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26 August 2016

European Banking Authority
Floor 46
One Canada Square,
London
E14 5AA

By email to mrelreport@eba.europa.eu

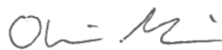
AFME response to the European Banking Authority's interim report on implementation and design of the MREL framework

Dear Sir/Madam,

Please find enclosed the Association for Financial Markets in Europe's response to the European Banking Authority's interim report on the implementation and design of the MREL framework.

Please do not hesitate to contact us if you have any questions or wish to discuss these issues further.

Yours sincerely



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Consultation response

AFME response to the EBA interim report on MREL

26 August 2016

Introduction

The Association for Financial Markets in Europe (AFME)[1] welcomes the opportunity to comment on the EBA's interim report on MREL (the "Interim Report").

We summarise below our high-level response to the consultation, which is followed by answers to the individual questions raised and commentary on a number of issues addressed in the Interim Report. We would be very happy to discuss these comments further with the EBA.

Executive Summary

AFME welcomes the publication of the Interim Report and the opportunity to respond ahead of the finalisation of the report. In particular we welcome the EBA's consideration of issues such as the interaction between the capital framework and MREL, intra-group issues and third country recognition of resolution powers. The EBA's work on these issues should provide helpful input into the European Commission's proposal and assist the co-legislators. We also welcome the summary of existing approaches to implementation of MREL and the quantitative impact analysis. However, there are a number of important areas where greater clarity is required such as the approach to internal MREL, treatment of MREL holdings and disclosure. There should be further opportunities for consultation with the industry once firmer proposals are made in these areas.

As set out in our previous paper on MREL and TLAC implementation[2], we suggest that an appropriate approach to the review of MREL and any TLAC legislative proposal would be to establish a single framework applicable to all banks which implements the TLAC Standard for GSIBs and establishes a common framework for all banks minimising inconsistencies and distortions. We regard the following key principles as important in framing implementation:

a) The European Union should implement the TLAC Standard for GSIBs as agreed with no material deviations. This is essential to provide international consistency, support cross-border cooperation and provide clarity for banks and the market.

[1] AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society. AFME is the European member of the Global Financial Markets Association (GFMA), a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is listed on the EU Transparency Register, registration number 65110063986-76.

[2] The implementation of TLAC and MREL in the EU, 6 May 2016, available at http://afme.eu/WorkArea/DownloadAsset.aspx?id=14149

b) Clarity regarding loss absorbing capacity requirements and confirmation that the above principle will be met should be provided as a matter of urgency in order to enable banks to plan implementation by the deadlines set in the TLAC Standard. An appropriate transitional period is required in the meantime and this should be aligned with the TLAC Standard. Many banks will need to issue significant amounts of eligible debt and investors require clarity as to the final requirements before investing, particularly in the current challenging market conditions. Clarity should also be provided as to how the existing MREL regime will be applied and when the new framework will come into force.

c) TLAC and MREL implementation should provide for a single framework for loss absorbing and recapitalisation capacity for banks in the EU. Overlapping requirements which apply to the same banks with different criteria seeking to achieve the same purpose would create confusion amongst investors, potentially result in conflicting requirements for banks and add additional complexity for banks and the authorities which would have to monitor and manage multiple requirements.

d) The purpose of MREL and TLAC is to facilitate the group resolution strategy. It is therefore vital that the calibration and location of MREL/TLAC is aligned with the resolution strategy for the group, as agreed in the Crisis Management Group or resolution college.

e) The European legislation should support cross-border cooperation both within the EU and with authorities in third countries.

While some of these principles are reflected in the Interim Report, we hope that they are clearly reflected in the final report, for example in relation to intra-group application and internal MREL.

