Groupe Crédit Mutuel – SRB Public consultation MREL Policy
February 2024

Subject: Public consultation on the future of MREL policy

The Crédit Mutuel Group welcomes the intention of the Single Resolution Board (SRB) to further engage with and consult the industry, namely on the future of MREL policy. Thanks to the resolution planning carried out in recent years, and to the build-up of the SRF, EU financial stability has really improved, and this should be reflected today in MREL calibration. We especially appreciate that the SRB finally considers the possibility of large banks using complementary resolution tools next to the bail-in, such as transfer tools in their preferred resolution strategy, which may impact future MREL requirements.

We think also that providing the industry with a view on a set of policy adaptations envisaged by the SRB would have allowed for richer outcomes and we would welcome a dialogue before the finalization of the revised policy.

The Crédit Mutuel Group shares the analysis and concurs with the lessons learnt from the recent and older crises as outlined by the SRB in its introduction to the consultation. It is further of the opinion that, under the current legal framework, several changes in the MREL policy can and, ideally, should already be introduced in the coming resolution planning cycle, capitalising on the very significant progresses made in terms of recovery and resolution planning, as well as accumulation of own funds and stable liabilities, among others thanks to the SRB actions, since the MREL framework was initially set up.

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)?

The Crédit Mutuel Group believes that transfer tools should be considered as complements to the bail-in tool as per the current regulatory framework for the largest banks and that they should be included in their preferred resolution strategy and of course reflected in their MREL target calibration.

We would further welcome a pragmatic approach concerning the operationalisation requirements of these complementary tools (documentations, testing…etc) and a view on the potential impact on the MREL calibration. As it is known, part of the assets that might be sold during the resolution process are included in the recovery plan (validated by the Single Supervisory Mechanism) and therefore, the inclusion of these sales should not be burdensome from an operational point of view.

Besides, the SRB guiding principles for perimeter identification that focus more 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 complements to bail-in.

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

This guidance already includes the following principles, i.e. that potential transfer perimeters:

Considering the Sale of Business tool (SoB):
- Should represent clear sets of businesses potentially attractive to third party acquirers;
- May include critical functions, the continuity of which should then be ensured by the selected acquirer;
- Could easily be structured and operated from a legal, financial and operational viewpoint, enabling a swift and efficient transfer under the responsibility of the resolution authority in case of resolution.

Considering Asset Separation Tool (AST):

- 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.

In our view, additional criteria to be considered when SoB or AST are expected to complement other tools include that these transfers should:

- Be proportionately impactful from a solvency and/or liquidity standpoint. Indeed, it is important not to spread over a wide variety of possible transfers, but to concentrate on a few that have a significant impact;
- Be actionable within a short timeframe, taking into account plausible resolution scenarios and the actions that the bank would have taken in the run-up to resolution, such as the preparation of the execution of recovery options;
- Focus on activities that are not considered as core to the expected post-resolution banking group and whose disposal would not affect the capacity of the remaining perimeter to recover over time;
- Ideally be incorporated in distinct legal entities (preferred solution). Disposal of business units and going concerns to be considered to the extent that they are easily identifiable, well defined and easily separable.

The Crédit Mutuel Group would further welcome that the SRB leverages on recovery plans as they are the starting point for the resolution planning process: under the regulatory framework, the institution must set out arrangements and measures to reduce risk and leverage exposure, or to restructure business lines including, where appropriate, an analysis of possible material divestment of assets, legal entities, or business lines, which are subject to detailed and regular assessment by the ECB. Furthermore, banks are required to incorporate a range of extreme (but plausible) stress scenarios similar to scenarios to be taken into account for resolution plans. Building up on recovery planning and on the ECB assessment that has examined and validated, quite concretely, the feasibility of possible material divestment regardless of the interconnectedness of the Group would allow banks as well as the SRB, to effectively manage time and resources in resolution planning in a cohesive manner.

In addition, effective capacity to sell entities or to transfer portfolios, as demonstrated through transaction records, should be duly recognized in the assessment of transfer strategies by the resolution authority.

