Federal Ministry
of Finance

Dr. Stefan Daske
Head of Division VII C 4

POSTAL ADDRESS Federal Ministry of Finance, 11016 Berlin

Via EUSurvey

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German Federal Ministry of Finance comments on the SRB MREL 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)?

GENERAL COMMENT: We were surprised to read that the public consultation contains elements which become relevant only when setting MREL for transfer tools as this is also part of the currently ongoing CMDI review. In our view it would have been more reasonable to start a public consultation on the combination of resolution tools when knowing the outcome of the CMDI review.

On the question: Alternative strategies are important to ensure more flexibility in resolution. At the same time resolution strategies including transfer strategies also need to be operationalised. It will be difficult resp. nearly impossible to define upfront what will be separated and transferred in a concrete resolution scenario. This will very much depend on the specific circumstances at hand. In particular, it cannot be pre-empted what kind of assets/liabilities a potential purchaser might want to purchase in a specific scenario. We therefore advise to refrain from any general predetermination of assets and liabilities subject to a transfer, but more focussing on the individual bank and the conditions of the specific crisis case. The situation at hand might also require the resolution authority to apply a different tool like the bail-in tool.

With regards to MREL: MREL is at the heart of the resolution framework and an important building block to ensure resolvability being the first line of defence and ensuring that shareholders and creditors bear the costs of resolution. Conversations with rating agencies show that higher MREL requirements as well as a better resolvability have an impact on a better rating of banks and market confidence in their stability. In particular, the MREL amount shall be sufficient for different scenarios which requires different applications of resolution tools, including a plain open-bank bail-in strategy.

Against this background, in the context of MREL it should be ensured that MREL requirements are sufficient to ensure a bail-in, finance a transfer and/ or allow access to the resolution fund, provided that the basic principle that shareholders and creditors need to bear losses first up to 8% is fulfilled. In particular if no SRF access is foreseen and 8% bail-in is not envisaged, MREL still needs to be sufficient to cater for different situations regarding the potential financing needs for a transfer without additional financial support. Therefore, it is important not to orientate at the lower end, but to choose a calibration which ensures resolution authorities the highest flexibility to apply all resolution strategies they planned for, including bail-in.

A further reduction of MREL, in particular when applying transfer strategies, in our view would have negative implications:

1) *It would bear the risk that an alternative strategy of bail-in is no longer credible nor feasible and/or that even for the application of the transfer strategy - there could be insufficient financing available, in particular if more financial support is needed and SRF access cannot be achieved via 8% bail-in. This needs to be avoided in order to ensure the flexibility and readiness of resolution authorities in a crisis scenario instead of reducing flexibility.*
2) *An adequate capital situation of the bank, which can be achieved by a successful bail-in (provided there is sufficient MREL) can enhance bank's ability to ensure liquidity, e.g. through easier refinancing on the market after a bail-in, and, thus, reduce the need for other backstops. Hence, sufficient MREL requirements would be an additional instrument also in a liquidity driven scenario like in the recent crisis cases.*

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?

In line with our answer under 1.1., it is impossible to predict what kind of assets and liabilities will be transferred and separated in a resolution scenario and as a consequence how a partial transfer would influence the composition and risk profile of the balance sheet of the resolved bank. In particular, in a crisis scenario it also cannot be expected that the price for the offset of losses will be higher than the assets remaining in the bank, i.e. it might be that the sale does not have any positive capital effects.

Therefore, we do not share the assumption that in a case of a partial asset transfer a general reduction of recapitalisation needs is appropriate as the lower value of the asset-based denominators and additional costs may offset each other.

Furthermore, a reduction recapitalisation needs due to reduction of assets cannot be generally extended to transfer strategies in general. For transfer strategies based on a share deal we expect that recapitalization needs are equal to the needs for an open-bank bail-in and no reductions can be applied, because it is not ensured that a potential buyer will provide (partial) recapitalization.

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?

The MCC aims at ensuring that banks are sufficiently capitalised after resolution to ensure the provision of critical functions and access to funding. I.e. MREL should be calibrated in a way to ensure that the resolution entity is sufficiently capitalised to sustain market confidence. The main factor for a bank to be able to sustain market confidence is that the resolved bank will be accepted by the market including rating agencies and its counterparties. This is not only limited to attracting funding without recourse to extraordinary public financial support, but also with regards to e.g. derivative counterparties. Therefore, we see a risk of non-sustaining market confidence following the bank's resolution if total own funds of the resolved bank are below the general regulatory requirements and, hence, below the requirements applicable to the bank's peers and, in particular, significantly below the actual own funds of the bank's peers. In order to gain back trust of market participants after the uncertainty caused by the resolution of the bank general regulatory requirements including buffer requirements should at least be met. We therefore have serious doubts how the market confidence after resolution can be ensured by decreased MCC requirements. In particular, sufficient capital can also ensure market confidence in the mid-term and therefore be helpful to access mid- and long-term funding.