We set out a summary of our comments on the provisional recommendations and issues discussed in the Interim Report in the table below. We also encourage the EBA to consider other areas that are likely to be important in relation to the implementation of MREL. These include work that is still underway at the Basel Committee on Banking Supervision (BCBS) on the treatment of TLAC holdings and Pillar 3 disclosures. AFME has contributed to discussions on these topics through the GFMA. The ongoing FSB work on recovery and resolution including internal TLAC should also be considered.

EBA provisional recommendations	AFME comments
Reference base for MREL requirement (denominator) The EBA's provisional view is that the preferred option should be to change the reference base of MREL to RWAs. The changed reference base should be complemented with a leverage ratio exposure backstop in parallel with the phase-in of the leverage ratio requirement within the capital framework. This approach achieves alignment with CRR / CRD regulatory requirements and with the FSB's TLAC standard and reduces complexity	 AFME agrees with the EBA's provisional view that the preferred option should be to change the reference base of MREL to RWAs and leverage ratio exposure with respect to GSIBs. This would be consistent with the TLAC Standard and avoid GSIBs having to monitor compliance with three different reference bases. We also agree that if these well understood and clearly defined prudential measures do not replace the MREL denominator, clarification of the definition of total

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without major substantive changes to the MREL setting process. If this change is not made, the EBA recommends changing the reference base of MREL from total liabilities and own funds to the leverage ratio exposure as a more consistently applied non-risk sensitive measure. If neither of these changes is made, the EBA considers that clarification of the definition of the existing denominator is necessary, either in the Level 1 text or through the introduction of a Level 2 mandate.	liabilities is necessary and that this definition should give full effect to contractual netting rights. Netting should apply not only to derivatives, but also to other securities financing transactions.
Relationship with regulatory requirements: The EBA's provisional view is that, in principle, the usability of regulatory capital buffers would be best preserved if they stack on top of MREL – i.e. that banks would not be able to use CET1 capital to meet MREL and also to meet regulatory capital buffers. However the implementation of this approach should carefully consider the interaction with automatic maximum distributable amount (MDA) restrictions on voluntary distributions and the supervisory review and evaluation process (SREP). This is particularly relevant for banks which rely mainly on capital instruments to meet MREL because of limited access to debt capital markets. The EBA's provisional view is that interactions between MREL and the net stable funding ratio (NSFR) do not give rise to any need for policy change.	AFME supports the EBA's provisional recommendation that capital buffers should stack on top of MREL. We also strongly support the need to carefully consider the interaction between MREL and MDA restrictions. In our view it would be inappropriate for MDA restrictions to be automatically triggered by virtue of a bank breaching its combined buffer solely as a result of CET1 being used to meet a temporary MREL shortfall. Article 141 of the Capital Requirements Directive should not be amended to include MREL. While we acknowledge that these issues also relate to the capital framework, they are important to consider in the MREL context, for example they will impact on calibration and the consequences of breach of MREL. We therefore encourage the EBA to address them in the final report. We agree with the EBA's provisional view that interactions between MREL and the NSFR at the consolidated level do not give rise to a need for policy change at this current time, although this should be kept under review as the MREL framework is finalised and implemented. However, further consideration should be given to the interaction between the NSFR and internal MREL as this could give rise to potential issues.