Recent and less recent crises have shown that transfer strategies could be implemented at very short notice, even without preparation. 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 on a positive assessment of such recovery plan by the competent authority;
- 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, 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 within 12 months is extremely unlikely. Accordingly, beyond defined critical thresholds, alerts triggered by the indicators included in the dashboards that banks must establish for recovery purpose could be also used by the resolution authorities the actual preparation work for transfers included in the resolution strategies, which would secure swift execution if resolution occurs and if transfers have not been executed in the recovery phase.

In accordance with the above-mentioned suggestions, we would welcome an update of the 2021 SRB operational guidance for banks on separability for transfer tools, the purpose[1] of which could be clarified and the requirements of which appear disproportionate and overlapping with recovery planning ones.

[1] In our view, it is misguided to aim at providing the SAR to potential investors. The SAR should aim at demonstrating the capabilities of an institution to quickly implement envisaged transfers but the relevant information to potential investors should be prepared in the run-up to Resolution, i.e., most likely in Recovery time or specifically at the request of the resolution authority upon breach of certain indicators of a deteriorating situation.

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Eventually, we would also like to emphasise the importance of coordination with Resolution Authorities to ensure that the SRB's regulatory perimeter is protected in a crisis, such that other jurisdictions do not prescribe actions for entities that fall under the SRB's remit and vice-versa.

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?

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.

It should also be reminded that the likelihood of an unexpected entry in resolution at very short notice is nil or extremely close to nil for a large bank as Crédit Mutuel as evidenced by previous extreme reverse stress exercises run by some banks at SRB request. Accordingly, a recovery phase would necessarily precede resolution and the implementation of recovery options would significantly reduce the size of the ailing bank, 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 and institutional 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 termination of business 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 default formula set by the SRB. As a matter of fact, despite the absence of decisive implementation of a long due credible recovery plan, the balance sheet of Credit Suisse decreased by one third between Q2 2022 and Q2 2023 and by one quarter of the last quarter of 2022 only.

Furthermore, the business model of the post-resolution group should necessarily change compared to the pre-resolution one (which would likely have proven inappropriate), and as already documented in the Business Reorganisation Plan. Partial transfers would help adapting the business model. Besides the size impacts, these transfers should be considered when estimating the required capital buffers of the post-resolution group, which should be calibrated on a smaller, different, and normally less risky group that the pre-resolution one.

Market confidence charge

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

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. An extremely high level of MCC would not make any difference in the investors and creditors attitude following a resolution and it should be avoided as a higher MREL weighs on bank lending capacity in going concern without a strong justification in resolution. Besides, the MCC is currently gold plating at European level, and the SRB should be able to exercise its discretion to reduce it.

In our view, the level of regulatory capital, even if very high, cannot, in itself, restore market confidence and is not its main driver, although an adequate path to regain a reasonable capital level over time will contribute to it.

In addition to necessary time, which is unavoidable, here are some other essential elements to restore market confidence:

- A clear and credible plan to stabilise the situation, including specifically on the liquidity front, and to gradually restore profitability and solvency. Confidence will only be restored if investors and large customers assess the resolution plan as credible and believe that it will effectively be executed. Therefore, the role of authorities is key and the SRB will need to communicate on the retained strategy and on identifiable milestones.

- As from the start, a clear, regular and supportive communication by the Resolution Authority as well as the Competent Authority, ideally jointly, explaining in a way that can be easily understood by all the stakeholders, the reasons having led to the FOLTF declaration, the actions undertaken to remedy such situation at short term, including in particular in terms of liquidity if and when relevant, and the plan to restore the situation in a sustainable way for the longer run. Such communication can be complemented as the situation evolves. Details about the longer-term business reorganisation plan do not need to be communicated immediately. At short term, it is essential that the communication by the authorities demonstrate that they have the situation under control. For instance, financial communication done by Novo Banco over the years is a good illustration.
- A decisive, effective and timely implementation of the announced plan as updated from time to time, which 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 reasonably profitable one.
- In summary: clear and supportive communication demonstrating understanding of the situation and stabilisation first, including liquidity; reasonable profitability and capitalisation second.

As mentioned, investors will be more inclined to lend to a resolved bank if there is a clear message from the central bank that it supports the resolution (see US and Swiss example). Emergency Liquidity Assistance should be available to banks resolved under the control of the SRB. Moreover, investors have long memories, and if authorities have to bail-in more to get a high MCC, that's not going to restore their confidence. Investors would probably prefer a limited bail-in and a low MCC, if any at all, over a high MCC and a massive bail-in.

