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SRB Public consultation on the future of MREL policy

– Executive Summary -

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The initiative of the Single Resolution Board (SRB) to engage with and consult the industry on the future of MREL policy is very welcome. As a context reminder of the current situation:

- MREL levels are very high and well above international TLAC standard. This is a matter of concern for the future of the industry as it will become biting for certain banks, and it is a real competitiveness issue in comparison with US peers.
- The 'Basel III' finalisation as implemented in Europe has started to worsen notably the situation in terms of MREL quantum with the expected rise in risk weighted assets (RWAs),
- Quanta are such that the capacity of European markets is reaching limits and several banks have become dependent on US markets
- Current applicable BRRD and SRMR texts allow for a review of the MREL calibration, notably regarding the recapitalization amount (RCA) and the Market Confidence Charge (MCC).

The ability for the SRB to change its MREL policy in the short term, under the current regulation, is key and in our view:

- As suggested, transfer tools should be used as complements to the bail-in tool, and they should be included in their preferred resolution strategy, which should be reflected in the required RCA.
- Regarding the MCC, resolved banks should be given time to rebuild their capital buffers, as per existing regulations. 'Market confidence' will only be restored after: (i) the clear communication of a credible plan, expressly supported by the relevant Authorities and (ii) the passage of time, demonstrating the first positive effects of such plan. The MCC could simply be removed.

We believe that both adjustments may be implemented in the short term with an effective and much needed relief for banks before implementation of the Basel III finalisation in the EU.

In the longer term, we advocate for a more radical change in the MREL calibration approach.

We welcome the idea of reducing the complexity of the MREL calibration and of enhancing its predictability and transparency, particularly for investors.

Easily understandable and applicable generic criteria, building on the logic of the TLAC standard, should be retained. Complex criteria and calculations should be avoided, as well as discretionary elements. In that respect, we consider it is not advisable to use the resolvability assessment for the calibration of MREL.

Our preference would go for a TLAC-like calibration system with a clear floor, which should apply to all banks across the EU, or at least across the Banking Union, and not just to banks under the SRB remit, as a matter of level playing field.

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SRB Public consultation on the future of MREL policy

At BNP Paribas we welcome the initiative of the Single Resolution Board (SRB) to engage with and consult the industry on the future of MREL policy.

To start with, we believe that the SRB's and the industry's own work for significantly enhancing the recovery planning, the resolution planning, the build-up of the SRF and the accumulation of own funds and eligible liabilities, which contribute to high financial stability in the Banking Union, should be recognized. These elements, when compared to the situation prevailing at the time the SRB was set up and the MREL was initially designed, should lead to an adjustment of the MREL calibration, removing any gold-plating practices.

We also share the SRB's analysis and concur with the lessons learnt from recent and less recent crises as outlined in the introduction to the consultation, especially when it comes to the possible combination of several resolution tools for all banks, including large ones, which directly impacts the setting of MREL targets. We are further of the opinion that several changes in the MREL policy could be introduced under the current legal framework and could apply without specific delay in the upcoming resolution planning cycle, leveraging on the very significant progresses made since the MREL framework was initially set up.

We note that the consultation remains at a high level. Specifying terms of possible changes to the existing MREL policy to the extent possible would have allowed for a more in-depth analysis. Accordingly, we believe it would be beneficial to further engage with the industry prior to the finalisation of the revised policy.

Please find below our answers to each question and note that we remain available to further detail, sustain or illustrate each of them upon demand.

1. Adjustment for preferred resolution strategies relying on a combination of resolution tools

Question 1.1:
Which criteria would you use to identify the assets/ liabilities subject to a transfer strategy in addition to those listed in guiding principles for perimeter identification (e.g. Business activities, size, separability, marketability)?

BNP Paribas strongly believes that transfer tools should be considered as complement to the bail-in tool, including for the largest banks, and that they should be included in their preferred resolution strategy ("PRS"). Such combination of tools should be reflected in the recapitalisation amount part of the MREL.
At the same time, reaching a common understanding of SRB's requirements regarding the operationalisation of these complementary tools (documentation, testing…) would be welcome, allowing adequate planning and possible anticipation. In this regard, BNP Paribas expects that the SRB leverage on the banks demonstrated capacity to transfer portfolios or sell entities without requiring as detailed documentation as for the operationalisation of the bail-in tool, which is specific to a resolution context only and, hence, will not have been experienced by the banks before being implemented.

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Besides the SRB guiding principles for perimeter identification that apparently focus on the transfer of the core activities of the bank, additional and specific principles should be considered when transfer tools are intended to be used as complement to bail-in.

This guidance already states that potential transfer perimeters should:

- Represent clear sets of businesses DEMONSTRABLY attractive to third party acquirers;
- Preserve the continuity of critical functions (if any is included in the perimeter, implying that the selected acquirer must be able to ensure it);
- Be easy to structure and operate distinctly from a legal, financial, and operational viewpoint, enabling an efficient transfer under the responsibility of the resolution authority in case of resolution.

