Register ID: 8754829960-32

EAPB Draft Position Paper on BRRD / SRMR Review Proposals

(Status: 30 March 2017)

General comments

On 23 November 2016, the European Commission published a set of proposals on the current legislative framework for the EU Banking Union. The proposals constitute the most substantial amendments to the existing provisions since the establishment of the post-crisis framework and make important changes to the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR). Whilst the general BRRD and SRMR framework remains valid, the main objectives of these proposals are to make further adjustments to the "bail-in" tool, used to absorb losses and internally recapitalise an institution that is failing or likely to fail, so that its viability is restored. It consists of writing down debt owed by a bank to creditors, as well as converting it into equity according to a pre-defined hierarchy.

The European Association of Public Banks (EAPB)* welcomes these legal proposals, which bring substantial progress. However, in order to establish more legal certainty, we would like to **suggest the following amendments to some items forming part of the review proposals:**

Determination of MREL

MREL is mainly determined by the systemic relevance of the institution for the European financial market as well as its resolvability. Therefore, EAPB welcomes the rules on the determination of MREL, which are to be set for each institution by the responsible resolution authority on the basis of a case-by-case institution-specific assessment and in an individual dialogue. However, EAPB is of the opinion that the rules for MREL should also take into account the extent to which creditors to a promotional bank owned by public authorities might be expected to contribute to its recovery or resolution. This should be strictly limited, given the responsibility of the public authority owners for the governance of the institution and the low risk business model and public policy mandate of such

Avenue de la Joyeuse Entrée 1-5, B–1040 Brussels
phone: +32 / 2 / 286 90 71 • fax: +32 / 2 / 231 03 47 • e-mail: info@eapb.eu • website: www.eapb.eu

institutions. Accordingly we suggest extending the existing exemptions from MREL laid down in Article 45a BRRD to promotional banks.

Interaction between MREL and TLAC

EAPB endorses the European Commission's intention to implement and integrate the TLAC standard into the existing MREL rules in order to avoid duplication caused by applying two parallel requirements and to provide legal certainty and consistency. By applying the TLAC requirements of 18% RWA and 6.75% Leverage Ratio Exposure only to G-SIBs, EAPB believes that this would be in line with the FSB's proposals and with the principle of proportionality.

By imposing different MREL requirements for G-SIBs and non-G-SIBs, it is the European Commission's clear intention to distinguish between them. Against this background, it appears unclear why Recital 11 BRRD states that systemically relevant institutions that are not identified as G-SIBs should not diverge disproportionately from the level and composition of MREL generally set for G-SIBs. Accordingly, we suggest deleting this recital.

Definition of credit institutions:

In the proposal to amend CRD, Article 2 (5a) lays down conditions according to which the European Commission may establish an exemption from CRR/CRD provisions for 'public development-type' institutions. The definition of 'credit institution' in BRRD Article 2 (1) and (2) makes reference only to Article 2 (5) CRD. This reference should be updated to cover any institution exempted under the new powers of the Commission.

BRRD	Proposed amendment
Article 2 (1)	(2) 'credit institution' means a credit institution as defined in point (1) of Article 4(1) of Regulation (EU) No 575/2013, not including the entities referred to in Article 2(5)**, 2 (5a) and 2 (5b)** of Directive 2013/36/EU;

Powers to address or remove impediments to resolvability

Regarding Article 17 BRRD, a new paragraph (j1) is introduced which would allow a resolution authority to require an institution to change the maturity profile of its liabilities to

ensure compliance with (external or internal) MREL requirements. EAPB is of the opinion that a resolution authority should under no circumstances have the power to enforce an MREL maturity structure, as the funding maturity structure (and strategy) of a bank is an important part of its liquidity and funding risk management framework. Maturity structures will also be influenced by market conditions (which may make longer term funding more or less attractive/available) as well as pricing considerations in addition to risk considerations.

Therefore, we believe that resolution authorities should only monitor the MREL maturity structure and potentially make recommendations. However, there is a need to consider the work undertaken by competent authorities with respect to a review of the funding and liquidity management of the institution, which will include a review of the maturity profile of funding and also include recommendations as appropriate. Any duplication of analysis (and in a worst case scenario contradicting recommendations) should be avoided.

