FEEDBACK STATEMENT TO CONSULTATION ON SRB MREL POLICY UNDER THE BANKING PACKAGE

Single Resolution Board

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SINGLE RESOLUTION BOARD

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1. INTRODUCTION

On 17 February 2020, the SRB launched a three-week consultation on its proposed MREL([1]) Policy under the Banking Package (BRRD2/SRMR2). The consultation asked a number of questions and garnered responses from 25 respondents spread across banks, banking associations, National Resolution Authorities (NRAs) and finance ministries. This Feedback Statement addresses the main comments received on the consultation and is published alongside the final SRB MREL Policy under the Banking Package.

([1]) Minimum Requirement for Own Funds and Eligible Liabilities.

2. MAIN ISSUES RAISED IN RESPONSE TO THE CONSULTATION

2.1. MREL calibration

The part of the consultation that received the most comments was the calibration of MREL. Most of the comments were about adjustments to the default calibration. Comments were also received on the Market Confidence Charge (MCC) formula.

ADJUSTMENTS TO THE DEFAULT MREL CALIBRATION

Respondents said they would welcome further adjustments to the default MREL formula. In particular, calls were made to allow for a higher cap for the balance sheet depletion effect and for a broader application of adjustments based on recovery options and transfer strategies.

The new framework permits the recapitalisation amount (RCA) of MREL to be adjusted upwards or downwards. The SRB will continue to adjust the default RCA on a case-by-case basis, where considered appropriate, for all types of institutions.

The prevalence of credit risk in the bank's risk profile will continue to be the yardstick for considering the balance sheet depletion effect. Any adjustment in this respect is limited to an amount equal to the loss absorption amount plus the Combined Buffer Requirement (CBR), and shall not exceed 10% of total assets.

Adjustments based on recovery options may be applied by the SRB in exceptional cases and subject to conditions, so that the option is credible and feasible, implementable immediately in resolution and will have a positive impact in any loss scenario. The SRB will consider the effects of such measures on the Total Risk Exposure Amount (TREA)/Leverage Ratio Exposure measure of the bank post resolution up to a reduction equal to 5% of TREA, when determining the RCA of MREL.

The SRB will continue to allow for adjustments to the RCA to reflect the transfer of assets where the resolution strategy relies primarily on a transfer tool. The adjustment takes the form of an institution-specific scaling factor applied to total assets, as a proxy to reflect the recapitalisation needs post resolution, or the assets that would be transferred and/or liquidated under normal insolvency proceedings.

RCA P2R

In relation to the pillar 2 requirement (P2R) of the recapitalisation component of MREL, respondents preferred a lower P2R reflecting the post-resolution balance sheet, rather than using current prudential requirements.

For the 2020 resolution planning cycle, the SRB will assume an unchanged P2R as a base assumption factoring in potential downward and upward drivers for post-resolution requirements - in particular, that resolution would put a bank previously facing difficulties on a sounder footing but that uncertainties over post-resolution restructuring may not have been dispelled by that point.

In relation to estimating the adjusted P2R requirements that would apply post resolution, the SRB will continue its dialogue with supervisory authorities for future planning cycles.

MCC

Many respondents commented on the new calibration of the MCC, which the SRB proposed to phase-in over four resolution planning cycles. Specifically, respondents favour maintaining the MCC in the current SRB policy([2]).

The SRB appreciates that the new MCC calibration in the Banking Package differs from the currently applicable MCC. To ensure a transition to the new MCC computed under the new default legislative formula, the SRB will apply a phased approach in order to allow institutions to adjust to the new MCC gradually. After four resolution planning cycles, the MCC will equate to the new MCC formula([3]) in the Banking Package.

MPE

In terms of the Multiple Point of Entry (MPE) approach for resolution, respondents to the consultation called for a level playing field between Single Point of Entry (SPE) and MPE. For subsidiaries based in the EU, requests were made to recognise the existence of bail-in, where as a result of its application, the exposures between resolution groups in the EU retain some value. Respondents also called for harmonisation of the assumption on losses taken in the MPE methodology, with the assumption on losses in the no-creditor-worse-off (NCWO) model.

The SRB has revised the methodology for the treatment of exposures between resolution groups based in the EU, to which a simulated bail-in applies for the calibration of the MPE MREL add-on. In line with the NCWO model's assumption on losses, a 75% resolution haircut applies to estimate the lower market value after resolution. The methodology for the treatment of exposures towards resolution groups based in third countries remains unchanged.