In addition, when transfers are envisaged as complement to bail-in, in our view, considered perimeters should:

- Be proportionately impactful from a solvency and/or liquidity standpoint. As transactions generally mobilise key staff in relatively large numbers, which might be necessary to support several resolution actions in times of high stress as resolution is, dispersion on many different actions with limited impact should be avoided.
- Focus on activities that are not considered as core to the expected post-resolution banking group. i.e. the transfer should protect the core of the franchise, and the interest of clients to the extent possible.
- Be actionable within a short timeframe (NB: when the envisaged disposal is an option of the recovery plan, preparatory work would already have been engaged in the run-up to resolution phase).
- Ideally be incorporated in distinct legal entities or should constitute easily identified and separable business units, which would ensure an easy and swift possible transfer.
- And, as relevant, they could include non-performing assets or activities that would harm the reputation, entail important risks (potentially difficult to manage post-resolution) or impede the restructuring of the post-resolution banking group.

As per the 2021 SRB operational guidance on separability, most of the banks under the SRB remit should already have prepared an advanced SAR (Separability Analysis Report) and a related transfer playbook. Consequently, these banks must already have identified potential Transfer Perimeters.

Considering the additional criteria listed above (impact, timeline and availability of resources), BNP Paribas believes that the Sale of Business Tool should be prioritized, with a specific focus on businesses incorporated as separate legal entities or on distinct, clearly identified and easily separable business units. BNP Paribas would further expect that the SRB leverages on recovery plans that are subject to annual detailed assessment by the European Central Bank (ECB) and often also to dry-run exercises. Building up on recovery planning and on the ECB assessment thereof, would ensure cohesion between recovery and resolution planning, and would also allow banks and the SRB to effectively manage time and resources. In addition, effective capacity to sell entities or to transfer portfolios, as demonstrated through M&A track records, should be duly recognized in the assessment of transfer strategies by the resolution authority.

Recent and more distant crises have shown that transfer strategies could be implemented at very short notice, even without preparation. One prominent example was the acquisition of Fortis Bank by BNP Paribas in 2008 that was negotiated and signed over a weekend, in a context where no CMDI framework existed, and no preparatory work had been undertaken ahead of the failure[1]. More recent cases as Banco Popular, Sberbank or Crédit Suisse show also that sales of small, medium-sized, or large banks, in whole or in parts, can be signed over a single weekend. What is true for transfers that may not have been planned in advance is even more true for transfers that would have been prepared and planned. And what is true for complex situations such as the abovementioned ones is even more true for simple assets in good condition as those earmarked as options in the recovery plan.

Considering the fiduciary duty of resolution authorities though, we perfectly understand their need for feasibility assurance when including transfer tools in resolution strategies. In practical terms, we would suggest such assurance to be assessed through:

– Relying mainly on recovery options included in the recovery plan and focusing on easily separable parts incorporated as distinct legal entities;
– Requiring a positive assessment of such recovery plan by the competent authority;
– Relying the M&A track record of the concerned bank and its internal teams available to support the transfers;
– Testing such capacity through dry-run exercises of relying on those performed in recovery planning; and
– Selectively requiring additional separability analyses if and when important issues are identified.

It should be noted that, for large banks, a sudden entry into resolution cannot be considered as a plausible scenario. As demonstrated to the SRB by BNP Paribas in 2020 through extreme scenario testing, a fast-moving scenario leading to an entry in resolution within 3 months is almost impossible, and a slow-moving scenario leading to an entry in resolution in less than 12 months is still very unlikely. Accordingly, beyond defined critical thresholds, alerts triggered on specific indicators included in the recovery dashboards that banks must establish could also be used by the resolution authorities. Breaching thresholds could trigger the actual preparation work for transfers included in the resolution strategies, which would secure swift execution in case resolution would occur and concerned transfers would not been executed or already prepared in the recovery phase that normally precedes the entry in resolution.

In accordance with the above-mentioned suggestions, BNP Paribas would welcome an update of the 2021 SRB operational guidance for banks on separability for transfer tools. This would allow both to clarify and streamline some existing requirements that may appear disproportionate and overlapping with existing requirements on recovery planning.

Finally, we would also like to emphasise the importance of coordination between National Resolution Authorities and the SRB as well as third country authorities to avoid potentially contradicting strategies or intents, and also to prevent any additional national fragmentation. Noting all of the above indeed, the application of additional resolution tools should not endanger the set SPE or MPE strategy and open the door to national ringfencing.