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Consequences of breach of MREL	
The EBA provisionally considers that resolution authorities should have clear responsibility and a leading role in responding to a breach of MREL. Achieving this objective would require additional powers and an accelerated procedure for the use of their powers to address impediments to resolvability. This accelerated procedure should allow resolution authorities to act on the basis of a previous assessment of resolvability and to shorten the timeline currently foreseen by the BRRD (in the context of Art 17). An accelerated procedure should be without prejudice to the need for proper consultation and cooperation with the competent authority. Competent authorities may also respond to breaches of MREL. Where this is the case the EBA's provisional view is that the legal basis for the use of competent authorities' existing powers in response to a breach of MREL should be further strengthened. The existing reference in EBA guidelines on triggers for use of early intervention measures could be incorporated in the Level 1 legislation and the ability to respond based on a persistently low level of MREL as well as a rapid deterioration clarified. Resolution and competent authorities should closely cooperate and coordinate, including by notifying and consulting each other in advance, on respective actions taken in response to a breach of MREL. *The EBA invites stakeholders' comments on whether and in what circumstances a breach of MREL should result in the Competent Authority making an assessment of whether the institution is failing or likely to fail.*	A breach of MREL should be taken seriously by the authorities. However, the response of the authorities should be tailored to address the cause of the breach. Where a breach of MREL occurs alongside a breach of capital requirements, the existing capital framework provides sufficient powers to address this. However, where a breach of MREL does not involve a breach of capital requirements, resolution authorities should assess the cause of the breach and agree, as necessary, a plan with the institution to remedy the breach as a barrier to resolvability, in close coordination with the competent authority. Such a plan should provide an appropriate timeframe in which the institution should restore its MREL position, taking into account the cause of the breach, market conditions and the availability of broader bail-in-able liabilities. We strongly support the EBA's provisional recommendation that resolution authorities and competent authorities should closely cooperate and coordinate. We consider that the authorities' existing powers are sufficient. We do not agree that there should be an accelerated process for the powers in article 17 BRRD, but clarification could be provided as to how a breach should be addressed using existing powers. In answer to the question as to whether and in what circumstances the competent authority should assess whether a firm is failing or likely to fail, we believe that the current BRRD provisions and EBA guidelines on failing or likely to fail are sufficient. A breach of MREL should not automatically result in a determination that the institution is failing or likely to fail, particularly given that MREL eligible liabilities are funding instruments as opposed to regulatory capital instruments. As such, the approach to addressing the breach should take into account the forward issuance plan of the institution before considering supervisory measures. This determination and assessment should remain with the competent authority in close cooperation with the resolution authority.

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Adequacy and calibration	
The EBA provisionally recommends that calibration of MREL should in all cases be closely linked to and justified by the institution's resolution strategy. Business models may be worth considering when calibrating MREL to the extent they translate into /lead to differences in resolution strategies. The EBA provisionally recommends that the current MREL assessment framework (under BRRD Article 45 and the RTS on MREL) be retained as the basis for setting 'Pillar 2'/firm- specific MREL requirements. This means that MREL should be set as the higher of the requirement resulting from this assessment and any Pillar 1 requirement, should one be introduced. Firm specific requirements should only be set at levels necessary to implement the resolution strategy.	AFME strongly supports the EBA's provisional recommendation that MREL should be closely linked to and justified by the institution's resolution strategy. We suggest that an appropriate approach to the review of MREL and any TLAC legislative proposal would be to establish a single framework applicable to all banks which implements the TLAC Standard for GSIBs and establishes a common framework for all banks minimising inconsistencies and distortions. We broadly support the current MREL calibration framework which is focused on the relevant resolution plan for the group, subject to implementation of the TLAC standard for GSIBs. We recommend that certain aspects of the existing MREL framework should be reviewed, in particular excluding capital buffers in the event that these sit on top of MREL and adjustments to the recapitalisation amount to take account of the likely depletion in the size of the bank at the point of resolution and expected changes to the group following resolution. We strongly support the recommendation that firm specific requirements should only be set at levels necessary to implement the resolution strategy. For GSIBs, MREL should be aligned with the TLAC requirement and any further firm-specific requirement should be duly justified by the resolution authority on the basis of being necessary to implement the resolution strategy. Consideration should be given to the potential impact on MREL calibration arising from potentially very substantial increases in RWAs under the capital standards agreed and proposed at the Basel Committee since the TLAC Standard was finalised. We believe that requiring MREL to be calibrated at 8% of total liabilities and own funds in order to ensure that it is possible to access resolution funds for solvency support is the wrong starting-point for calibration. The focus should be on resolvability and achieving the resolution objectives without the need to use resolution funds to absorb losses.

