POSITION PAPER

ESBG's response to the SRB consultation on the future MREL policy

ESBG (European Savings and Retail Banking Group)

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ESBG

Dear Sir/Madam,

Thank you for the opportunity to comment on the Single Resolution Board (SRB) consultation on the future minimum requirements for own funds and eligible liabilities (MREL) policy. The European Savings and Retail Banking Group (ESBG) would like to provide you with the comments below, which we hope will be considered by the SRB.

Questions for consultation

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)?*

ESBG would like to stress that in general the **guidance could be more explicit** and include greater reliance on the work already done by banks on recovery options, including the sale of various portfolios and/or businesses and/or entities.

When identifying the transfer perimeters, apart from the criteria listing in the guiding principles for perimeter identification (i.e. Business activities, size, separability, marketability), **one should consider M&A market practices in banking** (recent transactions involving banks or affiliated activities, such as asset management), though also anticipating the extreme nature of potential transactions in a resolution case.

The operationalization of a transaction in resolution may be challenging. In general, we believe that the SRB should strive for a share deal with no carve-outs to decrease implementation risk to the extent possible. In case of a partial sale, whereby the part that stays behind goes into insolvency, a guiding principle should be to limit the number of buyers. The more buyers, the more difficult the (e.g. IT) disentanglement may become.

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?*

We believe the borderline between recovery planning and resolution planning is quite thin when it comes to the implementation of a partial transfer strategy (e.g. sale of business). In practice, many recovery plans include several recovery options, which would meet the criteria for a “partial transfer strategy”, e.g. sale of portfolios, assets or subsidiaries. In this respect, the decisive distinction if those actions would be implemented as “recovery” or “resolution tool” actions, is SEVERITY of the crisis in terms of TIME.

Hence, for banks, whose resolution plans should factor-in a “(partial) transfer” tool, resolution authorities shall in the first place evaluate existing recovery options that would very likely NOT BE executed in an ACUTE, FAST MOVING

stress scenario (e.g. liquidity-driven crisis) due to LACK OF TIME. As those options and their impacts are quite well documented in banks' recovery plans, resolution authorities would have at hand reliable information about the potential impacts in terms of Risk Exposure, Leverage Exposure, Capital & Liquidity Impacts that such measures would have under different stress scenarios and use this information to gauge the balance sheet size and composition of the resolved bank, and as a consequence its recapitalization needs.

Regarding the **composition of the remaining balance sheet** after a partial transfer, that largely depends on:

1) **Prior to resolution events**: We expect significant balance sheet depletion in failing banks caused by execution of recovery option (e.g. deleveraging) and potential assets impairment and consecutive loss absorption through equity.

   We expect that the balance sheet depletion is larger than currently assumed in the MREL policy. The current policy limits the adjustment of assets to an amount equal to the Loss Absorption Amount plus the Counter Buffer Requirement and should in all cases not exceed 10% of total assets. Bank's recovery and resolution experts could investigate a more realistic potential range of balance sheet depletion above, leveraging on recovery plan and bail-in dry run scenarios.

2) **The extent to which assets (and liabilities) are sold**. This should be better reflected in the current adjustment for having a transfer strategy. The MREL policy should (a) consider the identified transfer perimeters by the banks and (b) assume the financial capability of the acquirer(s) to absorb one or more activities of the failing bank through the acquirer's current financial capacity, based on excess capital (risk and non-risk-weighted), or its access to capital.

Whereas the **risk profile of the remaining balance sheet** after a partial transfer would largely depend on:

1) **Prior to resolution events**: We expect lower risk density, assuming high risk-weighted assets were impaired, potentially counterbalanced by internal model changes.
2) **The type of assets (and liabilities) that were transferred.** We believe the MREL policy also should consider an adjustment of the risk density.