[1] As reminder, Fortis prepared 4 (physical at the time) data rooms in no more than a couple of days and invited several potential bidders. 3 of them showed up with substantial teams and BNP Paribas released a first binding offer for the whole Fortis group during the weekend. Though, the BE, NL and LU states decided to rescue the group and that offer was not retained. As the NL state changed mind and nationalised the NL part of the Fortis group on the next Friday, BNP Paribas made a new offer limiting it to the remaining banking activities, which was negotiated and signed over the 2nd weekend. (This all despite all the disentanglement issues that had not been anticipated at all, in a complex, dual headed holding structure.)

Question 1.2:
Do you have comments on how a partial transfer would influence the composition and risk profile of the balance sheet of the resolved bank for the recapitalisation needs?

The answer to such a question depends on the resolved bank's characteristics in terms of its risk profile, size, funding and business model, and inherently calls for a case-by-case analysis. Yet we still tried to draw relevant criteria to be taken into consideration across the board.

If transfer perimeters are proportionally impactful from a solvency and/or liquidity viewpoint, partial transfers would very directly reduce the recapitalisation needs of the resolved bank.
Furthermore, the business model of the post-resolution group should necessarily change compared to the pre-resolution one (which would have proven flawed). Partial transfers would help adapting the business model. Next to the size impacts, these transfers should be considered when estimating recapitalisation needs of the post-resolution group, which should be calibrated on a smaller, different, and normally less risky group than the pre-resolution one.

Furthermore, as already mentioned, the likelihood of an unexpected entry in resolution at very short notice is nil or extremely close to nil for a large bank. Accordingly, a recovery phase would necessarily precede resolution and the implementation of recovery options would significantly reduce the size of the bank in resolution, hence its recapitalisation needs too.

Next to these elements, the natural business attrition of a bank in the run-up to resolution should also be considered when calibrating the recapitalisation needs. This is particularly true for corporate banking activities and even more specifically so for global market activities where clients and counterparties would necessarily limit their business volumes with a banking group of which the situation deteriorates. As a matter of fact, rating downgrades below defined thresholds constitute automatic triggers of business termination for certain transactions and counterparties. This business attrition will entail a material reduction of the balance-sheet well beyond the "balance sheet depletion" as used today in the MREL calibration by the SRB. For instance, Crédit Suisse's market activities, shrank by 60% between end 2021 and Q1 2023 and by 30% on the first quarter of 2023.

Finally, possible important discounts on sale prices of assets may have to be considered too, due to stressed market conditions or to compressed timelines imposed on potential acquirers. The impact thereof depends on the value at which the assets are booked in the balance sheet of the seller and, if negative, it should be included in the recapitalisation needs. Based on the evolution of the share prices in the financial sector observed during the major crises since 2008, assuming a discount in the order of 25% on estimated values under normal circumstances to compute such potential negative impact would be altogether prudent and reasonable in our view. We note also that when focusing on impactful transfer perimeters, the positive impact of the RWA relief by far outweighs the possible impact of a sale at very distressed prices.

2. Market confidence charge

<u>Question 2.1 External MCC for resolution entities:</u>
What do you view as the main factors for a bank to be able to sustain market confidence during and immediately following its resolution?

We would first like to underline the fact that the MCC is not mandatory in all cases in the current framework, but a mere possibility. That is why under the current applicable framework the setting of the MCC does not rely on a default amount but calls the SRB to set a necessary and appropriate amount for an appropriate period not exceeding one year, depending on the very characteristics of the resolved bank at hand. In this regard, the CBR constitutes a starting point for the setting, if necessary, of an MCC, which ultimately must be adjusted and tailored to the resolved bank and must be effective in achieving the defined purpose.

When considering the merits of the MCC, we conclude that as an addition to existing requirements, in going-concern, it creates a drag on profitability and reduces a bank's lending capacity – in a sense, the opportunity cost of the MCC in going concern is the retained earnings i.e., capital generation that is sacrificed through the lower lending capacity. At the same time, there is no evidence that the MCC is an important determinant that affects market confidence post-resolution. Overall, we believe it would be beneficial to limit or, ideally, eliminate the MCC and resulting costs brought from the otherwise high MREL requirements imposed on banks.

It should be reminded indeed that market confidence is a matter of credibility that can only be recovered over time after an institution has gone through severe troubles, and even more so after it has been formally declared FOLTF. In such circumstances, even a very high MCC would make little difference in the investors and creditors attitude following a resolution in our view. As such, it appears incongruent to expect buffers to be back in place immediately after resolution. Moreover, investors have long memories, and if authorities increase the level of bail-in to get a high MCC, that will not help restoring their confidence, rather the opposite. Investors would very likely prefer a limited bail-in and a low MCC, if any at all, over a high MCC and a massive bail-in.

Investors will anyway not expect any dividend from a bank that has been recently resolved. The same is also true for contingent AT1 coupons, if any AT1 capital remains. Thus, there is no immediate requirement to fully rebuild capital buffers right upon resolution.

