ING

Date
23 October 2020

Contact
Matthijs van Oers
(Matthijs.van.Oers@ing.com)

Subject
Consultation on Draft Regulatory Technical Standards on Daisy Chains (EBA/CP/2020/18)

ING welcomes the European Banking Authority's ongoing efforts in providing the necessary technical standards in relation to the 2019 Banking Package. Regulatory Technical Standards (RTS) specifying how MREL instruments that are indirect subscribed to by the resolution entity will be treated by each intermediate entity are essential for banking groups in designing and implementing effective internal loss transfer arrangements.

ING also very much appreciates the opportunity to provide comments on the draft RTS. We are committed to support regulators in designing a regulatory framework that is effective and appropriate to its objectives. Hence, in this document we outline our views on the draft RTS on Daisy Chains, providing suggestions to enhance the suitability of the draft RTS in the context of the European Union's capital requirements and resolution frameworks.

We are available to the European Banking Authority to further elaborate on or clarify our views set out below.

Interaction with existing Level 1 deduction framework

1. In accordance with CRR[1] article 49(2) holdings of the own funds of a subsidiary are generally not deducted. A deduction regime specifically for MREL purposes will result in different amounts for own funds, RWA and Leverage Ratio Exposure for MREL purposes vis-à-vis own funds requirements where deduction is not required. This will severely affect comparability of figures disclosed by institutions to the public, but more importantly how a bank might be prudently managed with clear and understandable metrics.

2. Furthermore, we wish to highlight that the definition of 'own funds' as specified in BRRD[2] article 2(1)(38) links to the own funds definition prescribed in the CRR, which does not specify the deduction regime as proposed by the draft RTS. Therefore, the deduction regime will create formalistic issues due to the differences in definition used. This issue is already visible in the European Banking Authority's final draft ITS on disclosure and reporting on MREL and TLAC (EBA/ITS/2020/06) where 'own funds' consistently refers to CRR article 72. Different amounts of own funds used for MREL and for capital requirements will break these links embedded in the Level 1 regulations.

3. Requiring the deduction of daisy chained own funds instruments is at the discretion of the competent authority. If the RTS were to require that institutions apply a deduction of daisy chained own funds instruments this would be contrary to the Level 1 legislation. CRR article 49(2) provides the competent authority with the discretion to require banks to apply a deduction regime in individual circumstances for specific purposes. Article 49(2) has been in place since the introduction of the CRR and has not been

[1] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, as amended
[2] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council

amended as part of the Banking Package, which also contained the MREL and TLAC changes. The legislator left this mandate with the competent authority.

4. Further, article 49(2) lists 'structural separation of banking activities' and 'resolution planning' as specific purposes for which competent authority can make such an assessment. We note that structural separation of banking activities is opposite to what the internal MREL framework is aiming to achieve: an effective internal loss distribution mechanism.

Differences between internal own funds instruments and eligible liability instruments

5. We note that the European Banking Authority is required by BRRD article 45f(6) to draft technical standards specifying methods for instruments that are indirectly subscribed by the resolution entity. Indeed, for the purpose of internal MREL liabilities must be issued to the resolution entity, either directly or indirectly. For own funds instruments, however, there is no requirement that these instruments must be issued to the resolution entity. Own funds instruments must only be issued to another entity in the resolution group, which may or may not be the resolution entity (BRRD article 45f(2)(b)(ii)). Therefore, the draft RTS should not apply to own fund instruments, as these instruments are not required to be issued to the resolution entity, either directly or indirectly. We believe the European Banking Authority should limit the scope of its draft technical standards to eligible liability instruments referred to by BRRD article 45f(2)(a).

Value of Common Equity Tier 1 (CET1) instruments on the balance sheet of the intermediate entity

6. The draft RTS proposes the deduction of the amount of an intermediate entity's holdings of own funds instruments and eligible liabilities instruments. This provision does not consider how CET1 instruments of a subsidiary are accounted for on the balance sheet of the intermediate entity. In accordance with IFRS, investments in subsidiaries will be valued on the individual balance sheet of the intermediate entity using the equity method. This is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post acquisition change in the investor's share of the investee's net assets. The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income (IAS 28.3). The value on the intermediate entity's balance sheet does not represent the actual value of the instrument. It also includes amounts that would generally be considered own funds items, such as retained earnings and other reserves. The value of the investment in the subsidiary on the intermediate entity's balance sheet does not relate to the value of the actual capital instruments issued by the subsidiary. Therefore, the draft RTS is not practicable or reflective to the substantive nature of the value of the investment.

HoldCo vs. OpCo strategy

7. Generally, banking groups operating in a HoldCo strategy are more resolvable due to the clean balance sheet of the holding company. However, these group would be disproportionately affected by the proposed RTS, as these group generally operate with an operating company in between the holding company and the foreign subsidiaries. The proposed RTS will significantly affect the MREL requirement of the operating company. This may not be the case for groups with an OpCo strategy. Even though these groups are generally less resolvable.

Leverage Ratio Exposure

8. In line with general principles in prudential regulations, any amount deducted in the nominator of a ratio should also be excluded from its denominator. 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 extends this principle to RWA for deducted eligible liability instruments. However, the draft RTS fails to extend this principle to the Leverage Ratio Exposure for deducted eligible liability instruments. As a result, under the RTS as currently drafted, the intermediate entity will be

required to both deduct a eligible liability instrument it holds from a subsidiary and include it in its Leverage Ratio Exposure. This is a significant double-counting of exposures.