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?

The idea of an MCC for subsidiaries that are not resolution entities appears highly questionable.

For such subsidiaries, the conditions to restore confidence are similar to those mentioned in answer to the previous question with the noticeable and essential difference that there would be no bail-in by other creditors than the resolution entity. Indeed, if the subsidiary reaches the PONV, the recapitalisation is ensured by the resolution entity through internal MREL. Therefore, the main driver for confidence relies on the resolution execution at group level and not on the capital level of the subsidiary. Market confidence for non-resolution entities relies essentially on the parent support in going concern. In our view, an MCC for such subsidiaries is not justifiable as eligible liabilities for iMREL have to be subscribed essentially by the resolution entity, directly or indirectly and not by third parties.

For subsidiaries that are not resolution entities, the other difference is who does what. In case of a group-wide crisis, the communication should be closely coordinated between group and local authorities and with the subsidiary itself to ensure overall consistency. In case of a specific crisis limited to the subsidiary and not remediated by the group, which would trigger the application of write-down and conversion powers (art. 59 BRRD), in the communication, particular attention should be paid to the reasons for the intervention by the National Resolution Authority.

In all cases, communication should be tailored to the subsidiary and the market in which it operates. Similarly, and even less than for a resolution entity, it is not believed that the level of capitalisation is in itself necessary or sufficient to restore market confidence. Rather a clear plan, a clear communication and decisive actions demonstrating that the situation is understood, under control and being efficiently remediated at short and longer-term is key and, in any event, market confidence will only come back after a while.

Furthermore, “access to the market” shouldn’t include corporate deposits as it is the case for the time being for the SRB and the definition of wholesale funding it uses mechanically to assess the need to require a MCC for iMREL should be reviewed in any case.

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, the banking industry would appreciate a confirmation from the SRB that there will not be a double declaration on the monitoring of eligibility regarding the own funds instruments: to the ECB on the one hand and to the SRB on the other hand. It is important as well to confirm that this eligibility check would apply to the new issuances only and not to the stock and that this monitoring would be undertaken exclusively on an ex-post basis.

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 very different from the volume of own funds instrument issuances (in 2023, 4 times higher for certain groups). Given the number of eligibility criteria, it would be really burdensome to replicate what is done on the own funds for the ECB today, without mentioning that such detailed tables would have to be subject to a sign-off by the management body.

While we understand SRB's wish to control the compliance with eligibility criteria, a more pragmatic approach is essential and a certain proportionality should be envisaged, as bonds issuance are very standardized as noted by the SRB. A simplified process could consist in sending a self-assessment on the issuance programmes each time they are updated (once a year), instead of producing the Self-Assessment at each issuance to reduce the workload. As a fallback, a very simplified template should be used.

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)?

No, not to the best of our knowledge.

Discretionary exclusions

As much as possible, the French Banks would rely on the ACPR working paper[2] on this topic, and to which they contributed.

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)?

According to the ACPR's note on discretionary exclusions, it is mentioned that the closure of derivative contracts (valued on a net basis) through internal bail-in may result in replacement costs borne by the bank, especially for open positions requiring new hedging. The question seems to focus on the circumstances under which these closure-related costs would be sufficiently high to lead to value destruction.

To assess this, several factors could be relevant, including:

- Significance of derivative positions: If derivative positions are significant in terms of size or exposure relative to the bank's capital, the execution of re-hedging transactions may take time and leave the bank subject to

[2] Enhancing the credibility of the EU bail-in design: the example of the treatment of discretionary exclusions **(link)**

changes in market conditions (interest rates, FX rates, equity prices, …), leading to substantial replacement costs;
- Market volatility: Volatile market conditions can increase replacement costs, as it might be more expensive or difficult to hedge positions;
- Nature of derivatives: Some derivatives may be more complex to replace, especially if they involve less liquid assets or less efficient markets; in addition, there probably will be less counterparties willing to transact bilaterally with a bank subject to a resolution and the bank may only be able to access simple hedging products.

