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European Banking Authority
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Dear Mark,

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

This is the British Bankers' Association's response to the above consultation paper; we welcome the opportunity to provide our views.

Our response identifies the following key points:

- The draft RTS does not address the allocation of MREL within a group[1]. This is an important matter which should be addressed by the final RTS. In our view, the BRRD provides sufficient flexibility to set MREL for a group in the context of the resolution strategy and requirements for individual subsidiaries in conjunction with the consolidated requirement. Our response identifies a high level framework for this. Ultimately, at least for G-SIBs, the outcome should be consistent with the implementation of internal TLAC requirements;

- The proposed calculation of the loss absorption amount will result in significant inconsistency in requirements across Member States and fails to reflect the fact that it is unlikely that all capital will be exhausted at the point of resolution. We recommend therefore that the loss absorption amount be limited to the minimum requirement for authorisation. If it is nevertheless decided to retain the proposed calculation of the loss absorption amount it will be essential to grant the resolution authority the flexibility to adjust the amount;

- The recapitalisation amount should be set in the context of the resolution plan. We see no reason to hardwire the 8% loss absorption requirement for access to the resolution fund and question how it is possible to calculate ex ante what this amount would be at the point of resolution; and

- The proposal to make provision for transitional arrangements is welcome. We recommend that a comprehensive impact assessment – comparable to that being undertaken by the BIS to inform the development of TLAC – should be undertaken and be used to fine tune the phase in of MREL in a way which minimises the impact on customers and the wider economy. Whilst we are supportive of the eventual alignment of MREL with TLAC it would not be appropriate for resolution authorities to use MREL to fast track the implementation of TLAC.

We provide our responses to the questions in the consultation paper below.

[1] Used in this context the term "group" means an EU banking group as well as a parent banking group located outside the EU. This is important because the interaction between MREL and TLAC is particularly acute for non-EU SPOE G-SIBs.

1. **The draft text describes comprehensively capital requirements under 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?**

As the introduction to the consultation paper notes, minimum regulatory capital requirements are set to reflect the supervisor's judgement of the unexpected losses an institution should be able to absorb whilst still meeting the thresholds for authorisation. In the EU, the Capital Requirements Regulation recognises that the maximum harmonisation of minimum prudential requirements is a key element for the functioning of the internal market but nevertheless caters for Member States to address specific macroprudential or systemic risk through the application of additional buffers.

Given that the minimum requirement is set to reflect losses and provide consistency across Member States we strongly recommend that the loss absorption amount for the calculation of MREL be limited to this and that the EBA should not amplify the distortion which already results from additional national capital requirements. In particular, we note that the inclusion of the requirements listed under Article 2(2)(b) & (c) would be inconsistent with the objective of achieving an appropriate degree of convergence in how the MREL framework is applied and interpreted across Member States. Furthermore, we note that the leverage ratio requirement under Article 2(2)(e) front runs the European timetable for adoption. If a leverage requirement is nevertheless to be included we recommend that convergence would be enhanced if this related to the minimum required by the CRR and not national variants.

In addition, we note that given the 8% total capital ratio is set to ensure a firm can absorb total (expected and unexpected) losses whilst still continuing to meet the conditions for authorisation it is unreasonable to assume that the firm's capital resources would be exhausted prior to bail-in. It is noteworthy that the mean capital ratio for the eight banks subject to the 2014 UK stress test regime was 5.4% prior to the impact of any management actions[2].

Finally, we note that for a subsidiary the sum of the capital requirements specified in Article 2(2) would be likely to result in an MREL requirement in excess of the proposed 75% - 90% range indicated in the TLAC draft term sheet. This adds to the argument, discussed below, that there should be flexibility for the resolution authority to adjust down the loss absorption amount.

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?**

It will be essential to grant the resolution authority the discretion to adjust (down) the loss absorption amount for the purposes of MREL. Doing otherwise risks MREL requirements differing greatly due to differences in national capital requirements (particularly the application of the Systemic Risk Buffer and Pillar 2) which would be at odds with the objective of setting similar requirements for similar institutions across the Union.

In particular, it will also be important for the resolution authority to have the flexibility to adjust the loss absorption amount to ensure that the MREL requirement can be applied to a subsidiary on a solo basis in a manner which is consistent with the consolidated group requirement as implied by Article 45(8) or any internal TLAC requirement. We note that the draft FSB TLAC term sheet

[2] Table A: Projected CET1 capital ratios in the stress scenario, *Stress testing the UK banking system: 2014 results* (Bank of England), 16th December 2014

indicates that internal TLAC requirements will be set in a range between 75% and 90% of the standalone requirement which would have applied to the subsidiary. If this is the case, then it is possible that in the absence of discretion for the resolution authority to adjust that loss absorption amount the MREL requirement will be set in excess of that required for TLAC. We consider this issue further in response to question 6.