2) 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?*

Assuming a bank in going concern already anticipates market confidence after resolution is too optimistic. The external MCC for resolution entities should be set at zero. Market confidence does not equate to more capital of MREL-capacity, surely when facing liquidity crises. We believe that banks should aim at meeting the resolution objectives, strictly limited to a point that the bank/activity meets regulatory requirements in terms of solvency (leverage, pillar 1 and 2) and liquidity, as well as has a viable business model/activity post resolution (for the bank that was bailed-in or partially transferred and for the transferred activity). In addition, the bail-in of eligible liabilities would likely result in the newly re-capitalized bank to hold almost exclusively CET1 capital, the highest quality of capital. **In that sense, we think that market confidence (read: additional capital/MREL buffers; access to the markets) will be built after resolution**.

Apart from the capitalization level of the bank after resolution, we believe in fact that **a key factor for the bank to sustain market confidence is a reliable business reorganization plan and most notably, an access to stable short and long-term funding sources**, whereby any such funding sources shall ideally be provided or backed (e.g. guaranteed) by a public institution (e.g. central bank, SRF, etc.) at least for a limited period of time until the bank establishes access to market funding and re-gains the trust of market participants. The later has been also demonstrated by the arrangements made by the Swiss Authorities in the case of Credit Suisse's failure and would be even more relevant in case the failing bank were solely subject to a pure "open bank" bail-in (and not acquired / merged with another institution).

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?*

ESBG supports SRB's current MREL Policy in the sense that we see no justified need for SRB to factor in an MCC charge for all non-resolution entities' iMREL requirement.

We deem the current exceptions in SRB's MREL Policy (where SRB imposes an MCC charge) for OpCos and Subsidiaries with complex structures reliant on significant wholesale funding as completely reasonable and sufficient to achieve the resolution objectives for non-resolution entities.

This is especially the case where the subsidiary and the resolution entity are part of the same resolution group and are located in the same Member State. This argumentation is supported by the fact that if both resolution and non-resolution entities are located within the same Member State, there would be no legal, practical or any other restrictions or impediments that would prohibit the resolution entity (local parent bank) to downstream an amount of capital over the minimum regulatory requirement to its subsidiary that is deemed adequate to ensure market confidence.

Furthermore, as the resolution entity's external MREL requirement includes an MCC charge, a sufficient amount of capital at the resolution entity / resolution group is ensured and the capitalization level of a subsidiary within the same resolution group and Member State can be seen rather as a matter of corporate governance and strategic preference.

In addition, we would expect market confidence in subsidiaries (non-resolution entities), unless they act as an OpCo or rely significantly on wholesale funding, to be strongly correlated with market confidence in their local parent (resolution entity), which in turn would depend on the factors outlined in question 2.1 above. **Hence, in general we deem an extra MCC as not necessarily supportive of market confidence at the subsidiary level**.

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?*

In order to increase transparency, ESBG would very much welcome it if the MREL policy could show the responsibilities between the SRB and ECB in the monitoring of own funds instruments and eligible liabilities. **In this respect, we advocate a clear allocation of roles and responsibilities between the SRB and the ECB to avoid any duplication of work for both the authorities and the institutions with regard to any reporting queries**.

Referring to the envisaged self-assessment template, we advocate for a limited and proportionate impact for banks. The SRB can perform its eligibility check off-site, limiting the operational impact for banks. A more pragmatic approach is essential. A simplified process could consist in sending a self-assessment on the issuance programs each time they are updated (once a year), instead of producing the self-assessment at each issuance to reduce the workload. In a nutshell, a very simplified template should be used. We also advocate a more pragmatic approach to the supervision of **bonds**, as their issuance is generally highly standardized, as noted by the SRB itself.

That does not undermine the banks' primary responsibility for satisfying the eligibility of instruments. Hence the envisaged intensification of monitoring would be undertaken only on an ex-post basis.

Regarding **own funds**, these are already analysed and discussed with the ECB; thus, the situation should remain that way without duplicating the discussions between authorities, which would be burdensome.

Furthermore, it should be considered that Article 79a of the CRR already contains provisions for banks to carry out self-assessments of their compliance with the conditions on own funds and eligible liabilities. It is therefore reasonable to assume that the SRB would require banks to carry out such an assessment and to share and integrate the results as part of their regular interaction with the SRB. However, it is also very important that banks are free to choose how to comply with this self-assessment obligation. **It is therefore essential that the SRB refrains from introducing additional extensive reporting requirements that go beyond the mandate of Art. 79a**.