Consequently, we believe that this new paragraph (j1) should be deleted.

BRRD	Proposed amendment
Article 17 (5)	~~(j1) require an institution or an entity referred to in point (b), (c) or (d) of Article 1 (1), to change the maturity profile of items referred to in Article 45b or points (a) and (b) of Article 45g (3) to ensure continuous compliance with Article 45f or Article 45g.~~

Moratorium power to suspend certain obligations

The new Article 29a creates the possibility for the competent authority to suspend payments for a period of up to five days in order to determine whether early intervention measures are necessary or whether an institution is failing or likely to fail. However, EAPB believes that the suspension of payments of an institution will always send a very negative signal to financial markets and in particular to customers. Furthermore, it seems unclear what realistic prospect a bank would have of recovering its market credibility, when payments are suspended and then lifted without the bank entering into resolution. As such we believe that it would be extremely unlikely that any competent authority would be able to exercise these powers in practice without increasing the risk to the financial system, and therefore we suggest deleting this article.

BRRD	Proposed amendment
Article 29a	~~Power to suspend certain obligations.~~ ~~1. Member States shall establish that their respective competent authority, after having consulted the resolution authority, can exercise the power referred to in point (i) of Article 27 (1) only where the exercise of the suspension power is necessary to carry out the assessment provided for in the first sentence of Article 27(1) or to make the determination provided for in point (a) of Article 32(1).~~ ~~2. The suspension referred to in paragraph 1 shall not exceed the minimum period of time that the competent authority considers necessary to carry out the assessment referred to in point (a) of Article 27(1) or to make the determination referred to in point (a) of Article 32(1) and shall in any event not exceed 5 working days.~~ ~~3. Any suspension pursuant to paragraph 1 shall not apply to:~~ ~~(a) payment and delivery obligations owed to systems or operators of systems that have been designated in accordance with Directive 98/26/EC, CCPs and third country CCPs recognised by ESMA pursuant to Article 25 of Regulation (EU) No 648/2012 and to central banks;~~ ~~(b) eligible claims for the purpose of Directive 97/9/EC;~~ ~~(c) covered deposits.~~ ~~4. When exercising a power under this Article, competent authorities shall have regard to the impact the exercise of that power might have on the orderly functioning of financial markets.~~ ~~5. A payment or delivery obligation that would have been due during the suspension period shall be due immediately upon expiry of that period.~~ ~~6. When payment or delivery obligations under a contract are suspended pursuant to paragraph 1, the payment or delivery obligations of the entity's counterparties under that contract shall be suspended for the same period of time.~~ ~~7. Member States shall ensure that competent authorities notify the resolution authorities about the exercise of any power referred to in paragraph 1 without delay.~~ ~~8. Member States that make use of the option laid down in Article 32 (2) shall ensure that the suspension power referred to in paragraph 1 of this Article can also be exercised by the resolution authority, after having consulted the competent authority, where the exercise of that suspension power is necessary to make the determination provided for in point (a) of Article 32(1).~~

Reference base (denominator) for MREL

In general, we support the introduction of a consistent definition of the reference base for the calculation of MREL and TLAC. This would reduce complexity and lead to a more linear and transparent management of loss absorption requirements across the EU.

However, EAPB believes that the reference to the Leverage Ratio Exposure Measure is incorrect and should therefore be changed to Article 429 (4) of Regulation (EU) No 575/2013. Furthermore, it should be clarified that derogations from Article 429 (4), which are set out in Article 429a (1), should apply for the purposes of the MREL determination in order to ensure consistency throughout the legislative framework.

