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For publication

UniCredit reply to EBA consultation on draft RTS on criteria for determining the minimum requirement for own funds and eligible liabilities (MREL) under Directive 2014/59/EU

UniCredit is a major international financial institution with strong roots in 17 European countries, active in approximately 50 markets, with almost 8,000 branches and over 130,000 employees. UniCredit is among the top market players in Italy, Austria, Poland, CEE and Germany.

Background and EBA mandate

EBA is entrusted with the task to draft technical regulatory standards ("Draft RTS") aimed at specifying further the criteria set out in Directive 2014/59/EU ("BRRD") according to which resolution authorities have to set for each institution a minimum requirement for own funds and eligible liabilities ("MREL").

In fact, Article 45 of the BRRD states that: "Member States shall ensure that institutions meet, at all times, a minimum requirement for own funds and eligible liabilities, including subordinated debt and senior unsecured debt with at least 12 months remaining maturity and being subject to bail in. The minimum requirement shall be calculated as the amount of own funds and eligible liabilities expressed as a percentage of the total liabilities and own funds of the institution."

The quantity of MREL each institution shall hold will be determined by the resolution authority, after consulting the competent authority, at least on the basis of the following criteria identified in Article 45 paragraph 6, a) – f).

1) The need to ensure that the institution can be resolved by the application of the resolution tools including, where appropriate, the bail-in tool, in a way that meets the resolution objectives.
2) The need to ensure, in appropriate cases, that the institution has sufficient eligible liabilities to ensure that, if the bail- in tool were to be applied, losses could be absorbed and the Common Equity Tier 1 ratio of the institution could be restored to a level necessary to enable it to continue to comply with the conditions for authorisation and to continue to carry out the activities for which it is authorised under Directive 2013/36/EU or Directive 2014/65/EU and to sustain sufficient market confidence in the institution or entity
3) The need to ensure that, if the resolution plan anticipates that certain classes of eligible liabilities might be excluded from bail-in under Article 44(3) or that certain classes of eligible liabilities might be transferred to a recipient in full under a partial transfer, that the institution has sufficient other eligible liabilities to ensure that losses could be absorbed and the Common Equity Tier 1 ratio of the institution could be restored to a level necessary to

enable it to continue to comply with the conditions for authorisation and to continue to carry out the activities for which it is authorised under Directive 2013/36/EU or Directive 2014/65/EU.

4) The size, the business model, the funding model and the risk profile of the institution.
5) The extent to which the Deposit Guarantee Scheme could contribute to the financing of resolution in accordance with Article 109.
6) The extent to which the failure of the institution would have adverse effects on financial stability, including, due to its interconnectedness with other institutions or with the rest of the financial system through contagion to other institutions.

While several elements in the Draft RTS are in line with the mandate given by BRRD level 1 text, other elements go clearly beyond what required by the BRRD and try to advance the still to be defined international standard for Total Loss Absorbing Capacity. In fact, at page 5 of the EBA consultation it is written that: “The EBA expects these RTS to be compatible with the proposed FSB term sheet for TLAC for Globally Systemic Important Banks (G-SIBs)” thereby suggesting that the RTS shall make MREL compliant with TLAC.

While UniCredit agrees that once the final agreement on TLAC has been reached, MREL should be aligned with TLAC to the greatest extent, thereby avoiding that European GSIIs should comply with two different set of rules, we think that such alignment should be done only once the final TLAC term sheet has been agreed.

In fact, the possibility to make MREL compliant with TLAC is already foreseen in the BRRD as it stated that based on an EBA report, the Commission shall by 31 December 2016 make a proposal for the necessary adjustments to the MREL and might take into account international standards. The EBA report shall also assess how the MREL has been implemented in national law, including the possible divergences in the levels set for comparable institutions across Member States and the appropriate level of the minimum requirement for each business model.

In our view, such an observation period is necessary to make the necessary and appropriate legislative changes in the following. Such an observation period will also enable EBA to collect sufficient data about the levels of MREL for institutions with different business and funding models and risk profiles. Only based on these findings, a far reaching harmonized approach across the EU, including appropriate minimum levels for different categories of institutions should be set.

More specifically, UniCredit thinks there are a number of elements in the Draft RTS which should rather be defined by making changes to the BRRD, once – as said above - sufficient data and experience has been gained during the observation period:

1) MREL minimum requirements which make reference to the need to restore also Pillar 2 capital requirements and capital buffers.

2) The general need for identifying a loss absorption amount and if interaction between resolution authorities and supervisors is necessary for setting it as well as whether a procedure on how such interaction shall take place without interfering in each other’s competences.

3) The (minimum) level of capital an institution is expected to meet once it has undergone resolution.