Rather than focussing on re-building capital buffers, here are some other important elements that should help restoring market confidence:

- There must be a robust, credible and effective resolution plan and related restructuring plan for there to be market confidence.
- The resolution authority must communicate and keep an open dialogue to highlight that there is an effective approach in place and important milestones must be identified and relayed to the market and stakeholders. Clear and consistent communication from authorities is essential to support market confidence following a resolution.
- Liquidity is obviously key too and must be included in the communication. If central banks provide a clear message that they support a resolution, then investors are more likely to lend to resolved banks that receive support from the central bank. More specifically, this could be achieved if programmes such as the Emergency Liquidity Assistance (ELA) or ad hoc ones can be utilised for resolved banks. Clarity with regards to liquidity is critical for market confidence.

- Confidence will only be restored over time when investors assess the resolution/restructuring plan as credible and see it executed effectively. In this sense, it is essential that the execution of any announced plan is decisive, effective, and timely. This should demonstrate that the issues having caused the (quasi-) failure are tackled and that business model of the bank is adjusted accordingly, leading rapidly to a stabilised situation and gradually to a sustainable (profitable) business model.

In a nutshell: clear communication of a credible plan demonstrating understanding of the situation and stabilisation, notably for liquidity, first; reasonable profitability and capitalisation second. And of course, time.

Question 2.2 Internal MCC for subsidiaries that are non-resolution entities:
When setting an MCC for subsidiaries, what do you view as the main drivers for subsidiary banks to regain market confidence after the application of write-down and conversion powers?

We do not believe that a MCC is a relevant consideration for a subsidiary that is not a resolution entity. In fact, we struggle to envisage any circumstances in which it would be appropriate to set a MCC for such an entity. Rather, the key determinant of market confidence for a subsidiary is the support that is provided by the group and the ongoing ability of that subsidiary to operate as part of and benefit from the franchise of its group.
Further, restoring confidence in a subsidiary requires also the clear market perception that the group resolution strategy is properly operating, that home and host resolution authorities are cooperating well, with consistent communication to the market, and that they are exercising their powers consistently with the group resolution strategy.
In summary, to ensure market confidence for the subsidiary, effective execution of the announced group resolution plan is much more important than the capital base of the subsidiary. More so than for the resolution entity, it is not believed that the level of capitalisation including an MCC is in itself necessary to restore market confidence. Rather a clear communication and decisive actions demonstrating that the situation is understood, under control and being efficiently remediated in the short and longer term is key and, in any event, such market confidence will only come back after a while.

Besides these comments, if the current approach of the SRB for setting an MCC for subsidiaries was maintained, a review of the definition of "wholesale funding" would be required. In our view, it should not include client-related funding such as corporate deposits nor some institutional deposits. Similarly, the determination of complexity of an entity would also need to be reviewed.

3. Monitoring of eligibility

Question 3.1:
Do you have any comments on the described approach for eligibility monitoring that a resolution authority should implement to ensure effective loss-absorption capacity?

For the avoidance of doubt, we would appreciate a confirmation from the SRB that there is no consideration for a double declaration on the monitoring of eligibility regarding the own fund instruments: to the ECB on the one hand and to the SRB on the other hand. It is important as well that, if implemented, this eligibility check applies to the new issuances only and not to the stock.

As far as eligible liabilities are concerned, namely Senior Preferred (SP) and Senior Non-Preferred instruments (SNP), it is essential to bear in mind that the number of issuances is much higher than the volume of own funds instrument issuances. Given the number of eligibility criteria, it would be extremely burdensome to replicate what is required for the own funds by the ECB today (without mentioning that such detailed tables would have to be subject to a sign-off by the management body, who already signs-off the existing regular MREL reporting). The existing checklist framework (e.g. *Template for the Management Sign off form* of MREL instruments eligibility criteria) for eligibility assessment should therefore be considered as sufficient.

A more pragmatic approach is essential. As such, to simplify the process of bond issuance, the SRB should consider whether banks can provide a self-assessment of their respective issuance programmes every year, in contrast to producing and sending a self-assessment at each issuance which helps reduce the workload burden on banks. Alternatively, a simplified template would help facilitate a more efficient and proportionate approach or rather than requiring management sign-off for each issuance, SNP issuances could be sample tested by the resolution authority (on a random basis). In any case, if the SRB maintains the idea to report each new issuance it should at least set a floor on the size of the issuance on a case-by-case basis to only report those above it. In addition, new issuances should be scoped to public issuances which are the most relevant compared to private issuances that are more recurrent but have smaller size. Proportionality is essential not to overburden banks.

Question 3.2:
While MREL-securities traded on capital markets and/or subscribed by professional investors show a high degree of standardisation and harmonisation of practices, liabilities arising from different legal arrangements (i.e., incorporated into private-placement agreements) do not. Are you aware of any specificities presented by non-standardised claims that would be worth taking into account for the purpose of monitoring eligibility activities (also in light of the current management sign-off process)?