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 do not agree that private placements involve non-standard arrangements. Very often private placements are issued under existing standardized issuance programs and contain standardized language. In our view, non-standard features and arrangements where MREL eligibility may be questionable are where the instruments contain embedded derivatives, i.e. are structured notes and/or in the case of special instruments such as Schuldscheindarlehen or Namensschuldverschreibungen (DE, AT). In this case, however, it is the practice of the SRB to require internal and external legal opinions before the institution is allowed to count them towards its MREL. Therefore, we see this quasi "ex-ante" approval by the SRB as a "best practice" to ensure that banks report only those liabilities as MREL eligible that fulfil the eligibility criteria.
We therefore see no need for additional safeguards for non-standardized instruments beyond the current practice established by the SRB.

4) Discretionary exclusions:

Questions below are aimed at gathering views from the stakeholders on some specific liabilities in order to further inform the thinking of SRB regarding the exercise of its powers under SRMR in planning and resolution. This, however, should not be understood as suggesting a specific policy choice by the SRB or indicate that some liabilities are more or less likely to be considered as excluded on a discretionary basis in resolution. In the planning stage, the SRB will assess all relevant liabilities (including those where no specific questions were raised for the purpose of this consultation).

Moreover, where the SRB expresses an opinion in resolution planning that a liability is likely to be excluded based on the criteria of Commission Delegated Regulation (EU) 2016/860, this does neither indicate nor bind the SRB that write down and conversion powers under SRMR will not be exercised in relation to such liability in case of resolution, which will exclusively be governed by the specific circumstances at the point in time of adoption of the resolution scheme.

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)?*

For banks running a universal business model (retail and/or corporate business, but no pure investment banks) we regard the quantitative contribution to bail-in as very low. The reason is that under EMIR the derivative exposure vs. financial counterparties (i.e. credit institutions, investment firms, insurance, assurance and re-insurance undertakings, UCITs, institutions for occupational retirement provision, AIF, CSD) shall be fully collateralized. Hence, we would expect that derivative liabilities towards financial counterparties would anyway be excluded from bail-in as they reflect secured liabilities. Therefore, the spread of contagion for the financial system shall be quite limited.

Derivative liabilities to non-financial counterparties can be collateralized voluntarily but are often not collateralized, especially due to the potential operational burden for those non-financial counterparties. Hence, a potential bail-in would affect rather non-financial counterparties, however, we do not expect a destruction of value for holders of other/non-excluded liabilities. Derivative liabilities to non-financial counterparties should be treated in the same way as corporate deposits, namely they should not be excluded from bail-in.

The close-out of derivative contracts may crystallize additional losses that are not reflected in the going-concern valuation, stemming for example (a) from actual replacement costs incurred by the counterparty that would increase the close-out costs owed by the institution under resolution, or (b) from costs incurred by the institution under resolution in re-establishing trades on exposures subject to open market risk resulting from the close-out.

If the losses incurred or expected to be incurred from the close-out of derivatives exceed the share of the corresponding liabilities that would be effectively available for bail-in, the excess loss may increase the burden of bail-in for other creditors of the institution under resolution. In such cases, the amount of losses that would be borne by liabilities not arising from derivative contracts in a bail-in would be higher than without the close-out and bail-in of derivative contracts.

However, we would expect the amount of uncollateralized (and as a consequence bail-inable) derivative liabilities would be mostly vs. non-financial counterparties (assuming a Universal Bank business model) - usually derivatives sold by the bank as hedges to SME and Corporate clients (without professional treasury and not subject to daily collateral posting). Hence, the associated derivative liability shall be seen in the same way as a corporate or SME deposit - liabilities that are also not excluded from bail-in.

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?*

See our answer above to Question 4.1.

Moreover, specifically referring to derivatives that macro-hedge Interest Rate Risk in Banking Book (i.e. retail/mortgage banks), we emphasize that those are essential for the continuity of bank's Critical Functions and Core Business Lines. If the hedges were unwound, the continuity would be seriously jeopardised.