Based on these factors, if replacement costs are deemed excessive, it could lead to value destruction. Holders of other liabilities/non-excluded liabilities could then be better off if certain derivative contracts are excluded from internal bail-in rather than opting for bail-in. However, it is essential to consider these circumstances in the specific context of the bank, its activities, and market conditions at a given time.

Besides, 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 size difficult to quantify in advance.

The magnitude of the above issues can be lowered by narrowing the bail-in perimeter. For example, excluding all counterparties for which there is a CSA, whether there is a bail-in-able net exposure or not (present value lower than the value of the received collateral) would remove the counterparties whose exposures have the highest market risk (interbank counterparties and hedge funds). Having a blanket exclusion of these counterparties would lower the contagion risk and rehedging costs. It would also maintain a degree of market access for the bank and increase its ability to manage its risks in the post bail-in period. For the non-collateralised counterparties which remain in the perimeter (mostly corporates), the issues described in 4.2 and 4.4 would still have to be considered.

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?

In accordance with the ACPR note, the bail-in of net derivative exposures (post-closure) could have a negative impact on a bank's operations, potentially leading to value destruction under certain circumstances. Here are some points to consider:

- Banking business models: Different banking business models can influence how derivatives are utilized. For instance, a bank focused on market and trading activities may be more sensitive to fluctuations in underlying asset prices, while a retail bank could be more exposed to interest rate risks. The consequences of bailing in net exposures may vary based on these models.

- Types of derivative products: Some derivative products can be more complex, illiquid, or sensitive to market conditions. The impact of a bail-in may depend on the specific type of derivative products involved. For instance, complex credit derivatives might be more challenging to assess and manage post-closure, thereby increasing the risk of value destruction.
- Exclusion of other liabilities: The exclusion of other types of liabilities could potentially influence the effects of a bail-in. If certain liabilities are excluded from the bail-in, it could affect how costs are distributed and how the bank manages its liabilities. However, this would depend on the specifics of the excluded liabilities and their impact on the overall financial position of the bank.
- Impact on financial stability and risk of contagion.

In conclusion, the circumstances and extent to which the bail-in of net derivative exposures could lead to value destruction depend on various factors, including the bank's business model, the types of derivative products involved, the exclusion of other liabilities, and the impact on investor confidence. A thorough analysis of each specific situation would be necessary to assess these risks.

Besides, such an issue arises if there is an adverse impact on a bailed-in counterparty that also happens to be a debtor to the bank in resolution 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. 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 bank in resolution'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.

Based on the ACPR note, the internal bail-in of certain externally covered instruments could potentially lead to value destruction, depending on specific circumstances. Here are some considerations to take into account:

- Liquidation of the hedge: If the internal bail-in of certain instruments requires the liquidation of corresponding hedge, it could result in additional costs. The liquidation of coverage positions can be sensitive to market conditions, and if carried out under unfavorable conditions, it may lead to additional losses.
- Coverage objective: The circumstances under which value destruction could occur depend on the objective of the hedge. If the hedge was primarily established for economic reasons, such as protecting against fluctuations in asset prices, the liquidation of coverage could be more costly in terms of value destruction. On the other hand, if the hedge was primarily for accounting purposes, value destruction might be less likely.
- Structured notes incorporating derivatives: Structured notes incorporating derivatives can be complex and involve elements of hedging. In such cases, value destruction could be more likely, especially if the liquidation of hedging derivatives results in significant and unexpected losses for the bank.
- Concrete examples: It would be challenging to provide concrete examples without detailed information about specific financial instruments. However, consider the hypothetical example of a structured note linked to interest rate derivatives. If the bank used derivatives contracts to hedge the interest rate risk associated with this note, the liquidation of these derivatives could result in additional losses if market conditions are unfavorable at the time of liquidation.

In conclusion, the internal bail-in of certain externally hedged instruments could lead to value destruction, primarily depending on market conditions, the objective of the hedging, and the complexity of the involved financial instruments. A case-by-case evaluation would be necessary to determine the specific risk in each situation.