As a final point, we note that the proposal in Article 2(5) that the resolution authority provides the competent authority with a 'reasoned explanation' for any deviation from the loss absorption amount implied by the capital requirements risks the resolution authority effectively duplicating and second guessing the work of the competent authority. Not only does this risk undermining market confidence in the institution's capital position but we note that certain elements of the capital framework are confidential and furthermore firms are often provided an extended period of time to comply with Pillar 2 requirements. As an alternative, we therefore propose that the requirement should be for the resolution authority to inform the competent authority. In any case, we note that resolution colleges established under Article 88 of the BRRD provide a mandate for competent authorities and resolution authorities discuss the setting of MREL.

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?**

We believe historical loss analysis should be used to inform the assessment of necessary loss absorbency for firms of differing size, business model and structure. We note that the consultation paper identifies challenges to such an approach but do not believe that the impediments cited are significant. In particular, concerns about inconsistency would be overcome if the EBA undertook or oversaw the analysis. Problems of data availability and quality can be overcome and we note that the BCBS/FSB historic loss analysis as part of the TLAC QIS could act as the basis.

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

The capital requirements listed under Article 3(6) look to be an appropriate indicator of the capital required after resolution. However, we do not agree that it is necessary for the post-bail-in institution to be expected to comply with the combined buffer requirement, not least as it is likely that the total capital requirement will be met through CET1 and the firm will be the subject of significant reorganisation as the terms of the resolution are implemented. Buffers can and should be rebuilt over a period of time as part of the resolution process.

Furthermore, in a systemic crisis it is to be anticipated that recapitalising to a level which satisfied the combined buffer would result in the institution holding capital in excess of its peer group which could provide an unfair advantage relative to peers. In this regard, we note that Recital 69 of the BRRD recalls that the restructuring of an institution subject to bail-in should be conducted in a way which limits distortions of competition.

The necessary level of recapitalisation will also need to take into account the nature of the institution in question. If the institution comprises separately capitalised subsidiaries then it is likely that the consolidated capital requirement will be an inaccurate reflection of the level of capital required.

Finally, it should be underlined that the maintenance of market confidence in the resolved institution is as much a function of signals provided by central banks and regulators as the entity's absolute levels of capital. For example, we note that the resilience of primary markets and the continued provision of funding and liquidity during the Eurozone crisis indicate that this is the case. Even during a systemic crisis.

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?**

As noted above, we consider the maintenance of market confidence to be broader than a simple question of absolute capital requirements. Ensuring that counterparties do not closeout will depend as much on signalling from the authorities as the immediate post bail-in level of recapitalisation which in our view should be considered against the objectives of the resolution plan.

Whilst the use of a peer group approach as proposed by Article 3(7)(b) would mitigate to some extent the creation of a super bank it does not reflect the fact that G-SIBs or O-SIIs are subject to differing Pillar 2 requirements and the likelihood that the post resolution firm would be unlikely to continue to be a G-SIB or O-SII. For these reasons we do not support the proposed approach.

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?**

It is notable that the draft RTS does not address the issue of the application of MREL to a group (within the meaning discussed in footnote 1 above) despite the fact that this is an area of uncertainty with the provisions of Article 45. We believe that this should be addressed in the final standard and set out below our initial perspective on how this might be done.

The assessment of MREL at the solo level should be made in a way which accommodates the chosen resolution strategy. In particular, we note that the identification of the MREL to be applied to a subsidiary of an SPE Group should have regard to the consolidated requirement. In our view, there are three types of entity which should be considered when assessing MREL:

- Material subsidiaries which should be expected to hold a proportion of their standalone MREL in a manner consistent with the final outcome of the TLAC proposal;

- Non-material subsidiaries which should be expected to meet a lower MREL requirement than a material subsidiary; and

- Other entities which could be expected to be subject to liquidation in the event of failure and therefore should not be subject to an MREL requirement which includes a recapitalisation amount.

In terms of the differences between the consolidated and subsidiary capital requirements, we note that there will be differences between consolidated and subsidiary RWAs and that certain of the elements of the proposed loss absorption amount and recapitalisation amount are applicable only at the consolidated level, for example the G-SIB buffer and Pillar 2 requirements. Furthermore, leverage requirements are not necessarily applied at the level of subsidiaries.