2.2. Subordination and NCWO

Comments received on the consultation mainly focused on the interlinkage between subordination requirements and the MREL calibration and the SRB's proposed tool for performing the NCWO risk assessment.

([2]) Combined Buffer Requirement minus 125 Basis Points.

([3]) Combined Buffer Requirement minus the Countercyclical Buffer.

SUBORDINATION REQUIREMENTS

Some respondents raised concerns regarding the conditions for a non-G-SII([4]) or a non-Top-tier bank([5]) to be deemed as an "Other Pillar 1 bank" in accordance with Article 12d(5) of the SRMR2.

The SRB will not be responsible for assessing the conditions and making a determination that a non-G-SII or a non-Top-tier bank is to be deemed as an "Other Pillar 1 bank". The assessment of whether a non-G-SII or a non-Top-tier bank can be treated as an "Other Pillar 1 bank" is at the discretion of the NRA. Nonetheless, if the NRA does not exercise this discretion, the SRB may impose a level of subordination on a Pillar 2 basis at its own initiative (after consulting the NRA), pursuant to Article 12c(5) of the SRMR2.

INTERLINKAGE BETWEEN MREL CALIBRATION AND SUBORDINATION REQUIREMENTS

Some respondents asked for clarification on the interlinkage between the MREL requirement and the subordination requirement, and whether the prudential formula is capped by the MREL target.

The SRB has submitted a question on this to the EBA Single Rulebook Q&A process and will update the policy following the response.

NCWO RISK ASSESSMENT TOOL

Respondents to the consultation generally support the SRB's approach to quantifying NCWO risk. With the NCWO risk tool specifically, more visibility on how the NCWO tool operates would be welcomed.

Subordination requirements improve resolvability and seek to address risks which can result in a breach of the NCWO principle([6]). The subordination requirement is set at a level that will eliminate NCWO risk, based on a comparison of projected losses under resolution and insolvency for relevant claimants. To quantify NCWO risk, the SRB has developed a risk-sensitive analytical tool for implementing subordination levels that support resolvability.

The quantitative tool simulates resolution and insolvency scenarios, and compares the situation([7]) of certain groups of creditors in both scenarios. Where the estimate in resolution is lower than the value in insolvency, the tool determines the amount of senior resources that would need to be replaced with subordinated resources to make these two values equal. This amount reflects the quantitative change in the liability structure deemed to avoid NCWO risk under the specific assumptions of the valuation tool. At this equilibrium point, the approach assumes that NCWO risk will be avoided. Thus, the tool aims at operationalising the legal principles governing NCWO risk in a mathematical construct.

The SRB will illustrate the specific calculation used for the NCWO assessment during workshops with individual institutions.

([4]) Global Systemically Important Institutions.

([5]) Institutions with less than EUR100 billion assets in the resolution group.

([6]) That no creditor is worse off under resolution than under insolvency proceedings.

([7]) Value at disposal.

NCWO RISK ASSESSMENT TOOL PARAMETERS

In terms of the factors used for the NCWO risk assessment, respondents suggested that higher insolvency haircuts in the insolvency scenario and Price-to-Book values for post-resolution equity conversion should be used in the assessment.

The SRB will look at updating the parameters used for the NCWO risk assessment in future planning cycles. For the 2020 cycle, the uniform 10% insolvency haircut and 25% Price-to-book ratio will be maintained for the assessment.

2.3. Internal MREL

The majority of the comments received from respondents focused on the scope of non-resolution entities for internal MREL, the setting of a MCC in the context of internal MREL and the link between prudential and MREL waivers. The proposal to authorise the use of guarantees under the conditions of Article 12g(3) of the SRMR2 to meet internal MREL was widely supported by respondents.

SCOPE OF ENTITIES FOR INTERNAL MREL

Respondents called for further clarity regarding the scope of entities that will be subject to internal MREL in the steady state. Respondents also had concerns about the use of the term Relevant Legal Entity (RLE) to identify subsidiaries subject to an internal MREL, as the definition is used in the Commission Implementing Regulation (EU) 2018/1624 for reporting purposes.