BRRD	Proposed amendment
Article 45	*Application and calculation of the minimum requirement for own funds and eligible liabilities* 1. Member States shall ensure that institutions and entities referred to in points (b), (c) and (d) of Article 1(1) meet, at all times, a requirement for own funds and eligible liabilities in accordance with Articles 45 to 45i. 2. The requirement referred to in paragraph 1 shall be calculated in accordance with Article 45c(3) or (4) , as applicable, as the amount of own funds and eligible liabilities and expressed as percentages of: (a) the total risk exposure amount of the relevant entity referred to in paragraph 1 calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013, (b) the leverage ratio exposure measure of the relevant entity referred to in paragraph 1 calculated in accordance with Article 429 ~~(3)~~ (4) and taking into account the derogations subject to Article 429a (1) of Regulation (EU) No 575/2013.
SRMR	**Proposed amendment**
Article 12 (a)	This requirement referred to in paragraph 1 shall be calculated in accordance with, Article 12d(3) or (4) as applicable, as the amount of own funds and eligible liabilities and expressed as a percentage of: (a) the total risk exposure amount of the relevant entity referred to in paragraph 1 calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013; and (b) the leverage ratio exposure measure of the relevant entity referred to in paragraph 1 calculated in accordance with Article 429 ~~(3)~~ (4) and taking into account the derogations subject to Article 429a (1) of Regulation (EU) No 575/2013.

MREL Guidance

In Article 45e the concept of 'MREL guidance' is introduced, which allows resolution authorities to require institutions to meet higher levels of MREL. In particular, paragraph 1(a) of Article 45e states that this guidance is to 'cover potential additional losses of the

entity to those covered in Article 45c'. However, we are not clear how this would be possible as Article 45c paragraph 2(a) states that the loss absorption amount 'shall equal an amount sufficient to ensure that the losses expected to be incurred by the entity are fully absorbed'.

Furthermore, Article 45e paragraph 2 explicitly refers to the Pillar 2 guidance (P2G), which is set as a result of the SREP. We believe that this link is conceptually flawed, as P2G is set to ensure that institutions continue to meet their Pillar 1 and Pillar 2 capital requirements even under stressed conditions (i.e. stress losses would not erode the capital of the institution to such an extent as to make it breach its Pillar 1 plus Pillar 2 requirement). On the contrary, in case of resolution the entire amount of Pillar 1 and Pillar 2 capital is available to cover losses incurred as a result of the stress scenario. It is not therefore clear why the MREL guidance would be linked to P2G.

The MREL guidance is amongst others based on the CBR. Elements of the CBR are at the discretion of the national authority. Against the background that some jurisdictions impose relatively high additional capital requirements for systemically important banks to mitigate systemic risk, we suggest that the possibility for resolution authorities to adjust the guidance downwards should be maintained. We believe this is necessary in order to preserve a level playing field for banks operating in the single market.

MREL waivers for subsidiaries

Article 45g (5) lays down the possibility for resolution authorities of resolution entity's subsidiaries to fully waive the MREL applicable to those subsidiaries, if both the resolution entity and its subsidiaries are established in the same Member State. EAPB believes that the possibility to waive the application of MREL should be aligned with the new proposed capital and liquidity waivers (Art 7 and 8 CRR) in the sense that a waiver for entities located across member states of the banking union should be introduced as well.

BRRD	Proposed amendment
Article 45g (5)	The resolution authority of a subsidiary that is not a resolution entity may fully waive the application of this Article to that subsidiary where: (a) both the subsidiary and the resolution entity are subject to authorisation

	and supervision ~~by the same~~ **in a** Member state;

Supervisory reporting and public disclosure of MREL

EAPB believes that the public disclosure of the MREL requirement will have to be considered cautiously by the resolution authorities and banks, in particular at the beginning of the process. As of now, there is still a lot of uncertainty driven partly by the fact that resolution plans are still not completed. Therefore, we suggest a transitional provision to not start MREL disclosure until after the requirement has been in force for a certain time period in order to ensure the stability of the requirement.

Furthermore, we propose that reporting requirements of banks to the SRB and the EBA should be harmonised and based on the established reporting frequencies (Common Reporting Framework – CoRep). The determination of the MREL quota is referring to RWA and the leverage ratio exposure, which together with fundamental elements such as own funds are subject of the CoRep reporting. Therefore, in order for institutions to fulfil their MREL reporting requirements, we believe an adequate time buffer is essential.

Breach of MREL

Under Article 45k BRRD, a list of new powers for resolution authorities is introduced in case of breaches of the MREL requirements, including, for instance, early intervention measures in accordance with Article 27 BRRD. EAPB believes that the competences of resolution authorities as set out in the BRRD are adequate to address the issue as they are obliged to require and verify that banks meet MREL and shall take any decision in parallel with the development and the maintenance of resolution plans (Art. 45 para. 15 BRRD).

