POSITION PAPER

ESBG response to the EBA consultation on criteria for determining the minimum requirements for own funds and eligible liabilities under Directive 2014/59/EU

ESBG (European Savings and Retail Banking Group)

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ESBG Transparency Register ID 8765978796-80

February 2015

Dear Sir/Madam,

Thank you for the opportunity to comment on the EBA's consultation on *criteria for determining the minimum requirements for own funds and eligible liabilities (MREL) under Directive 2014/59/EU*.

General comments:

Two-step process for the MREL:
ESBG notes that the proposal on the MREL consists of two individual amounts – loss absorption amount and recapitalisation amount – both of which might be over-conservatively determined. ESBG is concerned that such an approach might lead to an excessive total MREL. A careful analysis of the impact of the proposed MREL requirements on banks and capital/funding markets should be made.

Interaction between institutions and resolution authorities:
ESBG further suggests that the EBA explicitly states the need for interaction between the resolution authority and the institution when assessing the level of the MREL derived from the resolution plan; particularly when determining the balance sheet and the capital requirements of a potential post-resolution institution.

Disclosure:
ESBG would very much appreciate if the EBA could expound further on disclosure requirements regarding the MREL. It would indeed be helpful to have guidelines on disclosure to ensure the level playing field in dealing with investors and analysts.

Treatment of own funds deductions:
When specifying the MREL, the EBA should take into account that the post-resolution entity will have different capital requirements than the current entity. In this respect, when assessing the recapitalisation amount, ESBG would like to ask the EBA to take into account that the new post-resolution institution will not only have fewer RWAs, but also fewer own funds deductions.

Treatment of liabilities issued by subsidiaries:
ESBG would furthermore appreciate if the EBA could clarify whether eligible liabilities issued by subsidiaries could be eligible on a consolidated basis if these securities are held by third parties (external to the group).

Sub-consolidation of credit institution subsidiaries:
The EBA could also develop the MREL on a sub-consolidated level and shed some more light on the eligibility of intra-group liabilities for sub-consolidated MREL.

Shareholders' commitments:
ESBG suggests that the EBA includes committed amounts by current shareholders as eligible MREL instruments. These commitments may be statutory or contractual.

Transitional arrangements (grandfathering of senior unsecured debt):
ESBG would moreover propose that current senior unsecured debt might be fully eligible during a grandfathering period. Otherwise, a complete new asset class might be needed, causing a certain overflow in the market.

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?***

ESBG proposes to first focus on the capital requirement stated in Article 2(2)(a) draft RTS to approximate the loss absorption amount. These figures are risk based and reflect in the best way the individual risk profile of the respective institutes based on common rules defined in the CRR.

Despite the fact that, in theory, the inclusion of the capital requirements stated in Article 2(2)(b) and (c) draft RTS would factor in other relevant aspects of prudential supervision, it cannot be excluded that the actual application of such capital requirements in different jurisdictions might lead to arbitrary requirements – based on the different supervisory authorities' risk aversion or macro-prudential approach – and that a level playing field might not be achieved.

The "Basel I floor" and the "leverage ratio requirement" as stated in Article 2(2)(d) and (e) draft RTS are nominal back-stop measures and are non-optimal indicators for loss in resolution of an institute.

Question 2: ***Should paragraph 5 refer only to the resolution authority increasing the loss absorption amount, rather than adjusting it? Are there 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 (for example, due to the use of national discretions in setting capital requirements)?***

ESBG prefers that paragraph 5 refers to the resolution authority *adjusting* the loss absorption amount. In any case, we assume that such an adjustment will – preferably – be a "fine-tuning" of the loss absorption amount, thus not leading to continuous modifications.

We assume that *adjust* is the right wording and EBA should stick to that version of the text. A fixed floor would have the advantage of a level playing field. However, the current draft is more flexible and allows for considerations of individual economic factors. If the risk of a "bail-out" in a crisis situation could be banned after the assessment of the resolution authority with reduced capital requirements, then a reduction in a loss absorption amount would be appropriate, in our opinion.

Based on the fact that the draft RTS do not mention the frequency of the assessments of the loss absorption amount, which is done by the resolution authority, ESBG would moreover like to ask the EBA whether the assumption is correct that these assessments will be made at the same time as the drawing up and updating of the resolution plans.

<u>Question 4:</u> 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?