Art. 12(d) SRMR clearly states that, in general, the MCC shall be equal to the CBR. Therefore, from a legislative/regulatory perspective we do not see room for a ***general*** *downward adjustment of the MCC.*

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?

Please see our answer under 2.1. Also, with regards to subsidiaries it is key that there is enough market confidence in the subsidiaries of a resolved bank in order to ensure that also the subsidiary has its own market access and is a reliable counterparty for entities outside the resolution group. In that context it is important that subsidiaries, in case of need, have enough capital. Only where all of the non-resolution entities business-relationships are with resolution group entities, e.g. for intermediate holding entities or subsidiaries that only provide critical services to the group and do not conduct any banking business outside the group, it seems reasonable to waive iMCC.

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?

We see merit in a bank specific in-depth analysis whether MREL-eligible instruments are actually bailinable.

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)?

n/a

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)?

Answer refers to the questions 4.1. to 4.3.: From our perspective it is particularly beneficial to assess to what extent specific derivatives and structured notes are bail-inable. In particular, it should be avoided to give the impressions that all kind of derivatives and structured notes might be excluded from bail-in as this would set wrong incentives for banks to issue instruments with derivative components only to make them not bail-inable. This could lead to high NCWO-risks.

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 answer 4.1.

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.

See answer 4.1.

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?

See answer 4.1.

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?

See answer 4.1.

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?

With regards to the ongoing discussion on potential discretionary exclusions of depositors: In our view all deposits with the exception of covered deposits are bail-in able and the current safeguards from the existing creditor hierarchy are sufficient. Resolvability implies that banks can provide sufficient information with regards to all liabilities, i.e. can also identify deposits exceeding the coverage level. If not, this should be addressed by corresponding subordination requirements. Beyond that we disagree with a general exclusion of depositors for the aforementioned reasons.

Some general remarks regarding extensions of discretionary exclusions from bail-in: Any MREL reductions or discretionary exclusions from MREL are not necessary and therefore should be avoided, unless they are crucial in exceptional circumstances as described under Art. 27(5) SRMR. Sufficient MREL ensures an adequate capital situation of the bank, which can be achieved by a successful bail-in (provided there is sufficient MREL).

This can be reasoned as follows: As already highlighted MREL is at the heart of the resolution framework and an important building block to ensure resolvability being the first line of defence and ensuring that shareholders and creditors bear the costs of resolution. This does not only hold true in a solvency crisis, but also with regards to liquidity: Sufficient MREL ensures an adequate capital situation of the bank, which can be achieved by a successful bail-in (provided there is sufficient MREL). Moreover, in order to ensure access to central banks as a lender of last resort, it is key that the resolved bank is well recapitalised. Besides existing central bank facilities, in order to have access to the SRF the basic principle that shareholders and creditors need to bear losses first up to 8% needs to be fulfilled.

5. Long-term policy considerations: Rethinking approach to adjustments in the MREL policy

Answers to the questions below could be of broader nature and not be limited to considerations on adjustments under the current framework.

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?

GENERAL REMARK:

This question refers to long-term policy considerations which require EU- legislators to review the current legal framework. The power of initiative lies with the European Commission and EU legislators but not with resolution authorities. Consultations and discussions with the industry might suggest that the European Commission needs to amend the legal framework and could bear the risk that the European Commission due to this discussion might be forced to act. This should be clearly avoided.

On the proposal: Setting a harmonised floor and a single adjustment driver in our view is precarious for the following reasons: A harmonized floor with a single adjustment driver will not reduce complexity as different factors will still need to be considered. Moreover, the weight of the different additional factors, when combined to a single factor, will need to be evaluated by different IRTs. Due to the potential discretion of IRTs this adjustment driver will be less comparable and therefore there is a risk of not respecting the level playing field and that such a framework would lead to a "race to the bottom".

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.

Please see our general remark provided under 5.1.

Linking the calibration of MREL with the resolvability assessment has the disadvantage that in order to calibrate a meaningful floor several factors are needed, which makes this approach evenly or even more complex (recall that current legislation already includes a baseline scenario for bail-in, see also answer under 5.1.). IRTs then have discretion how these factors are weighted, which bears the risk of non-comparability and not ensuring a level playing field.

Moreover, in our opinion, the resolvability of a bank can only be used as a component of penalizing or rewarding the bank. However, also using certain resolvability criteria as a reward we do not see that elements like a good resolution governance or communication should lead to a reduction of the MREL requirement as for the aforementioned reasons – MREL is the first line of defence in resolution. Against this background, and also in order to ensure flexibility and optionality of resolution authorities, we have serious doubts of linking the calibration of MREL with the resolvability assessment as far as an MREL reduction is concerned.

However, if the resolvability assessment was considered for the calibration of MREL, it could in our view only lead to an MREL surcharge on the basis of the current determination (which would be a sort of "floor"). However, it needs to be ensured that such upwards adjustments are transparent and not on a discretionary basis. This would require first more work on a comparable and more standardised resolvability assessment.

Question 5.3.

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

See our answers under 5.1. and 5.2.