Moreover, EAPB is concerned that the provisions set out in Article 45k are stricter than the MDA restrictions, which apply in case of a breach of MREL plus CBR with a grace period of 6 months. MREL should not be considered an indicator for a bank's viability, particularly as some 'breaches' of MREL can be purely technical or just a question of timing, (e.g. if an anticipated bond issue is delayed by a few weeks). Therefore, the requirements should be

formulated more precisely. The reporting of just “any” breach of MREL could lead to wrong conclusions being drawn. As the requirement aims to give the relevant authorities the right to choose between intervention rights of different intensity, a clarification of the proportionality of the intervention is needed.

EAPB suggests adding an intermediate step whereby a breach of MREL is only considered a breach that would justify the use of powers if it is not temporary, e.g. if the breach lasts longer than a reasonable amount of time, e.g. 6 months. As a first step after a breach of MREL there should be an analysis concerning the cause of a shortfall. Based on the result the next step could be that the bank would be required to prepare a strategy to restore MREL within an agreed timeframe. The consequences of an MREL breach should not be automatic.

Moreover, in regard to the power to commence early intervention measures, EAPB is of the opinion that a breach of MREL should not alone be a sufficient condition tojustify a determination that a bank is failing or likely to fail. As mentioned in Recital 41 of the BRRD, the fact, that an institution does not meet the requirements for authorisation should not justify per-se the entry into resolution, especially if the institution is still or likely to still be viable. MREL is only an instrument in the context of resolution.

BRRD	**Proposed amendment**
Article 45k	1. Any not temporary breach of the minimum requirement for own funds and eligible liabilities by an entity shall be addressed by the relevant authorities in a proportional manner based on an analysis of the cause of the shortfall on the basis of at least one of the following: (a) powers to address or remove impediments to resolvability in accordance with Article 17 and Article 18; (b) measures referred to in Article 104 of Directive 2013/36/EC; ~~(c) early intervention measures in accordance with Article 27;~~ (d) administrative penalties and other administrative measures in accordance with Article 110 and Article 111;
SRMR	**Proposed amendment**
Article 12 (g)	1. Any not temporary breach of the minimum requirement for own funds and eligible liabilities by an entity shall be addressed by the relevant authorities in a proportional manner based on an analysis of the cause of the shortfall on the basis of at least one of the following means: (a) powers to address or remove impediments to resolvability in accordance with Article 10; (b) measures referred to in Article 104 of Directive 2013/36/EC;

	~~(c) early intervention measures in accordance with Article 13;~~ (d) administrative penalties and other administrative measures in accordance with Article 110 and Article 111 of Directive 2014/59/EU".

Third country recognition of bail-in

Regarding the amended rules on contractual recognition of bail-in under Article 55 BRRD, EAPB welcomes the possibility for resolution authorities to waive the obligation of institutions to include bail-in recognition clauses in agreements or instruments governed by third country laws. This would provide banks and the competent supervisory and resolution authorities with the required degree of flexibility. In addition, EAPB is of the view that the respective authorities should have the right to determine the appropriate consequences and measures to be taken in view of the relevance of the agreements in question and the impact on the resolvability of the respective bank. However, it appears the drafting of this clause may incorrectly state that all of the proposed criteria must be met before a waiver from Article 55 can be given. We believe that it should be sufficient if only one of the criteria is met.

Moreover, in order to ensure consistency with Article 108 BRRD, we believe thatArticle 55 (2) sentence 2 needs further clarification regarding unsecured liabilities, which are to be excluded from waivers. We believe that only the new asset class of non-preferred senior unsecured debt should be excluded, whereas other preferred unsecured liabilities should be subject to waivers.

Insolvency Hierarchy

Regarding the new rules under Article 108 BRRD, EAPB welcomes the separate legislative proposal amending the BRRD aiming at a harmonised approach to subordination requirements, as regards the ranking of unsecured debt instruments in insolvency hierarchy. Following these new rules, Member States are required to create a new asset class of ‘non-preferred’ senior unsecured debt, which could only be bailed-in during bank resolution, after writing down or converting any own fund instruments and before bailing-in other senior liabilities. Accordingly, only the non-preferred senior

unsecured class should be eligible to meet the subordination requirement of TLAC and MREL. Nonetheless, we note that in order to meet the subordination requirements, a number of Member States have already amended the ranking of creditor claims under their national insolvency law, thereby creating significant divergences.