In the 2018 and 2019 resolution planning cycles, the SRB issued binding targets for non-resolution entities of banking groups considered as RLEs. The scope of non-resolution entities for which the SRB will set internal MREL will expand in the 2020 planning cycle to cover entities providing critical functions and/or those meeting the 4% threshold of the resolution group's total risk exposure amount, or leverage exposure, or total operating income.

The SRB will continue to expand the scope of non-resolution entities for which internal MREL will be required in future cycles and will continue to review the criteria for internal MREL.

The focus on RLEs in the 2020 planning cycle does not prevent (and should not discourage) banks from implementing an internal MREL mechanism encompassing other entities in the resolution group.

The SRB will maintain the RLE definition for identifying non-resolution entities subject to an internal MREL. To enhance clarification, the SRB has added a reference to the final policy explaining that RLE refers to the scope of entities for which the SRB sets internal MREL. This definition is not the same as the RLE definition in the Commission Implementing Regulation (EU) 2018/1624 for reporting purposes, and therefore does not purport to modify the scope of obligations in that Regulation.

MCC FOR INTERNAL MREL

Respondents welcomed the MCC not being applied by default to non-resolution entities for their internal MREL targets; however, clarification was sought on how and to which non-resolution entities the MCC will be applied.

In terms of the MCC for internal MREL, the SRB does not plan to impose a MCC for internal MREL by default. The appropriateness of a MCC for internal MREL for each non-resolution entity will be determined by taking into account the features of the subsidiaries concerned. In performing this assessment, the SRB will take into account if an internal MCC is necessary to sustain market confidence due to the subsidiary's complexity and strong reliance on wholesale funding.

WAIVERS

Comments were received from respondents linking internal MREL and capital waivers and asking for clarification on the interaction between both waivers.

The SRB can waive subsidiary institutions qualifying as non-resolution entities from internal MREL. Waiving a requirement is at the SRB's discretion, and is not an entitlement for institutions.

Supervisory waivers from the application of prudential requirements on an individual basis are not a precondition for the granting of an MREL waiver. Nonetheless one important consideration is whether the subsidiary has obtained a supervisory waiver.

The competent authority independently assesses the conditions for granting a supervisory waiver, and a positive supervisory assessment shows that the relevant group is generally able and willing to provide funding and loss absorption in a going-concern perspective. Nonetheless, evidence would also need to be demonstrated that the funding and loss-transfer arrangements are also robust in a resolution scenario in order for an internal MREL waiver to be feasible.

COLLATERALISED GUARANTEES

The proposal to authorise the use of guarantees under the conditions of Article 12g(3) of the SRMR2 to meet internal MREL was widely supported by respondents. Respondents requested clarification on whether partially collateralised guarantees are a pre-condition for internal MREL waivers.

Collateralised guarantees are not a pre-condition for MREL waivers: they represent an alternative means for meeting the MREL-requirement, whereas under a waiver no requirement needs to be met. The SRB will permit collateralised guarantees to substitute in full or in part prepositioned instruments to meet internal MREL. As a prerequisite for permitting such guarantees, the non-resolution entity and resolution entity must be located in the same Member State, demonstrate that no legal or regulatory barriers exist to the transfer of collateral from the resolution entity to the relevant subsidiary and that the contractual arrangements between the two entities will meet all the conditions in the legislation.

2.4. Cooperatives

Some of the comments received asked for clarification on the scope of cooperatives to which the resolution framework applies, how to recognise resolution entities within the cooperative network, and the conditions for waivers of internal MREL for affiliated institutions that are not resolution entities.

SCOPE OF COOPERATIVES

Some respondents requested clarification that the policy on cooperatives only applies to prudential cooperative networks as per Articles 10 and 113(6) of the Capital Requirement Regulation (CRR).

Cooperative networks need to be assessed in accordance with the BRRD2/SRMR2 definitions. CRR rules can give an indication, but there is no provision supporting the approach that only cooperative groups qualifying as such under Article 10 and/or 113(6) of the CRR can be considered cooperatives for resolution purposes.

NETWORK ELIGIBILITY TREATMENT

Clarification was also sought on which affiliates of a cooperative network could be considered resolution entities for the purposes of MREL compliance for the entire cooperative network.