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 general, why should the bail-in of a derivative lead to destruction of value if at the same time the bail-in of a non-covered deposit would not lead to destruction of value?
In particular regarding derivative liabilities, we do not see a scenario where the exclusion from bail-in would lead to a profit or lower loss in resolution, generating value for holders of other/non-excluded liabilities.

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

1) *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?*

Our members do not identify particular challenges expected since this information is covered in banks' IT systems.

2) *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?*

For the following types of secured liabilities, our assessment is as follows:

- Covered bonds: no operational challenges are expected due to the daily valuation of collateral pool;
- Repos: no operational challenges are expected due to the daily valuation of underlying collateral;
- Derivative liabilities: no operational challenges are expected for those subject to netting and CSA agreements due to daily valuation and collateral posting;
- Collateral swaps: no operational challenges expected for those subject to netting and CSA agreements due to daily valuation and collateral posting;
- Pledges provided for collateralized guarantee (iMREL) and the financial resilience of critical service providers: no operational challenges expected due to daily valuation of underlying collateral.

3) *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?*

No operational challenges expected as the position is part of the bail-in dataset and has to be available within 24 hours.

5) Long-term policy considerations: 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?*

First and foremost, it shall be ensured that the MREL calibration methodology is **transparent**, **understandable and does not violate the level playing field for banks competing in the Common Market.** At the same time, we also believe that the current MREL calibration is both complex and conservative in its computation.

Nevertheless, rather than a simplified MREL calibration methodology, ESBG expects the SRB to keep, to a large extent, the MREL calibration, as defined in its 2023 MREL policy, unchanged and stable for the future - which, given the current complexity, is a very important feature, so that banks, market participants, investors, rating agencies, etc. do not have to be re-educated about MREL and banks can reliably plan the issuance of MREL eligible instruments. ESBG also considers that the current MREL policy should continue to capture the elements reflecting each bank's resolution strategy, business model, size, complexity, risk profile, governance, and balance sheet structure in order to guarantee an adequate amount of MREL resources are available in order to ensure the smooth implementation of a bail-in.

In the long term, the SRB is considering replacing the approach for determining institution-specific MREL. In future, MREL could be determined on the basis of a harmonized minimum value for all banks. The SRB would take into account institution-specific features by means of an adjustment factor. The level of the adjustment factor could also be based on the overall assessment of resolvability.

We reject a change in the approach to determining MREL. The principal objective of MREL-setting is to urge banks to have sufficient (a) loss absorbing and (b) recapitalization capacity. As not all banks have equal risk, complexity, scale and resolution strategies, the approach should be as proportionate as possible. Therefore, we are not in favor of harmonized floor and a single adjustment driver. The MREL policy should enable the SRB to set an appropriate, proportionate, bank specific MREL, leveraging on existing prudential requirements, maximally avoiding gold plating by National Resolution Authorities and in a transparent manner. Moreover, the SRB itself rightly points out that changes can only be made if the European legislator first creates a mandate in the BRRD legal framework.

It is also unclear whether, according to the SRB, such an approach should also apply to institutions for which normal insolvency proceedings have been defined in the resolution planning. For these institutions, the competent resolution authorities regularly do not set MREL that exceed the own funds requirements (see Art. 45c (2) subpara. 2 BRRD), although the resolution authority may deviate from this approach in individual cases. In any case, this tried and tested approach should not be deviated from by setting a harmonized minimum value, as small and medium-sized institutions regularly do not have access to capital markets and issuing additional liabilities causes difficulties and excessive costs. These institutions should also not be burdened with additional bureaucracy, e.g. through further reporting or notification obligations.

In our view, the SRB's ideas on the future design of the approach for determining MREL also indicate that they do not reduce complexity. We would like to point out that the current approach to determining MREL already allows resolution authorities to make adjustments with regard to the suitability of institution-specific resolution strategies that also take into account aspects of resolvability. In addition, the level of institution specific MREL requirements also plays a role in other regulations, e.g. in determining the level of contributions to the Single Resolution Fund. These contributions are determined on a risk basis: MREL-eligible liabilities held via MREL are risk-reducing and will have the effect of reducing contributions in future. A harmonized minimum value with only one adjustment factor would have a counterproductive effect here and should therefore be rejected.