Accordingly, in order to avoid more uncertainty regarding the structure and design of newly issued debt instruments, EAPB supports a fast-track approach in regard to Article 108 BRRD. However, the ranking of unsecured debt instruments in insolvency hierarchy cannot be separated from the eligibility criteria laid down in Article 72b (2) CRR. In order to create legal certainty and avoid the emergence of issuing gaps or delays for institutions as well as ensuring equal competitive conditions, it is our opinion that the eligible criteria should enter into force at the same time as Art. 108 BRRD on a date still to be future determined. Otherwise, the new insolvency hierarchy would become legally binding, whereas the final criteria laid down in Art. 72b CRR would still lack legal certainty.

Moreover we are of the opinion that a grandfathering clause must be included in Art. 108 BRRD, clearly stating that all instruments issued before national applications of the harmonized ranking of unsecured debt instruments shall be subject to national laws until the end of their tenor. Only such a step would make it meaningful and market-undistorting management of the diverse liability classes possible.

Furthermore EAPB suggests that the number of requirements should be minimized as much as possible in order to accommodate a smooth transposition into national legislation. As such, we believe that requirements only laying down the ranking are necessary and that the requirements (a) and (b) are related to eligibility criteria and should therefore not form part of this general framework.

BRRD	Proposed amendment
Article 1 (2)	2. Member States shall ensure that, for entities referred to in points (a), (b), (c) and (d) of Article 1(1), ordinary unsecured claims resulting from debt instruments with the highest priority ranking among debt instruments in national law governing normal insolvency proceedings have a higher priority ranking than that of unsecured claims resulting from debt instruments which meet the following conditions:

	~~(a) the initial contractual maturity of debt instruments spans one year;~~ ~~(b) they have no derivative features;~~ (c) the relevant contractual documentation related to the issuance explicitly refers to the ranking under this subparagraph. 3. Member States shall ensure that ordinary unsecured claims resulting from debt instruments referred to in paragraph 2 shall have a higher priority ranking in national law governing normal insolvency proceedings than the priority ranking of claims resulting from instruments referred to in points (a) to (d) of Article 48(1). 4. Member States shall ensure that their national laws governing normal insolvency proceedings as they were adopted at [31 December 2016] apply to ordinary unsecured claims resulting from debt instruments issued by entities referred to in points (a), (b), (c) and (d) of Article 1(1) prior to [date of application of this Directive – July 2017]."

Eligible liabilities under MREL

MREL-eligible liabilities are an important part of the funding structure of a bank and are part of managing interest rate- and liquidity risks, and EAPB takes the view that mandatory directions of the resolution authority might interfere with the institution's management of these risks and/or any directions in this context given by the competent supervisory authorities. In that regard, EAPB is favourable towards the proposal to apply mandatory subordination only to G-SIBs, as this would be in line with the TLAC-standard. In this context, EAPB supports the new rules, which leave it to the discretion of the resolution authority to take into account the specificities of the bank concerned, and to determine the extent of subordination on a case-by-case basis.

We are in favour of the proposal's intention to not restrict eligibility to subordinated instruments, but to maintain senior unsecured debt counting as eligible for meeting the MREL requirements within the new approach of harmonising the ranking of senior unsecured debt. Had senior unsecured debt been excluded, this would have significantly increased the costs of fulfilling the MREL requirements for our members, given their low-risk nature which translates into a small amount of capital in absolute terms, and their reliance on whole sale funding, resulting in a liability structure driven by senior unsecured debt.

However, some of the requirements in Article 72b paragraph 2 go beyond the requirements in the TLAC term sheet and appear not to be aligned with the objectives of TLAC/MREL and as such unnecessarily restrict European banks.

To avoid disproportionate costs for new issues and in order not to unnecessarily constrict market depth for issues, we are asking for a differentiation concerning MREL-eligibility between the original BRRD-criteria and the newly introduced TLAC-criteria. To this end, it would make sense to solely apply the criteria taken over from the TLAC-term sheet to the liabilities to be likewise newly issued pursuant to Art. 108 para. 2 BRRD-draft which are at the same time necessary to meet the subordination requirements as called for by the TLAC-term sheet.