A cooperative network can have more than one resolution entity. The liabilities of all the resolution entities, subject to conditions, can count towards compliance with the consolidated MREL requirement of the group. Liabilities that count towards compliance with the consolidated MREL target are called network eligible liabilities. In determining which liabilities are network eligible liabilities, the SRB will assess the features of the solidarity mechanism, the resolution strategy and the possibility to treat the cooperative network as a whole in resolution.

WAIVERS FROM INTERNAL MREL FOR AFFILIATED INSTITUTIONS THAT ARE NOT RESOLUTION ENTITIES

In terms of eligibility for internal MREL waivers for affiliated institutions that are not resolution entities, some respondents had concerns about the SRB's proposal to assess a prompt transfer of own funds or repayment of liabilities on a bilateral basis between the central body and the respective affiliate.

A network-wide perspective for MREL-eligibility is not adopted in the case where an individual waiver is to be granted, as the waiver is being sought for an individual affiliate institution. Thus, the assessment of any impediment to the prompt transfer of own funds or repayment of liabilities is based on an analysis of the bilateral relationship between the central body and the affiliated institution for which a waiver from an individual MREL target is being sought.

2.5. Eligibility of liabilities issued under third country law

The majority of comments received in relation to contractual recognition clauses related to the treatment of existing AT1 and T2 instruments without clauses, and the conditions that need to be fulfilled for legal opinions on the effectiveness and enforceability of contractual recognition clauses for bail-in.

TREATMENT OF EXISTING AT1 AND T2 INSTRUMENTS

Respondents raised concerns about the proposed treatment of existing AT1 and T2 instruments (issued after the date of application of national provisions transposing BRRD1), which will be excluded from being MREL-eligible due to the absence of bail-in recognition clauses. Respondents suggested that such instruments should be subject to the grandfathering provisions included

in Article 494b of the CRR or a similar transitional treatment. Several respondents suggested that the relevant date should be the date of transposition of BRRD2.

As a consequence of the change to Article 55 in the BRRD2, and in the absence of a suitable binding international agreement with the third country or statutory recognition, liabilities including AT1 and T2 instruments governed by third-country law issued after the date of application of national provisions transposing BRRD1 are not counted towards MREL, unless the institution has included an effective and enforceable contractual recognition clause. However, if shortfalls occur because of this, it may be taken into account for the setting of transitional periods.

CONDITIONS FOR LEGAL OPINIONS DEMONSTRATING THE EFFECTIVENESS OF BAIL-IN CLAUSES

Some comments raised concerns about the SRB's criteria for legal opinions demonstrating the effectiveness of bail-in clauses. Respondents see the criteria as difficult to fulfil in their entirety.

If liabilities are governed by the law of a third country and in the absence of a statutory cross-border recognition framework, a contractual recognition clause must be included in the contract, such that the liability may be subject to the write-down and conversion powers of an EU resolution authority. In order to demonstrate the effectiveness and enforceability of such contractual clauses in contracts governed by third country law, legal opinions can be requested.

The rationale for this is to ensure that the contractual recognition clauses are robust and enforceable, should they be called upon in a resolution action. Resolution authorities also have the discretion to exclude liabilities from counting towards MREL where the effectiveness and enforceability of such contractual recognition clauses are not adequately demonstrated.

The SRB expects legal opinions submitted in support of a contractual recognition clause to address the criteria in Box 2 of the policy. In light of feedback received in the consultation, the SRB has altered the focus for assessing such legal opinions, so that verification of the minimum set of criteria in Box 2 of the policy will be the focus.

2.6. Transition periods

The main comments from respondents concerned the deadline for setting binding MREL targets.

BINDING MREL TARGETS

Some respondents raised concerns that the SRB's policy prevents resolution authorities from setting binding MREL targets before 1 January 2024.

In terms of meeting MREL, including internal MREL and subordination requirements, statutory transitional arrangements exist until 1 January 2024([8]). Between now and then, two intermediate targets will be issued: a first binding intermediate target to be met by 1 January 2022; and a second intermediate target of an informative nature for 1 January 2023.

Thus, the level of intermediate targets and the uniform deadline of 1 January 2024 for all the banks are based on the level 1 legislation.

([8]) Article 45m(1) subparagraph 3 of the BRRD2 provides that a transitional period that ends after 1 January 2024 may be set by the resolution authority where duly justified and appropriate on the basis of the criteria specified in Article 45m(7) of the BRRD2.

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