EACB Comments on the draft RTS on criteria for determining the minimum requirement for own funds and eligible liabilities under Directive 2014/59/EU

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The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 31 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4.200 locally operating banks and 68.000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 205 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 78 million members and 860.000 employees and have a total average market share of about 20%.

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General remarks

The members of the EACB gladly take the opportunity to comment on the proposed EBA draft RTS.

We welcome the suggested approach, which our members consider neutral regarding the business model of cooperative banks and reflecting proportionality.

Moreover, we appreciate that the EBA tries to coordinate, to the possible degree, with relevant provisions of the FSB's TLAC project.

However, we are concerned by the calibration criteria introduced in this draft RTS and we suggest to accommodate for sufficient flexibility to avoid that the MREL calibration leads to higher requirements for banks which are subject to both ratios (G-SIBs). This is a matter of level playing field for EU banks.

Answers to specific questions

Q.1 The draft text above 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 backstop capital measures (Basel I floor and leverage ratio). 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?

We equally consider valid the presumption that capital requirements reflect a judgement of both the regulator and the supervisor about the amount of unexpected losses an institution can bear. Thus, as a baseline the losses of an institution can be covered by its required prudential capital.

However, we have some concern about including, at this stage, "any" leverage ratio in the parameters for the capital requirements (Art. 2(2)(e)). For the time being, not all Member States have implemented a leverage (phase in until 2017) and where that has happened, the (national) ratios are not the same. The requirement may therefore distort competition, even more since those ratios were not adopted as a parameter for the determination of MREL.

We would not go far, however, to believe that the full amount of capital would be absorbed. In most cases, it will only be a part of the regulatory capital that will be absorbed in case of difficulties. Indeed, the scenario of depleting the entirety of minimum own funds (including buffers and Pillar 2 requirements) is rather unlikely. It seems difficult to assume that a supervisor would let a bank to loose all buffers without requiring any recovery or early intervention measures.

We furthermore would like to remind that even in cases where the amount of capital should be insufficient, deposit guarantee protection and/or institutional protection schemes will provide another line of defence.

Q.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)?

We would like the resolution authority to be open to reflections in both ways in determining loss absorption amounts: the judgement that in a given case the regulatory capital requirements are "more than enough" for a loss absorption amount, must remain possible. We therefore have a clear preference for the wording "adjust".

Moreover, we would like to express our concern about the wording of the Article 2(3)-(6): we believe that the overruling of the baseline presumption in Article 2(3) should only be possible in exceptional circumstances. There should be some very specific, well defined reasons, linked to impediments to the resolvability of the institution, for an upward adjustment of the loss-absorption amount for institutions by the resolution authority.

Following BRRD, also the draft RTS poses the determination of the MREL as a key element of resolution planning and resolvability assessment. Consequently, the following aspects need a more explicit clarification:

i) How it is reflected in terms of MREL the case of a resolvability assessment concluding that an institution can be wound down under normal insolvency procedures.

ii) How simplified obligations in terms of resolution planning translate consistently into the MREL required when the resolution authority demands simplified obligations to a certain institution.

In our understanding, in both these cases, the recapitalisation amount required should be equal to zero and therefore the required MREL should just be equal to the overall capital requirements (Art. 3(2) draft RTS).

In addition, with regard to any upward adjustment of the loss-absorption amount, it must be underlined that the supervisory assessment of an entity's capital requirements (and solvency) shall not be challenged by the resolution authority. The resolution authority is empowered to determine the loss absorbency amount but the prudential perspective cannot be disregarded. As the supervisor may already take into account certain aspects under its SREP requirements, , any "upward"-adjustment of the resolution authority should be consistent with and follow the determinations already undertaken by the competent supervisory authority in the first place. Priority should be given to measures by the competent supervisor in order to ensure convergence and to avoid a duplication of requirements. To avoid such duplications of requirements, consultation with the supervisory authority should be made mandatory for the resolution authority shall it intend to set the loss absorbency amount at higher levels.

Finally, we would appreciate clarification regarding the possible measures of the resolution authority under Article 2(5) regarding the substance of the adjustment: in fact, article 45(1) of the BRRD explicitly states that the MREL may be fulfilled with own funds <u>or</u> eligible liabilities. Even if Article 2 is only referring to capital requirements, any "adjustment" of the resolution authority should <u>always</u> leave the choice to the institution of whether it intends to fulfil the additional loss-absorption requirement with own funds or eligible liabilities. We do not see any legal basis for imposing specifically a higher capital charge.