We are not aware of any specificities presented by non-standardised claims that would be worth taking into account for the purpose of eligibility monitoring activities.

4. Discretionary exclusions

Question 4.1:
Closing of derivative contracts (valued on a net basis) through bail-in may lead to replacement costs incurred by the bank, particularly in respect of open positions for the bank which require re-hedging. In your view, under what circumstances would the costs related to close-out be high enough to lead to destruction of value (meaning that holders of other/non-excluded liabilities would be better off when particular derivative contracts are excluded from bail-in than if derivatives were bailed-in)?

The bank whose transactions are bailed-in needs to re-hedge the corresponding risk, leading to high-re-hedging costs when the corresponding market risk is significant. The effect will be magnified where the bank has little or no market access in the context/aftermath of the bail-in as market counterparties can be expected to stay away from a stressed institution to which they are already exposed. One also needs to bear in mind that the re-hedging exercise would mobilise scarce trading resources at a difficult time.

One should not assume that the risk to be re-hedged would be low thanks to some portfolio effect. There is a likelihood that all the portfolios which have a negative value (from the bank's point of view) share the same directionality with respect to some market factor (EUR swap rates, USD/EUR exchange rate …) and their risk would aggregate rather than diversify away. In some cases (energy hedges), the offsetting risk would clearly come from trades which are not bailed-in because they have a positive value for the bank (the value of trades with producers has generally the opposite sign of those with utilities). One could not assume only a subset of markets / underlying products would be affected and would have instead to expect a general disruption.

Beyond the direct impact of above re-hedging on the bank and other market participants, some general market contagion would be expected (higher risk premia, higher transaction costs, lower liquidity …). The systemic impact would be negative and its reach, difficult to quantify in advance.

Question 4.2:
Under which circumstances and to what extent, could bailing in net liabilities under derivatives (after close out) negatively impact a bank's business, leading to destruction of value? Please elaborate (e.g. potential differences across different banking business models or types of derivatives themselves). Do you think the exclusion of other types of liabilities could lead to such effects?

Such an issue arises if there is an adverse impact on a bailed-in counterparty that also happens to be a debtor to the bailed-in bank or other third parties. This could result from the counterparty having suffered a loss and being no longer properly hedged, and therefore having a worsened credit profile as a consequence. In some cases, issues with the hedging program could trigger some covenants and lead to a direct acceleration or deterioration of financing structures. The resulting increase in Expected Loss on the bailed-in bank's financing exposures will have adverse consequences, possibly in the very short term if it triggers new accounting provisions and will eventually lead to higher realised credit losses, lowering retained earnings and capital.

Question 4.3:
Some instruments have been hedged externally and thus their bail-in would also require a winding down of the corresponding hedge. In your view, can this lead to destruction of value (meaning that holders of other/non-excluded liabilities would be better off when such liabilities are excluded from bail-in than when they are bailed-in)? If yes, under which circumstances (e.g. does it depend on the hedging purpose such as economic or accounting)? Do you think this could be the case for structured notes with embedded derivatives? In such case, please provide concrete examples of structured notes where destruction of value could appear.

In our understanding, if an instrument (which could be any bond, not just structured note) is bailed-in the hedge should be unwound one way or an other. This could lead to an operational bottleneck as, in principle, almost all the instruments in a given insolvency ranking class would be bailed-in at the same level and that for different classes, consequently a large number of hedges should be dealt with at the same time.

This may effectively lead to negative P&L impacts on the hedges, which would be unwound in a context of important market movements and with possible delays. Generally though, we would expect that the bail-in of the principal amount of an instrument and the contribution to loss absorption and/or recapitalisation would outweigh the negative impact. But, in cases where the principal amount of an issued instrument is bailed-in, for a small fraction only, the balance might be less clear. One must also take into account that re-hedging will be more difficult and costly if the bank loses its access to the market, possibly as a consequence of some derivatives counterparties being bailed-in.

Question 4.4:
Without prejudice to the considerations for discretionary exclusions regime, as regards bail-in operationalisation:

- *Are there any operational challenges that may hamper the bank's ability to provide, on short notice, the information about its derivative contracts as required for the purposes of valuation pursuant to Articles 36 and 49 of Directive 2014/59/EU? If so, do these challenges concentrate in any particular category of derivatives?*
- *Are there particular types of collateral that might create operational challenges to determine – in a short timeframe – the extent by which the value of secured liabilities, or a liability for which collateral is pledged, exceeds the value of the assets, pledge, lien or collateral against which it is secured.*
- *Are there particular challenges – in a short timeframe – in identifying the amount of a deposit that exceeds the coverage level provided for in Article 6 of the Deposit Guarantee Scheme Directive which would be eligible for bail-in.*

For derivative contracts, one must consider the operational challenge of looking at the whole portfolio, valuing it according to the requirements of Article 36 and making the assessment required by Article 49. These tasks will necessarily take a long period, even if one has access to significant resources. Article 49 requires an analysis much beyond the valuation of derivatives exposures: one must not only evaluate the credit impact of the bail-in on the counterparty, but also consider its liabilities (which would be assets of the bailed-in bank).