4) The definition of appropriate peer groups for all kind of banks both at consolidated and at individual level (in the event that a subsidiary is not exempted from the obligation to hold a MREL).

UniCredit answers to Questions

Question 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?

Answer

UniCredit agrees that institutions should have sufficient loss absorbing and recapitalization capacity in order to enable them to perform their critical functions post resolution. A good indication about the magnitude of institutions' critical functions will be contained in the institutions' resolution plan. This should be the basis for assessing the appropriate MREL. However, it is wrong to assume that a bank would need to be fully recapitalized to the scale of the pre-resolution institution as well as to assume at the point of resolution all its capital would be wiped off. UniCredit does not believe that this should be the case as the recapitalization is aimed at ensuring that the resolved institution will be able to perform its critical functions and not to carry out the full scale of its pre-resolution business.

In addition, the loss absorption amount as defined in the Draft RTS focuses on the going concern capital needs and not on the total loss absorbing capacity, which itself includes a broader range of liabilities.

Article 2 (3) and (4) of the Draft RTS grant the resolution authority the right to assess whether the need for loss absorption is adequately reflected in an institutions' capital requirements. We believe that the setting of going concern capital and the assessment of its overall adequacy should be entirely left to supervisory authorities. Resolution authorities should rather ensure that there is a minimum level of capacity for loss absorption and recapitalization under the defined resolution strategy. It may be that until the end of the observation period (October 2016) it is not straightforward to assess the level of loss absorption that is appropriate for this purpose and that some minimum capital requirements need to be set at a level deemed appropriate to ensure sufficient loss absorbency. However, we do not agree that total capital requirements including capital buffers and pillar 2 capital requirements equate to the degree of loss absorption that should be required for the purpose of setting MREL. If any reference to capital requirements were introduced, it should only be used to ensure a well balanced mix of capital and other bail in able liabilities and relate to pillar 1 capital (Article 92 CRR) only. Using the overall capital requirements (including capital buffers) as a common minimum standard would not only, as pointed out above, interfere with supervisory competences, but also multiply the existing different national approaches towards regulatory capital needs.

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)?

Answer

As a general principle we support the possibility for resolution authorities to adjust the amount of MREL rather than only increasing it. In some cases high capital requirements are an expression of different national supervisory approaches or of different RWA applications rather than an indication for potential higher losses. However, we are concerned about the potential source of conflict between supervisors and resolution authorities if such adjustments were to lead to the conclusion that the minimum loss absorption amount is not adequately reflected in the capital requirements set by supervisors. Therefore the Draft RTS should clearly establish that the resolution authority is not making an assessment of the adequacy of capital but only of the amount of loss absorption that is considered necessary for setting the MREL.

<u>Question 3</u>

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 understand the rationale of article 2(6) of the Draft RTS which links resolvability to the loss absorption amount. If the resolvability shall impact MREL, than it should be considered in the recapitalization amount and not in the loss absorption amount. In addition, the BRRD sets out a clear approach for removing impediments for resolvability.

<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?

Answer

The components are appropriate to some extent only. We strongly support the fact that the resolution authority shall first of all consider the resolution strategy of an institution in the determination of the amount of recapitalization.

However, due consideration should be given also to the following:

1) Only the critical functions of a bank shall be maintained and therefore it is not necessary to recapitalize the entire group pre resolution. Some of the buffers and Pillar 2 add-ons may not be applicable anymore on the envisaged post-resolution bank, if the resolution plan foresees significant downsizing, sales, or wind down of risky assets.

2) It is very likely that a bank in resolution will still have some remaining capital at the moment in which the resolution authorities intervene.

3) All MREL eligible instruments (as defined in the BRRD) should be considered when defining the recapitalization amount.

We fully support what stated in article 3 (1) that the MREL requirements should be tailor-made to the institution and its resolution plan. On the other hand we do not agree with article 3 (6) stating that the recapitalization amount shall at least be equal to minimum capital requirements and Pillar 2 capital add-ons. As substantial differences across jurisdictions with respect to prudential capital requirements exist - as a result of the exercise of national and supervisory discretions in the imposition of different buffer levels or Pillar 2 requirements - the Draft RTS could amplify current divergence by using the prudential requirement as the basis for the MREL.

Therefore, we recommend deciding about the setting of references to minimum levels relating to pillar 2 requirements and to capital buffers only after the MREL observation period. Until then, progress will also have been made in the further development of the Single Rule Book and the removal of national options contained in the CRD and CRR.

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 support the proposal to assess whether a G-SII has sufficient capital to regain market access after resolution by looking at the median CET1 capital ratio of a peer group of other G-SIIs (article 3 (7) let b). Market confidence is not only dependent upon the CET1 capital ratio, but is also dependent upon other factors such as statements by resolution authorities.