Own funds deductions according to CRR/CRD IV (e.g. for minority capital on consolidated basis), though justified in general for regulatory purposes should not be applicable in resolution/insolvency in the specific case.

Q.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?

As indicated already under question 2, we believe that it will be very difficult to differentiate the loss-absorption assessment from the supervisory assessment. Even if the criteria may differ (what we are not fully convinced of) both assessments may be based on the same underlying facts. We therefore see a serious danger of overlaps and conflicts.

This situation can either be overcome by specific well-defined benchmarks for loss-absorption or by a close (mandatory) consultation process between supervisory authorities and resolution authorities.

Q.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?

We do not see that the combined buffer requirement should be part of the recapitalization amount as this would turn them into minimum requirements rather than buffers on top of the minimum requirements. Similar reasons have led the FSB in its TLAC-consultation to exclude the combined buffer requirement from recapitalization amount.

We also believe that the above argument is true for Pillar 2 requirements. They should be considered as buffers as well, rather than as minimum requirements. So Pillar II requirements should decrease as well, also because we assume that an institution is safer once the loss has materialized, i.e. after resolution as toxic assets have been written down. Indeed, once the institution enters into resolution, authorities would impose a tough restructuring plan which may eliminate, or at least significantly reduce, all the previous capital, liquidity, business and governance uncertainties. As a consequence the restructured entity is likely not to have any Pillar 2 capital surcharges.

Q.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?

Although we acknowledge that G/O-SIIs will require a higher recapitalization amount than other banks due to their systemic importance we would like to point out that a full recapitalization to an ex-ante status is not foreseen by the BRRD. It should suffice to recapitalize G/O-SIIs in a way to gain time and reorganize the failed G/O-SIIs appropriately without disrupting markets but not to put the institution in its initial situation prior to resolution. Moreover, G-SIIs from different jurisdictions may be subject to significantly different Pillar 2 and buffer requirements, affecting their total CET1 ratio. Any comparison should be adjusted for differences due to national discretions and reflecting competent authorities' appreciation of risk.

Nevertheless, if the EBA should maintain its suggested approach, the reference to a "peer group" for determining the additional amount may be a difficult issue in particular with regard to OSIIs and their diferrent business models. Resolution will imply significant restructuring so that the identification of a "new" peer group has to be identified. In the midst of resolution, this may be a complex issue..

Q.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?

Article 45 of the BRRD requires institutions to fulfil MREL both at individual and consolidated level. MREL should also reflect the appropriate resolution strategy.

MREL should normally be implemented on a consolidated level in order to consider the diversification effects within the group structure adequately. The MREL requirement at group level would be consistent with the BRRD's rule of intra group financial support (Article 19-26 BRRD). According to the instrument of intra group financial support, the entire financial group is not necessarily considered to be failing, if one unit of the group is likely to fail. Nevertheless, if MREL has to be met at individual level, such subsidiaries with specialised and very specific business models (e.g. the German building societies and other institutions overwhelmingly financed via deposits of deposit holders in the scope of DGSD) should only have to fulfil the loss absorption amount and not any additional recapitalisation amount. To meet any higher amount of eligible liabilities, such specialised institutions would be forced to issue bail-inable instruments although the only possible investors would be intra-group members. Therefore, in contradiction with the principle of achieving improved stability for the financial sector by distributing losses also among external investors, in these cases losses would just be passed on within the group structure.

Thus, the derogation from the application of MREL on an individual level should not be automatically tied to the waiver requirements in accordance with Article 7(3) of Regulation (EU) No 575/2013.

On the other hand, the MREL is to be determined on an individual basis, which implies that different resolution strategies (Multiple-Point-of-Entry, MPE, and Single-Point-of-Entry, SPE) should be considered. For the MREL at individual level for MPE banks, not every capital requirement set at consolidated level should be considered. This is particularly the case of the systemic capital buffer or any Pillar 2 capital surcharge imposed at consolidated level.