As a point of comparison, while the termination of derivative transaction in a "regular" default situation (single entity, no significant market impact or systemic dimension) can take place very quickly, the process of finalising the computations and preparing the resulting claim notice to communicate the claim amount to the counterparty typically takes several weeks. In a bail-in scenario, a similar process must be run concurrently for a large number of claims / counterparties, in what is likely to be a stressed market where there are potentially numerous stressed entities.

One must also take into account that the evaluation of replacement transactions is a complex exercise as they can be done in a number of ways:

- Replacement transactions can be "exact" replacement transactions for which the suitability review needs to assess "only" the correctness of pricing / timing, which requires using some difficult-to-estimate parameters, such as various value adjustments that can differ between counterparties. The same replacement transaction for two different counterparties could therefore be done at different prices because of different adjustments. Further, making any assessment about fairness is not straightforward; if one set of replacement trades is not accepted, one of the bailed-in counterparties will be at a risk of further loss through no fault of their own, particularly where they follow the contractual close-out process. Put another way, counterparties cannot know ex ante what process will be deemed "reasonable" for these purposes, particularly where this departs from the contractual close-out provisions which have been pre-agreed and which are standardised in the market.
- Replacement trades can also be "at market", where the bailed-in counterparty is instead hedging its overall market risk without looking to replicate exactly the bailed-in trades. While the quality of "at market" trades is easier to assess, one would then need to factor in other pricing parameters to value the bailed-in exposure (value adjustments for example). Note that replacing the exposure in that way can create accounting issues for some counterparties, leading them to try "exact" replacements even if it is likely to take longer.
- Last, one must factor in the possibility that a bailed-in counterparty will have provided replacement trades for only part of its exposure. One must then determine whether the exposure that has not been replaced must be valued in line with the (partial) replacement trades or with another data set.

When there are some contractual or legal set-off rights between the derivatives and other exposures, they must be taken into account in order to fully assess the total impact on the counterparty. This requires access to additional data (beyond the definition of the derivative portfolio) and a methodology for considering the impact of the set-off. However, where the bail-in process would not take into account such setoffs, which would be permitted and/or mandatory in liquidation, it would likely be in contradiction to the "NCWO" principle.

For all the above, there is a clear trade-off between running the process either as speedily as possible to minimise uncertainty or market impact or as thoroughly as possible for fairness reasons and to lower the risk of some bailed-in counterparties contesting the valuation. There is no clear criterion to establish how to strike the balance between the two objectives.

The above challenges exist for all derivative categories, as the relevant framework for the work that needs to be done is the master agreement with each counterparty, where all derivative products are commingled.

5. Rethinking approach to adjustments in the MREL policy

Question 5.1:
What are your views on the current MREL calibration methodology? How do you assess the complexity of the current framework and would you support an approach to MREL by developing a new methodology with a harmonised floor and a single adjustment driver? In your view, does a single adjustment driver based on factors like resolution strategy, resolvability, etc. reduce complexity?

We welcome the idea of reducing the complexity of the MREL calibration and of enhancing its predictability and transparency. While predictable for its rather mechanical aspects for those directly involved at the individual bank level, the current methodology to determine MREL requirements is perceived as unduly complex, difficult to grasp and hard to compare with other banks or jurisdictions by many stakeholders, including notably investors in EU banks' securities Particularly when compared to the TLAC approach adopted in the US (for GSIIs only), the EU MREL approach and calibration is not only much higher but also particularly complex .

Complexity

The complexity of the level one texts complemented with not necessarily clearer and often very constraining and more conservative level two texts and policies, guidelines and Q&As the articulation of the MDA and of the M-MDA, and so on render the EU/BU framework hardly understandable for non-initiated, non-specialised stakeholders and for investors. We believe a simpler approach was intended by the BRRD / SRMR and the overlay of MREL policy and supervisory practice has departed from this. That contributes to putting EU/BU banks at a clear competitive disadvantage vis-à-vis their international competitors, notably the US ones. Equity investors disregard EU/BU banks that trade at an important discount vs. US ones and debt investors require significant premiums from them compared to what is required from US banks.

In that respect, a simplified MREL calibration framework with a harmonised floor is highly desirable and a default calibration similar to the internationally adopted and recognised TLAC standard would make it easily readable to almost all stakeholders; adjustments, if any, should remain exceptional and duly justified.

