, universal versus investment banking).

**Question 9:**

*Is this limit on the transition period appropriate?*

**Answer:**

For level playing field reasons, we believe that the transition period should be the rule and not an option at the authorities’ discretion.

Consideration might be given to a longer transitional period for countries where the senior unsecured debt market is not developed or does not have the capacity to absorb the necessary amounts of MREL eligible liabilities. It will require, in such countries, substantially longer time to build the investor base for the required amount of debt to be issued than proposed transition period of 48 months.

It is of particular importance to conduct a thorough market research to assess the capacity of the individual market especially for issuers, which are currently not present on the senior unsecured market.

**Question 10:**

*Should the resolution authority also set a transitional period for the MREL of banks which are undergoing or have undergone a resolution process?*

**Answer:**

Yes, it makes sense to set a relevant transitional period during or after the resolution process, depending on the resolution outcome. It can be assumed that for an institution in or shortly after resolution, even the market expectation will reflect the situation and the institution will not be expected to reach the target immediately. Once the MREL is depleted in resolution, we would expect the minimum capital requirements to be restored immediately and the buffers to be rebuilt over time, with the timeframe dependent on prevailing circumstances. A transition of 5 years seems a minimum to ensure that banks have sufficient time to issue compliant instruments in their respective markets. We note that the CRR introduced a phasing out period of 10 years for capital instruments issued under CRD 3 which were no longer compliant.

**Question 11:**

*Overall, do you consider that the draft RTS strikes the appropriate balance between the need to adapt the MREL to the circumstances of individual institutions and promoting consistency in the setting of adequate levels of MREL across resolution authorities?*

**Answer:**

We appreciate the whole concept of BRRD, but we call for the unification rules. During the transitional period for CRR, stricter national discretions and earlier launch of capital buffers (but still in accordance with the CRR/CRD IV), banks in some countries have comparative disadvantage over other banks, and after the application of MREL RTS in proposed text this disadvantage will be doubled. If possible, banks’ MREL should be based on standardized rules (ITS) stemming from fully phased-in CRR/CRD IV legislation without any national discretions.

In our opinion, assessment study should be performed on local levels (all institutions included), because the overall shortfall of eligible liabilities (€36bn in scenario 1, alternative B) could be misleading. We suppose that substantial surplus of eligible liabilities in some countries in your assessment study off-sets substantial deficit of eligible liabilities in other countries. For example, only 2 Slovak banks were included in the study, and according to our information, Slovak banking sector is in deficit of €1.845bn of eligible liabilities, which in comparison to its asset volume is a considerable amount.

**Question 12**

*Are there additional issues, not identified in this section, which should be considered in the final impact assessment?*

**Answer:**

**Using RWAs as the denominator for MREL**

Based on Article 45, point 19(i) of Directive 2014/59/EU (BRRD), EBA shall assess by October 2016 whether it is more appropriate to use the institution’s risk-weighted assets or total liabilities and own funds as the denominator for the requirement. We would appreciate EBA performs this assessment as soon as possible and preferably reflects it in the technical standard from the very beginning. We believe that using RWAs as the denominator would better reflect the economic reality.

Regarding third subparagraph of Q11 answer, Slovak banking sector is in deficit of €1.845bn of eligible liabilities, which could indicates potential vulnerabilities of our banks. But during the financial crisis, any public or parental financial support has not been provided, our sector is well capitalized (above EU-average) with low loan-to-deposit ratio. Furthermore, in local market it would be very difficult to sell €1.845bn of eligible liabilities (unsecured bonds) to investors. The last but not least, it would have substantial impact on profitability and unnecessary changes in liabilities’ structure or artificial growth of balance sheets.

1. Approx. 91.5% of banking sector (without branches of foreign credit institutions) by assets. [↑](#footnote-ref-1)
2. **€2.869bn** (**5.82%** of total assets) according to extra buffers from 2016. [↑](#footnote-ref-2)
3. Net loans to deposit. [↑](#footnote-ref-3)