Whether a solo institution in a group has enough loss absorbency capacity in insolvency will very much depend upon:

- where the loss arises within a consolidated group;
- distribution of own funds and subordinated debt within the group;
- group internal risk transfer (via debt, equity, off-balance-sheet items, IPS or other informal considerations) and consolidation effects;
- corporate structure of the group (note that decentralized banking groups have different risk transfer channels due to their reverse pyramid structure than standard banking groups regardless whether and which joint liability scheme they take part in) including minority participations;
- the resolution strategy chosen (note that SPE and MPE strategies may have different consequences for group parents on a solo basis);
- willingness of resolution authorities to cooperate (note that banking groups may work inside and outside of SRM Member States or EU Member States, i.e. only being partially subject to the BRRD or the SRM Regulation).

On a consolidated basis excess minority capital deducted will nevertheless absorb losses when the loss occurs in the unit or sub-consolidated group that is owned by minority shareholders. Whether losses will occur in such "minority" units will depend on the distribution of RWA within the consolidated group. When the majority of RWA is located in the "minority" unit there is a high probability that the consolidated capital requirement may not be fully consumed by losses as deducted excess minority capital will absorb losses.

On the subsidiary level of a consolidated group, intragroup funding (i.e. intragroup liabilities) should be considered when determining the recapitalization amount. Shareholder loans are often considered as surrogate capital in local insolvency legislation in one way or another and will thus have a higher probability of being bailed-in compared to other senior unsecured liabilities. Thus intragroup liabilities shall also be considered when determining the recapitalization amount.

Q.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?

We understand that Art. 5 imposes that if liabilities excluded from bail-in make up to 10% of a given insolvency class, it shall not decrease the MREL-amount of a credit institution. Taken this as a common understanding of Art. 5 we agree to a *de-minimis* derogation for excluded liabilities regarding the recapitalization amount. However, we believe that a 10% *de-minimis* rule may be rather modest and that it should be higher (up to 30%).

Q.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?

Yes, we believe that all banks, which pose a risk to the financial stability and fulfill the requirements for resolution mentioned in Art. 32 para 1 BRRD, should have sufficient MREL to recapitalize functions that are systemic and could disrupt markets

Q.9 Is this limit on the transition period appropriate?

Given that this transition period:

- coincides with the transition periods of the CRR/CRD IV to increase own funds;
- is shorter than the CRR/CRDIV transition periods,

we are concerned about the potential demand from investors for risk-bearing liabilities. Moreover, there may be additional difficulties for non-listed institutions. In our opinion, there were no sufficient reflections on the transition period. We therefore suggest that the transitional period should be extended to 120 months.

Moreover, we suggest a comprehensive QIS exercise in order to ensure that even an extended transitional period is workable.

Q.10 Should the resolution authority also set a transitional period for the MREL of banks which are undergoing or have undergone a resolution process?

Yes, if their loss-absorbing capacity has been reduced in the undergone resolution process.

Q.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?

We have the feeling that the draft RTS:

- is too geared towards G-SII by mostly automatically accepting that the entire institution has to be recapitalized without major reorganization, thus placing them outside standard insolvency proceedings;
- mainly deals with large groups that are owned by a common shareholder, but ignores decentralized banking groups;
- does not give clear guidance on how to treat loss absorbing capacity of minority shareholders and IPS;
- does not deal with intragroup risk transmission mechanisms which heavily influence cross loss burden sharing (distribution of own funds, intragroup financing and guarantees and their treatment in resolution);
- does not clearly state what consequences arise from different resolution strategies;
- is very much focused on national or intra Eurozone/EU groups, but does not consider banking groups working within and outside the EU;

Q.12 Are there additional issues, not identified in this section, which should be considered in the final impact assessment?

According to Art. 3(2) of the draft RTS the recapitalisation amount should be zero in cases where the resolvability assessment concludes that the liquidation of the institution under normal insolvency processes is feasible and credible, that is to say that a public interest for resolution in the meaning of Art. 32(1)(c) BRRD does not exist. According to our understanding the existence of such an public interest should not only be considered as a requirement with regard to Art. 3 but with regard to the determination of the MREL itself and therefore of all six criteria. Indeed, it would have only a limited extent if an institution would have to maintain MREL but no public interest would be in place and a resolution, in particular a bail-in, would not be permitted.

The draft RTS, and in particular Art. 8, does not clarify how the six criteria should concretely operate together, and for instance whether there is a special weighting among the criteria. It could be considered whether some more concrete details should be incorporated in the Article.

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