The principle of proportionality should be taken into consideration when determining the recapitalisation amount. The idea of Article 3(2) draft RTS is appropriate – a recapitalisation amount could even be set at "0". If the resolution authority comes to the conclusion that there is no public interest in a resolution of the institution (see EBA/CP/2014/16), this result should be taken into account not only for determining the recapitalisation amount but also for determining the MREL. If the resolution authority concludes that there is no public interest for a resolution, the determination of the MREL above "0" should – if at all – only have a symbolic character.

ESBG proposes that the EBA avoids the duplication of both the Pillar 2 requirements and the combined capital buffer requirements (CBR) when determining the level of eligible liabilities. We understand that the post-resolution institution would bear different and lower risks than those borne by the original institution. In particular, both the current Pillar 2 requirements and the CBR could not apply. The requirements of a post-resolution institution should be adequate to its characteristics. This does not mean that it could be subject to capital distribution restrictions.

The recapitalisation amount should not be determined in isolation and not additively to the "loss absorption amount". Rather, the resolution authority should consider an appropriate recapitalisation level post resolution and upon implementation of the specific resolution plan. Especially the reduction in capital demand due to the usage of resolution tools should be taken into account.

The MREL requirement set by the resolution authority should consider the aggregate effect of losses, which reduces the risk weighted assets, occurring up to resolution, following potential earlier recovery measures (e.g. sale of subsidiaries), the then remaining capitalisation and additional downside at entry point of resolution.

In opposition to the identification of the "loss absorption amount", the "Basel I floor" and the "leverage ratio" are proper indicators to estimate the recapitalisation amount. The recapitalisation amount has to be sufficiently high that the institute can comply with all regulatory requirements.

With respect to Article 3(7)(a) draft RTS ESBG understands that the EBA has an interest that capital requirements listed in Article 3(6) draft RTS following recapitalisation should be met and that the resulting institution should also meet its combined capital requirements. However, we question whether, immediately following resolution, a "buffer on the buffer" as outlined in Article 3(7)(b) draft RTS should be met. Rather, such a "sufficient market confidence buffer" (if individually necessary) should be built up via further retained earnings over a transition period after the resolution action. It is the foremost objective of the specific resolution action itself to create required market confidence for the resulting institution by appropriate de-risking (following asset valuation) and recapitalisation in line with the CRR/CRD IV requirements.

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?***

ESBG does not agree with a de minimis derogation from this provision for excluded liabilities to simplify the process, if this leads to a de facto exclusion of senior unsecured bonds as MREL eligible instruments. In such a case a de minimis derogation could lead to significant market intervention due to a de facto exclusion of the current stock of senior unsecured bonds as MREL eligible instruments. In ESBG's view, that was not intended by the BRRD.

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?***

According to Article 7(2) draft RTS the resolution authority has ample room for discretion when determining the MREL for G-SIIs and O-SIIs. In ESBG's opinion, this discretion is too far-reaching. If such a special treatment was introduced, there should be clearly pre-defined criteria or even quotas in place which would have to be taken into account by the resolution authority when determining the MREL. Furthermore, the aforementioned discretion should only be considered for O-SIIs, as for G-SIIs the probability of using means of the resolution fund is there in any case.

Question 9: ***Is this limit on the transition period appropriate?***

ESBG agrees that it is fundamental to establish an appropriate transitional period in order to give institutions enough time to issue new capital requirements with bail-in features and replace current instruments where necessary.

However, we suggest that the EBA considers introducing a transitional period for the MREL which is similar to the transitional period regarding the filling up of the Single Resolution Fund. In particular with regard to institutions without access to capital markets, a transitional period of 48 months could be too short. A period of at least 72 months would be appropriate.

Finally, ESBG believes that the EBA could consider linking any transitional period not only to the institution's individual situation, but also to regional circumstances (e.g. advancement in size and quality of necessary regional capital market).

About WSBI-ESBG (European Savings and Retail Banking Group)

ESBG brings together savings and retail banks of the European Union and European Economic Area that believe in a common identity for European policies. ESBG members support the development of a single market for Europe that adheres to the principle of subsidiarity, whereby the European Union only acts when individual Member States cannot sufficiently do so. They believe that pluralism and diversity in the European banking sector safeguard the market against shocks that arise from time to time, whether caused by internal or external forces. Members seek to defend the European social and economic model that combines economic growth with high living standards and good working conditions. To these ends, ESBG members come together to agree on and promote common positions on relevant matters of a regulatory or supervisory nature.

ESBG members represent one of the largest European retail banking networks, comprising of approximately one-third of the retail banking market in Europe, with total assets of over €7,300 billion, non-bank deposits of €3,480 billion and non-bank loans of €3,950 billion (31 December 2012).

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Published by ESBG, February 2015