In particular we are concerned regarding the additional criteria that have been introduced in Article 72b (g) (k) (m) and (o) CRR including set-off/netting arrangements, authority approval for redemption, acceleration clauses as well as contractual bail-in provisions, which are outlined further below.

Set-off or netting arrangements

Regarding set-off or netting arrangements in paragraph 2 lit. g, we suggest to only exclude liabilities with contractual sett-off or netting arrangements from the MREL calculations. Such contracts are mostly based on reciprocal claims of the same type and in the event of default would be offset against each other.

Calls, early redemptions and repurchases

Furthermore, CRR 72b (k) makes eligible liabilities subject to the supervisory approval regime that today applies to CET1, AT1 and Tier 2 instruments. However, making eligible liabilities subject to Article 77 and 78 introduces a significant new restriction on institutions' abilities to optimise funding and capital structure because they would be subject to time consuming and costly processes with applications, supervisory review, documentation etc.

As long as an institution does not execute early calls, redemptions or repayments that would put the institutions in breach of MREL requirements, such a supervisory approval process should therefore not be a requirement. Accordingly we suggest deleting this criterion.

No acceleration rights

Concerning ‚no acceleration rights' in paragraph 2 lit. m we note that termination rights if the issuer does not meet its payment obligations is a market standard and would affect a large portion of existing debt programs. Consequently, if a contractual condition for no acceleration of liabilities were required as a prerequisite for MREL eligibility, it would potentially cause serious disruptions and costs to the debt programs of European banks when renegotiating the debt programs. Furthermore it would be extremely costly if senior unsecured liabilities would not be counted eligible for MREL and TLAC because of the no acceleration clause and therefore had to be replaced with alternative funding. Therefore, we suggest waiving this MREL criterion.

Contractual bail-in clauses

Given the statutory bail-in provisions according to European law, we believe that introducing contractual bail-in provisions as laid down in paragraph 2 lit. o would lead to a duplication without any added value. On the contrary, MREL eligibility is a subset of bail-inable instruments and liabilities which are not eligible for MREL may be bail-inable. As such, we believe that introducing contractual bail-in provisions might give investors the false impression that instruments without such a clause are exempted from bail-in which is not the case. Moreover, this provision implies an inappropriate extension of the proposed provisions concerning contractual bail-in clauses for non-member states in Article 55 BRRD. Consequently we are of the opinion that an additional inclusion of this criterion is not necessary.

Grandfathering

Furthermore EAPB is concerned that it will be impossible to meet MREL requirements in the short term without being able to include current outstanding senior unsecured debt.

Therefore, it is necessary that some form of grandfathering will be introduced to allow such debt to fulfil the MREL requirements in a transition period.

CRR	Proposed amendment
Article 72b	*Eligible liabilities instruments* 2.Liabilities shall qualify as eligible liabilities instruments provided that all of the following conditions are met: (g) the liabilities are not subject to any **contractual** set off arrangements or netting rights that would undermine their capacity to absorb losses in resolution; ~~(k) the liabilities may only be called, redeemed, repurchased or repaid early where theconditions laid down in Articles 77 and 78 are met;~~ ~~(m) the provisions governing the liabilities do not give the holder the right to accelerate the future scheduled payment of interest or principal, other than in case of the insolvency or liquidation of the resolution~~ ~~(o) the contractual provisions governing the liabilities require that, where the resolution authority exercises write-down and conversion powers in accordance with Article 48 of Directive 2014/59/EU, the principal amount of the liabilities be written down on a permanent basis or the liabilities be converted to Common Equity Tier 1 instruments.~~

Finally, it should also be noted that the pending **date of the entry into force** and the uncertainty surrounding the first date of application of the BRRD and SRMR proposals imply major concerns for public banks and **should soon be clearly communicated to all affected stakeholders**.

* ***The European Association of Public Banks (EAPB)*** *gathers over 30 member organisations which include promotional banks such as national or regional public development banks and local funding agencies, public financial institutions, associations of public banks and banks with similar interests from 17 European Member States and countries, representing directly and indirectly the interests of over 90 financial institutions towards the EU and other European stakeholders.*