If the peer group approach is kept, we think the MREL requirements should be aligned to the G-SIIs bucketing methodology and should equally apply to O-SIIs but should not be restricted only to those O-SIIs which are established in the same jurisdiction. The amount of recapitalization needed to gain market confidence for individual subsidiaries that have to comply with MREL (MREL waiver not applied) and that are part of a G-SII or O-SII group shall be measured with peer groups corresponding to their size and business profile and not necessarily with G-SIIs or O-SIIs.

In any case it would be more appropriate to identify a peer group at consolidated level only and on the basis of the G-SII buckets, taking into account the bucket the bank will probably belong to after resolution (a bank could also lose its G-SII status after resolution, if the resolution plan indicates deleveraging and / or the sale or reduction of certain activities). The requirement to fulfill immediately the requirements of the peer group before resolution seems overly severe and is penalizing G-SIIs.

Defining the appropriate peer groups should only be done when the BRRD will be revised as a follow up of the results obtained during the observation period.

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

As said above, Unicredit regards important that when setting the MREL at consolidated or subsidiary level there should be a clear link with the overall resolution strategy of the group.

More specifically, UniCredit believes that for SPE firms MREL should be set (solely) on a group consolidated basis and hence applying the possibility to set MREL for subsidiaries of SPE firms at zero or close to zero. Conversely, for MPE firms it should be applied at the level of the relevant subsidiary (the "resolution subsidiary" in the TLAC terminology); when determining the MREL at individual level, the resolution authority should not include any capital requirement set at consolidated level. This is particularly the case of the systemic capital buffer or any Pillar 2 capital surcharge imposed at consolidated level.

With respect to the setting of MREL requirements at the relevant subsidiary level it is stipulated in the BRRD that the level will depend, apart from the business model and risk profile of the subsidiary (including the own funds of the subsidiary), also on the requirement that has been set for the group. in this regard, we believe that a proportionate discount should be given to internal MREL requirements depending on the quantity of MREL set at consolidated level.

Moreover, for those material subsidiaries in MPE resolution strategies and outside of the same resolution framework the required amount of MREL should not be excessive otherwise it would raise at least three concerns: i) could be at odds with the resolution strategies set out in the resolution plans and agreed between home and host; ii) can cause an unjustified ring fencing prejudicing efficient capital allocation for banking groups; iii) the sum of subsidiary requirements is likely to be higher than the consolidated requirement for the whole group and such difference may be material for some banks.

Furthermore, in jurisdictions where resolution entities and material subsidiaries are subject to the same harmonized resolution framework and the same resolution authority the setting of a MREL at subsidiary level is not necessary.

UniCredit argues that excessive MREL requirements for subsidiaries of a Group, given the ongoing ring fencing of capital in various jurisdictions, actually has the potential of making G-SII operating in many jurisdictions more vulnerable, as their ability to move and deploy capital, especially in times of crisis, are significantly curtailed.

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

Pursuant to Article 44 (2) of the BRRD the are a number of liabilities excluded from MREL. Moreover, according to Article 44 (3) the resolution authorities – in exceptional circumstances – may exclude or partially exclude certain liabilities. Article 5 of the Draft RTS states that in setting the MREL the resolution authorities should take into account the liabilities which are likely to be excluded except those which do not exceed 10% of any one class of liabilities. The resolution authority shall ensure that MREL is sufficient to absorb the amount of losses and recapitalize without these liabilities being bailed in.

We support the *de minimis* derogation from this provision. However, the 10% threshold can easily be breached as a result of volatility of certain liabilities – at least during a financial markets turmoil - as the ones related to the overnight interbank funding referred to in Article 44 (2) (e) of the BBRD. For this reason and in order to ensure more flexibility to the resolution authority we propose to set a higher threshold.

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 do not agree that only systemic institutions should have sufficient bail in able liabilities to access resolution funds. The BRRD does not foresee that access to resolution funds is limited to G-

SIIs and O-SIIs. Therefore, only banks whose resolution plan foresees insolvency as the only option in case of failure should be excluded.

Moreover, the 8% indicated in Article 44 of BRRD refers to the all liabilities which are not excluded from bail in and not to MREL eligible liabilities. As there is a good amount of liabilities which are bail-in able, but cannot be included in MREL, it must be made clear that there should be no general rule that requires banks to meet an MREL of 8%. Reaching the 8% equivalent may not only be obtained by increasing the MREL, but also by increasing the amount of bail in able liabilities.

However, we agree that all institutions that are potentially subject to resolution should have sufficient bail in able liabilities to meet the BRRD criteria for accessing the Single Resolution Fund. Appropriate transition periods may be needed.