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.*

Several operational considerations could hinder a bank's ability to operationalize internal bail-in effectively, especially concerning derivative contracts, collaterals, and deposits. Here are some key points:

- Operational challenges related to derivative contracts: It is suggested that operational difficulties might arise regarding the bank's ability to promptly provide necessary information about its derivative contracts. This could include challenges related to collecting, managing, and communicating data on derivative contracts. These difficulties might be heightened in the case of diversity or complexity among the derivative products held by the bank.
- Collaterals and operational challenges: The question also mentions potential operational challenges related to the swift determination of the value of liabilities secured by collaterals. Rapidly identifying to what extent the value of secured liabilities exceeds the value of assets can be a challenge, especially if the collaterals are diverse or complex. This could affect the ability to adequately assess the amount available for internal bail-in.
- Specific challenges for deposits: The question also raises the possibility of operational challenges in the quick identification of the amount of a deposit exceeding the coverage level stipulated by the Deposit Guarantee Schemes Directive. This could involve the need to rapidly determine which portions of a deposit are eligible for internal bail-in in case the guarantee limits are exceeded. These potential obstacles are therefore significant, when it is rather unlikely that deposits will be subject to a bail-in.

In summary, operational difficulties in the context of internal bail-in could stem from the complexity of derivative contracts, the evaluation of collaterals, and the rapid identification of eligible deposits. Operational challenges may vary depending on the specific nature of the financial instruments and coverage mechanisms involved. Effective management of these aspects would require robust information systems and well-defined operational processes.

Focus on the derivative contracts

For derivative contracts, one must consider the operational challenge of looking at the whole portfolio, valuing it according to the requirements of Article 36 BRRD and making the assessment required by Article 49 BRRD. These tasks will necessarily take a long period, even if one has access to significant resources. Article 49 BRRD 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 often 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 similarly stressed market where there are potentially numerous stressed entities.

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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 is likely that it will be in contradiction to the "NCWO" principle.

For all the above, there is a clear trade-off between running the process as speedily as possible to minimise uncertainty or market impact and 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, and bearing in mind that the applicable terms of the master agreement will likely differ by counterparty.

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, in principle, reducing the complexity of the MREL calibration. The current methodology to determine MREL requirements is, while for its rather mechanical aspects predictable for those involved at the individual bank level, perceived as unduly complex, subjective and hard to compare with other banks or jurisdictions.

An overly complex MREL calibration methodology

The currently applicable general principles at the basis of the MREL calibration could appear as sound and reasonable. However, the 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 very high MREL levels (on average 20%-25% above the TLAC). The complexity of the level one texts complemented with not necessarily clearer and often very constraining and more conservative level two texts and policies, the

articulation of the MDA and of the M-MDA render the EU/BU framework hardly understandable for non-initiated, non-specialised stakeholders (counterparties, investors, shareholders, third country authorities, …). We would also like to stress the importance to respect the principle of the hierarchy of norms, and that consequently, a policy cannot be more restrictive or prescriptive than level 1 texts. This complexity and the MREL regulatory framework contribute to put 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 single adjustment driver could be welcome but only if the new methodology associated is clearly defined, made public to the industry and doesn't entail by itself a higher MREL requirement. Indeed, a single adjustment driver would go in the direction of simplification but it should anyway be easily understandable, objective, predictable and transparent. The concept of resolvability appears too vague and discretionary in that respect. Besides, adjustments, if any, should remain exceptional and duly justified.

A MREL calibration methodology disadvantageous in terms of competitiveness

The current methodology was determined by EBA in 2015, at a time where in BRRD almost all liabilities were eligible to MREL (structured notes, debts issued by subsidiaries, large deposits...). EBA's impact assessment at that time noted that almost all banks complied with the envisaged ratio (based on 2014 data[3]).

With CRR2/BRRD2, MREL has been aligned with FSB's TLAC requirements comprising:

- A high proportion of subordinated debts for large banks.
- Requirements in contractual conditions to ensure an easy bail-in (no set off, bail-in clause) and stability over time (no acceleration possible, regulatory approval to repay the debt before maturity).
- Limitation to vanilla remuneration (except if a capital is guaranteed continuously).
- A restriction to debts issued by the point of entry.

Eligibility criteria have been strengthened while the calibration has not been aligned with the FSB's one. At the present time, for a bank earmarked for an open bank bail-in strategy, the MREL consists roughly in doubling all capital requirements in RWAs (2 times Pillar 1, plus 2 times Pillar 2 Requirements (P2R), plus 2 times CBR)[4], while TLAC is only two times Pillar 1 +2 % + one-time CBR.