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 support the principle that there should be a de minimis threshold and believe this is a pragmatic way to identify when the potential risk that classes of liability will be excluded from bail-in may present a risk to the successful implementation of the resolution strategy. This approach could be mirrored in the final TLAC term sheet provisions relating to subordination and holding companies. We note that the consultation paper does not expand on the rationale for setting this at 10%. We

therefore suggest that the EBA undertakes an analysis of institutions' balance sheets to determine the most appropriate level. In our view, a threshold in the region of at least 15 - 20% would be more appropriate and would still be sufficiently conservative to offset the risk of successful legal challenge.

Whatever the threshold, we believe there should be further guidance on how a resolution authority should go about determining whether a class of liability should be excluded from bail-in in exceptional circumstances. In this regard, we note that BRRD Article 44(11) provides the European Commission with the power to adopt a delegated act to specify the circumstances in which such exclusions from bail-in should be considered necessary.

Finally, we note that the drafting of Article 5 risks creating the presumption that MREL should automatically be increased if the resolution authority identifies that more than 10% of a class of liabilities are likely to excluded from bail-in and rank alongside liabilities which qualify for MREL. This is in contrast to Recital 4 and the introduction to the consultation paper which suggest that the resolution authority should have discretion to determine whether the best course of action is to increase MREL, require subordination or utilise other measures to remove impediments to resolvability. This is an important difference which we believe should be reflected in the body of the RTS.

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?

We note that the consequence of this proposal is to hardcode the minimum level of MREL at 8% of total liabilities for systemic institutions, something which could be interpreted as going beyond the mandate for the RTS provided by Article 45(2) of the BRRD. Nevertheless it is welcome that Article 7(2) of the RTS provides a framework for the resolution authority to conclude that access to the resolution fund will not be necessary and therefore to dispense with the 8% requirement. The implication of Article 7(2)(c), however, is not clear. It suggests that the preferred resolution strategy should assume that losses are only borne by liabilities which meet the MREL eligibility criteria and therefore ignores the secondary loss absorbing capacity provided by liabilities eligible for bail-in but which no longer meet the requirements for MREL, e.g. debt instruments in their final year to maturity.

Furthermore we note that Article 7 does not specify how the 8% should be measured. Article 44(5) of the BRRD stipulates that the 8% contribution to loss absorption and recapitalisation should be measured at the time of the resolution action. Not only is this a source of uncertainty but it provides a perverse incentive for the competent authorities to place an institution in resolution sooner rather than later in order to ensure access to resolution financing.

9. Is this limit on the transition period appropriate?

The proposal for a transitional period and phasing in of the requirements is to be welcomed; not least given that institutions will have a very short time between receiving the notification of their MREL requirement and the 1st January 2016 effective date of the provisions. The length of the transitional period should be at least sufficient to cover the period prior to finalisation and implementation of the TLAC requirements and informed by the impact analysis.

It would be useful to understand the basis on which the 48 month time limit has been set. Logic would suggest that this should be set following a quantitative impact assessment which identified the likely total MREL requirement and the impact of this on customers, economic growth, market capacity and competitive dynamics. Thought could be given to the adoption of a standard timeline for the phase in of the requirements, equivalent to that used for the transition to Basel III and TLAC requirements. In considering the transition for subsidiaries subject to MREL it should be recalled that it is not just the recapitalisation amount that may need to be satisfied but also the loss absorption amount if this includes Pillar 2 or other buffers applied only at the consolidated level.

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

This is a logical approach. Institutions will require a reasonable timeframe over which to rebuild MREL following a stress or resolution. We note and support the approach proposed by the FSB for TLAC to be rebuilt over a period of 12 to 24 months. Fundamentally, the rehabilitation post resolution should be detailed in the business reorganisation plan.

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?

It is noteworthy that the draft RTS seeks to drive convergence in the application of MREL perhaps more determinedly than envisaged by the level 1 text prior to the 2016 application review to be provided by the EBA to the Commission under the Article 45(19) mandate. Nevertheless, there is an obvious interest in using the RTS to foster the conditions for convergence and equitable treatment for institutions with similar risk profiles and resolvability levels. In this regard, it is disappointing that the proposal reinforces a number of factors which will work against convergence. For example, the draft embeds national discretion under CRD IV into the MREL framework, amplifying differences, it leaves substantial scope for further discretion on the part of the resolution authority without adequately specifying the criteria that the authority should consider, and it excludes any mechanism for benchmarking between countries to assess the consistency of implementation.

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

The final impact assessment could usefully explore the likely MREL shortfall and relate this in terms of the impact on customers, the real economy, economic growth, market capacity and competitive dynamics.

It would also be useful to understand in greater detail the potential contribution to resolution that would be expected from Deposit Guarantee Schemes and how this interacts with Article 4(4) which requires that any reduction in MREL should take account of the overall risk of exhausting the means of the DGS.

Please let us know if it would be helpful to discuss and of the points related to the draft RTS in more detail.

Yours sincerely,

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