If any, a single adjustment driver would also go in the direction of simplification. It should anyway be easily understandable, objective, predictable and transparent. As mentioned in response to Question 5.2 however, we do not believe the adjustment driver should be based on the resolvability assessment. Resolution strategy might better qualify as driver as long as it does not generate level playing field issues within the EU/BU nor internationally.

Higher Requirements

In 2015, the EBA developed the current MREL calibration methodology where, in BRRD1, the majority of the liabilities were eligible to MREL, such as (but not limited to) structured notes, debts issued by subsidiaries, and large deposits. The impact assessment from the EBA duly noted that the majority of the banks met the MREL ratio as of end-2014 data[2].

With CRR2 / BRRD2, the MREL eligibility requirement aligned with the TLAC ones developed by the Financial Stability Board (FSB). Both requirements entail:

- A high proportion of subordinated debts for large banks.

[2] EBA-RTS-2015-05 RTS on MREL Criteria.pdf (europa.eu) – see page 35

- Contractual conditions to ensure there is an easy bail-in (no set-off and/or bail-in clause) and stability in the medium to long-term (no acceleration possible and/or regulatory approval to repay the debt before maturity).
- Distribution restrictions in the case of a breach of buffer requirements.

The eligibility criteria for the MREL methodology have been enhanced, although the calibration diverges from the FSB's criteria. Currently, a bank with an open bail-in strategy faces MREL requirements of almost twice the own funds requirements (in % of RWAs) i.e., almost 2 x (Pillar 1 + Pillar 2 + CBR)[3]. Meanwhile, for the FSB's requirement, the default TLAC is 18% of RWAs (i.e., 2xP1 + 2%) + CBR.

According to the SRB Q2 2023 MREL dashboard, the average subordinated MREL in RWAs (without CBR) stands at 20.5%, while TLAC requirement (without CBR) amounts to 18%, or 14.5% if the bank uses the senior debt allowance. The total MREL requirement (without CBR) is 23.7% on average (vs. 18% TLAC). With a total RWA of € 7,434bn, the 5% differential between MREL and TLAC represents an additional ca. € 370bn of SNP or eligible SP instruments to be issued and rolled for banks under the SRB remit, compared to the TLAC requirements. Assuming an average annual yield of 3.6%[4], those € 370bn additional requirements represent a total gross cost of ca. € 13.3bn per year for the EU-banks, of which probably € 5 to 6bn drag on the net interest income and permanently affect their capacity to support the economy, year after year, an effect that will further increase with the finalisation of Basel III.

As such, although the currently applicable general principles at the basis of the MREL calibration appear sound and reasonable, on closer inspection the very conservative approaches adopted by the Competent authorities for the calibration of the capital requirements, equating the Loss Absorbing Amount (LAA), on the one hand, and by the SRB as resolution authority for the calibration of the ReCapitalisation Amount (RCA), on the other hand, lead to excessive MREL targets levels (on average 20%-25% above the TLAC).

Such high requirements have many not so desirable consequences:

- The EU bond market is not extremely deep and non-EU banks take a good part of it with large issuances volumes at, on average, wider spreads. This limits the liquidity available to EU banks. For instance, issuances from the non-EU banks represented 20%-30% on average in the last five years, (of which ca. 10% for US banks). In order to meet their requirements, EU banks must diversify their funding away from their EU domestic market and tap into other markets. This is necessary for SNP/SP or Own Funds, although this approach is associated with a heavier cost. Major EU banks must issue a large portion of their MREL in the US market, whereas on average it is approximately 30-40bp more costly than the EUR one. (See also the tables in appendix showing that, in absolute terms, EU banks are more than 3 times more dependent on the US market than the reverse, and that, while significantly smaller in size, EU banks must issue almost twice as much debt as US banks)
- There is also high market volatility and markets can close rapidly with possible negative ramifications, particularly in stress periods. During such periods, the higher the requirements imposed on banks, the higher the costs and the higher the risks of breaches of requirements and contagion.

[3] To be precise, the CCYB only counts once, and a small reduction of B/S in resolution is applied by the SRB
[4] As of 15 December 2023, the annual yield of the iBoxx EUR Banks Senior Bail-In (i.e. for Senior HoldCo or Senior Non-Preferred) stood at 3.68% and the annual yield of the iBoxx EUR Banks Senior Preferred stood at 3.49%.

- Funding requirements for green and digital transition are building up rapidly. However, the progress of this transition is impeded by constraints imposed on EU banks, including MREL, limiting their capacity to fund the transition, thus favouring the non-EU banks who do not face as many restrictions as their EU counterparts.
- The capacity of EU banks to support the EU economy and their profitability, already affected by their high MREL requirements, will further decline due to the impact of the finalisation of Basel III on the RWAs of large EU banks (see EBA's QIS) that will automatically be doubled if the MREL policy does not change.

In summary high requirements:

- Make EU banks heavily dependent on the US market;
- Limit their capacity to finance the necessary green and digital transition of the European economy, which is in turn becoming more and more dependent on foreign, mainly US, banks and markets;
- And bear heavily on the profitability of EU banks.