Question 9

Is this limit on the transition period appropriate?

Answer

Provided that MREL comprises all elements set out in the BRRD (own funds and qualifying eligible liabilities), the transition period of 48 months is deemed sufficient. However, any transition period shall be fully harmonized, meaning that different national resolution authorities should not be in a positon to set different transition periods at national basis and for different banks. European transition periods should also take into account any possible transition periods agreed in the frame of the future TLAC standard with which the MREL will have to conform at least for GSIIs. This is even more so if the final TLAC standard will not fully recognize senior unsecured debt as TLAC eligible as this is likely to have a huge impact on banks' issuance and raises issues of market absorption capacity. A market survey to test the potential market absorption capacity should be carried out before deciding on a final transition period.

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. Since, MREL will be used to recapitalize the remaining critical parts of the resolved bank, as defined in the resolution plan, the banks which have undergone a resolution process should have a sufficient transitional period for reconstituting the MREL.

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 effort of EBA to promote consistency across resolution authorities in the setting of adequate levels of MREL. Nevertheless, as substantial differences across jurisdictions with respect to capital buffers and Pillar 2 measures exist and are allowed under the CRR and CRD - in the exercise of national discretions and different supervisory assessment in the imposition of different buffer levels or in the determination of Pillar 2 requirements - these RTS could amplify current divergence if they suggest using also these prudential requirements as the basis for the calculation of the MREL.

Therefore, as said above in the reply to question 4, we recommend creating an equal interpretation across Member States with the aim to ensure the level playing field within the European Union and to set minimum levels relating to Pillar 2 requirements and to capital buffers only after the MREL observation period.

Question 12

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

Answer

Although not directly linked to the RTS consultation, UniCredit would like to point out a problem relating to the TLAC concept which impacts on any future discussions on MREL and which we believe can be addressed by European law / creditor hierarchy set out in national insolvency law. If no solution is found for making statutory subordinated senior debt TLAC compliant, the negative consequences for the European banking sector and for the European economy would be significant. We therefore strongly argue to start this discussion as soon as possible.

Senior Unsecured Debt: We believe that there is a viable solution that achieves the objectives of reducing risk to Resolution Authorities from legal challenges in resolution whilst enabling banks to issue MREL/TLAC eligible senior instruments in a format that the market can absorb.

The central foundation of the Unicredit proposal is that the market for senior debt is far deeper than that for subordinated debt and therefore more capable of absorbing potential supply. Numerous fixed income funds are precluded through their mandates from buying subordinated debt.

Although MREL currently widely recognizes senior unsecured debt as eligible, we believe that some changes should be initiated already by now in order to promote the future compliance with TLAC without putting into question the MREL principles established in the BRRD. In exchange, our proposal, which is set out in the following should lead the FSB to fully recognize senior unsecured debt as TLAC eligible.

The solution in our opinion lies in getting an instrument which is called senior debt eligible for MREL (so that issuance volumes can be achieved) but is subordinated enough to excluded liabilities (or to liabilities with a high possibility to be excluded on discretionary basis) to lower the risk of legal challenge for resolution authorities.

The two major asset classes that rank pari-passu with senior debt are corporate deposits and derivatives. If they were given a form of preference above senior debt, so as to clarify their ranking in the creditor hierarchy, a significant amount of legal risk for regulators would be removed.

This could be achieved either through a) a change in the BRRD directive by extending the depositor preference set out in Article 108 to all deposits and to derivatives or b) an amendment to the national insolvency law. In both cases, the EBA opinion can be an important precursor for promoting such an approach.

We believe the proposal would bring with it a large number of benefits:

1. **Capital Markets Access/Disruption:** By having an instrument that is called 'senior debt' one would be able to access a far deeper pool of capital and therefore ensure the success of TLAC and the ability of European banks to raise the required amounts. In fact if the amendment was done on a statutory basis then there would not be a need to issue

significant amount of additional instruments as the existing senior debt on the balance sheets would qualify and hence

   a. minimize any major market disruption by having overhang of a large amount securities having to come to market and
   b. accelerate the time to be fully compliant with TLAC / MREL requirements

2. **Transparency:** This solution would further clarify to investors the exact hierarchy and remove doubts about the application of discretionary exclusions from bail in and the related NCWO problem

3. **Harmonisation:** Harmonises eligible securities for TLAC and MREL making it easier for European banks to adopt and manage both regulations

4. **Level Playing Field:** Allows equilibration between US and UK Hold Co Bank Models and European Op Co Bank Models where senior would be TLAC eligible for both

5. **Legal Challenge**: Reduces legal challenge to regulators as creditor hierarchy is further clarified

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