In addition, we generally consider it essential that the SRB presents the approach for determining the institution specific MREL to the institutions in a more transparent manner than before. To this end, key aspects of the calculation logic for MREL calibration, including the procedure for institution-specific adjustments, should be published in a more detailed and comprehensible manner as part of the MREL policy.

This also applies to the format and criteria used by the SRB for calculating an appropriate MREL level when institutions apply for the withdrawal of MREL in accordance with Art. 78a CRR. Here, too, the SRB should make transparent its key criteria for assessing the application and, in particular, how it deals with the results of the MREL planning and forecast calculations to be included under baseline and stress conditions. We consider this to be essential in order to be able to efficiently adapt the MREL management of the institutions to future administrative decisions of the SRB.

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.*

ESBG's members are critical of linking the MREL determination with the results of the resolvability assessment. In other words, MREL is not the obvious solution for all resolvability impediments. Such a link would not lead to an increase in transparency, but rather would significantly worsen the planning certainty and reliability of the MREL determination. Before such a link is pursued further, the transparency, comparability and verifiability of the assessment of resolvability should first be increased.

We would like to stress that if this approach was adopted, it would in fact lead to excessive discretionary powers in the hands of the SRB, who could subjectively adjust the MREL when there are weaknesses in terms of resolvability. In our view, the calibration of MREL should not be linked to resolvability assessment except maybe in a binary way where institutions with clearly identified and justified substantive impediments to resolvability could be subject to a predetermined surcharge of subordinated MREL.

Additionally, establishing a more or less complex scoring system based on the Expectations for Banks dimensions and related principles would only provide an illusion of transparency. It would not remove the inherent subjectivity attached to that kind of assessment.

Nevertheless, if the SRB decided to move in this direction anyway, we would expect that the SRB would only be allowed to reduce the MREL requirement for banks scoring good on resolvability assessment. but without the option to increase it based on a poorer score.

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

In ESBG's view, there's no need to establish a further MREL floor, as clear minimum subordination requirements have already been defined in the BRRD and SRMR, which were also only introduced during the last revision of the BRRD and SRMR. In our view, such deviations would further increase the complexity of the MREL definition. In our opinion, the floor (already currently) is set at the prudential capital requirements.

We therefore do not support the introduction of a "floor" and **advocate for the retention of the current MREL calibration methodology** as representing an MREL "cap" provided they have been categorized as so-called "resolution institutions".

On a different point, for legal and planning certainty, we would also welcome it if the SRB could also provide an outlook on the requirements under CRR III in its MREL policy, as most of these will come into force on January 1, 2025. Specifically, we would be grateful if the SRB could confirm at an early stage that the new requirements pursuant to Art. 128 (1) (c) CRR III relate to liabilities pursuant to Art. 72b (2) CRR, meaning that the subordination criterion pursuant to Art. 72b (2) (d) CRR must also be met (i.e. senior non-preferred instruments). i.e. senior non-preferred instruments) and, in view of the regulatory purpose and scope of application of Art. 128 CRR III ("Subordinated debt exposures"), a possible inclusion of senior preferred instruments for G-SIBs pursuant to Art. 72 (3) CRR cannot be considered in this respect.

About ESBG (European Savings and Retail Banking Group)

ESBG represents the locally focused European banking sector, helping savings and retail banks in 21 European countries strengthen their unique approach that focuses on providing service to local communities and boosting SMEs. An advocate for a proportionate approach to banking rules, ESBG unites at EU level some 900 banks, which together employ more than 650,000 people driven to innovate at roughly 50,000 outlets. ESBG members have total assets of €5.3 trillion, provide €1 trillion in corporate loans (including to SMEs), and serve 163 million Europeans seeking retail banking services. ESBG members are committed to further unleash the promise of sustainable, responsible 21st century banking. Our transparency ID is 8765978796-80.

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