According the SRB's Q2 2023 MREL dashboard, average subordinated MREL in RWAs (without CBR) amounts to 20.5%, while TLAC requirement (without CBR) is 18% or 14.5% if the bank uses the Senior debt allowance. The total MREL requirement (without CBR) is 23.7% in average. With a total RWA of EUR 7 434 bn, the 5% differential between MREL and TLAC represents about an additional EUR 370 bn of SNP/eligible SP instruments to issue and roll for banks in the SRB's remit, compared to the TLAC requirement. Assuming an average annual yield of 3.60%[5], those EUR 370 bn additional issuance volume cost (gross interest charge) approximately EUR 13.3bn per year to EU-banks.

This comparison exercise of MREL requirement vs TLAC requirement puts emphasis on the high level of current MREL targets, and its consequences on European bank's competitiveness. This does not entail, however, that the scope of application of TLAC requirement should be extended to banks that have not been subject to it until now (e.g. the Crédit Mutuel Group), but only that the calibration of MREL could be revised in order to simplify and to reduce it. The consequences of a high requirement are manyfold:

- The depth of the EU bond market is not infinite and is already partly filled with non-EU banks that offer large issuances volumes, at wider spreads (on average), thereby limiting the overall market liquidity available to EU banks. As an illustration, issuances from non-EU banks represented 20% - 30% of the annual Financial EUR bond supply on average in the last 5 years, and about 10% per year coming from US banks, which is significant. To be able to issue large volume, EU banks are obliged to diversify their funding away from their EU domestic market in order to access other pockets of liquidity for SNP/SP or Own Funds. This comes at a cost. As an

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

[4] To be precise, the ccyb only counts once, and a small reduction of balance sheet in resolution is applied by the SRB

[5] 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%.

illustration, major EU banks issue a large portion of their MREL in the US-market, whereas on average it is

~30-40bp more expensive than EUR.
- Markets are very volatile and can close suddenly as shown in the recent years (pandemic, war, Credit Suisse case). High requirements force EU banks to issue during sub optimal (high cost) market windows.
- The constraints on issuances limit the room for manoeuvre to finance the economy at a stage where the green and digital transition financing needs are huge. This paves the way for non-EU banks that have less constraints and creates as well a significant dependency of the EU industry on non-EU banks.
- MREL issuances weighs on the banks' profitability, and the situation will worsen with Basel III RWAs (see EBA's QIS).

The MREL subordination requirements framework could also be reconsidered

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.

Today, calibrating the MREL according to resolvability criteria is not possible. However, if this approach were adopted, discretionary powers in the hands of the SRB would significantly increase, which is not desirable. Furthermore, adjusting the MREL would most likely not address the resolvability issues, if any. There is no obvious link.

Resolvability in itself is neither a clearly measurable concept, nor a very objective one. Actually, 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 the illusion of transparency and predictability in our view. It would not remove the inherent subjectivity attached to that kind of assessment.

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

In our view, the MREL calibration can be reviewed on several aspects:

- Loss Absorption Amount: the assumption in BRRD/SRMR that the bank has lost all its capital requirement in resolution seems rather unrealistic and it is rather likely that some capital would remain.
- Recapitalisation Amount: BRRD/SRM provide that the recapitalisation amount must be calibrated according to the bank's shape in resolution. The resolution authority should make an assessment of the downsizing of certain activities and take into account transfers that are deemed realistic and operationalized, as well as the measures (and namely the sale of certain activities or entities) that would have been taken before the FOLTF declaration in case the institution has for example experienced a recovery situation before its entry into resolution.
- Market confidence: as explained above it is not justified to add buffers for market confidence purpose.

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

Furthermore, a minimum floor for every bank that will be resolved, whichever the strategy retained, should be defined and ideally applied 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 the remaining part. The industry estimates that 16% RWA and 5% LRE should be this floor for total MREL.

This is justified by market discipline; each bank should ensure its own resolvability without relying on funds (DGS, SRF) funded by the industry. Indeed, experience shows that even small banks manage to issue MREL debts.

Finally, 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.