Question 5.2:
Do you see any merits or disadvantages to linking the calibration of MREL with the resolvability assessment? If so, please explain and elaborate.

In our view, it would not be advisable to use the resolvability assessment for the calibration of MREL.

First, there is no obvious link between resolvability and recapitalisation needs in case of failure. Accordingly, the calibration of MREL should not be linked to resolvability assessment, subject only to one possible exception. If substantive impediments to resolvability are identified and are directly related to the use of the bail-in tool, a predetermined surcharge of subordinated MREL would be justifiable. In situations where identified impediments to resolvability are related to other aspects than the use of the bail-in tool, a surcharge of subordinated MREL will not alleviate the impediments. Instead, measures to improve the resolvability should be related to the specific areas where the impediments are identified.

Second, despite the efforts undertaken by the SRB to render the concept of resolvability comparable and transparent across the different types of banks, the resolvability assessment itself is and should remain idiosyncratic and bank specific.
Establishing a more or less complex scoring system based on the 7 dimensions and related principles of the Expectations for banks would only provide an illusion of objectivity, transparency and predictability. It would not remove the inherent subjectivity attached to that kind of assessment.

Finally, sufficient loss absorption capacity (MREL) is a key determinant of the resolvability assessment. Hence, determining the MREL requirements based on the resolvability assessment would create a circular reference, which should be avoided.

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Question 5.3: *Which other factors should be included in the calibration of MREL? How could a harmonised floor be determined?*

Several aspects of the current approach to MREL calibration could be reviewed

- Loss absorption amount: Upon entry resolution, it is assumed the bank would have lost all its required own funds, which is obviously excessive, particularly for large banks, as authorities would have to intervene ahead of such extreme event. This assumption of full capital depletion as implied in the BRRD/SRMR should be reviewed in our opinion.
- Recapitalisation amount: As foreseen in the BRRD/SRM regulation it should be based on the size of the bank which is under resolution. As a result, the resolution authority should make a proper assessment of the bank activity reduction in the run-up to resolution and consider realistic transfers when determining the recapitalisation amount.
- Market confidence charge: As mentioned above, re-instating the combined buffer requirement as a way to restore market confidence right upon resolution is hardly justifiable. Ideally, it should be removed.

As suggested hereabove, the calibration of MREL (including subordinated MREL) should be easily understandable, predictable, and transparent and should provide more room for manoeuvre for EU banks while restoring competitiveness.

It is key that any review of the MREL calibration framework ensures close alignment to TLAC / international standards, which would help levelling the global playing field and facilitate global cooperation among regulators and cross-border recognition of resolution actions.

Our clear preference would go for a radical change to a TLAC-like calibration system, including a harmonized floor, based on the following criteria, which would offer an easily understandable, predictable and transparent approach:

(i) a risk-based standard level expressed as a percentage of TREA, potentially slightly adjusted for resolution strategies based on sale of business with market exit compared to open-bank ones and that preserves the neutrality of MREL regarding the resolution strategy chosen; and

(ii) a simple non-risk-based level expressed as a percentage of LRE.

This should apply to all bank across the EU, or at least across the BU, and not just to banks under the SRB remit as a matter of level playing field.

To absorb losses and contribute to the capitalization of any bank earmarked for resolution, BNP Paribas would recommend setting a floor at 16% of RWA + CBR and 5% LRE. The recommendation is justified by market discipline, as each bank should ensure they can support and back their own resolvability without reliance on external funds (DGS, SRF).

Similarly, and consistently with our recommendation for simplicity, transparency and predictability of the system, a cap could be introduced too, allowing the resolution authority to treat exceptions with duly justified add-ons within pre-set limits.

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Appendix: Issuances of US and EU banks since 2020

(Source: Bond Radar – all public issuances of debt securities by banks, in USD million equivalent)

North America Banks Total vol. USD M eq.

Currency	2020	2021	2022	2023	2024	Total
EUR	29,549	44,954	60,422	34,862	1,097	170,883
USD	233,872	285,412	303,224	208,268	38,746	1,069,522
Others	3,328	23,018	20,462	15,341	1,901	64,049
Total	266,749	353,384	384,108	258,470	41,744	1,304,455
% EUR	**11%**	**13%**	**16%**	**13%**	**3%**	**13%**

Western Europe Banks Total vol. USD M eq.

Currency	2020	2021	2022	2023	2024	Total
EUR	256,382	273,952	348,059	394,251	70,193	1,342,836
USD	120,778	144,638	149,570	141,472	24,349	580,807
Others	31,342	41,326	49,626	70,279	8,901	201,474
Total	408,502	459,916	547,255	606,002	103,442	2,125,118
% USD	**30%**	**31%**	**27%**	**23%**	**24%**	**27%**