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	As highlighted in the Interim Report, there is no mandatory relationship between MREL and the 8% threshold and there is a significant difference in scope between MREL eligibility and the scope of "bail-in-able" liabilities. Further, resolution funds can only be used for indirect recapitalisation and only in certain specified "exceptional" circumstances, so this form of recapitalisation does not appear appropriate for consideration in resoluton planning for a wide range of scenarios. We therefore strongly support the statement that any assessment of the relevance of the threshold "has to be made taking into account all liabilities eligible (in full or in part) for bail-in, not only MREL-eligible instruments" and this should be made explicit in the legislative framework.
Eligibility The EBA's provisional view is that for at least some banks mandatory subordination of MREL-eligible liabilities would improve resolvability and contribute to clarity for investors. Subordination requirements introduced in Level 1 legislation should focus on establishing to which other liabilities MREL-qualifying liabilities need to be subordinated, rather than specifying the legal form of that subordination (contractual, statutory or structural). Regardless of whether additional subordination requirements are introduced, the EBA's provisional view is that relevant information should be available to bank creditors on banks' creditor hierarchies and the effects of national insolvency law. The EBA invites stakeholders to comment on the appropriate scope of any subordination requirements. *More precisely stakeholders are invited to comment on what the highest priority information and*	We support the implementation of the TLAC Standard including subordination requirements for GSIBs. As part of this, the EU should implement the exemptions to subordination and the transitional arrangements provided for in the TLAC Standard. With respect to other eligibility criteria, we support the alignment of the MREL eligibility criteria with the TLAC Standard. However, one area that we encourage the EBA to consider further is the treatment of structured notes, in particular in relation to transitional arrangements. We support the EBA's provisional view that subordination requirements should focus on establishing to which other liabilities the subordination of MREL eligible liabilities is required, rather than the legal form of subordination. The scope of liabilities to which any subordination should be required should be aligned with the TLAC Standard. We suggest that a definition of "excluded liabilities" should be introduced to clarify this. We also strongly support the EBA's provisional recommendation that "regardless of whether additional subordination requirements are introduced,

disclosure needs are, in the three areas of i) disclosure of bank balance sheet structures; ii) disclosure of banks' MREL requirements and iii) availability of standardised information on statutory creditor hierarchies.	... relevant information should be available to bank creditors on banks' creditor hierarchies and the effects of national insolvency law." We agree that appropriate disclosure is necessary to support the market for MREL issuance. However disclosure requirements should only apply once the final framework and requirements are clear. Disclosure prior to this point could be unhelpful and be misinterpreted by investors. For this reason an appropriate transitional period for disclosure is required. We encourage the European authorities to apply the international disclosure standards once finalised by the BCBS to avoid divergence between the EU and other jurisdictions. The finalisation of disclosure standards for MREL should take into account the comments provided by the industry during the Basel consultation process. The EBA together with European institutions and authorities should work with the BCBS and the industry to determine how to coordinate disclosures regarding the creditor hierarchy, regulatory capital stack and the quantum of eligible MREL. Given the variation in eligibility with the EU, it is essential that a well-defined disclosure framework is in place well before any regulatory initiative to limit banks' holdings of MREL liabilities.
Third country recognition The EBA's provisional view is that some reduction of the burden of compliance with third country recognition requirements is necessary. This could be achieved by narrowing the scope of the requirement, while maintaining the effectiveness of contractual recognition for MREL liabilities. *The EBA invites stakeholders' to comment on the practical difficulties faced in implementing the recognition clauses, specifically in the field of MREL, and on alternative approaches to improve the regime without creating incentives to evade the scope of bail-in.*	AFME welcomes the consideration of third country recognition of resolution powers in the Interim Report. We highlight below a number of very significant practical difficulties with the current scope of article 55 BRRD ("Article 55"). We strongly support the EBA's provisional recommendation that a reduction of the burden of compliance with third country recognition requirements is necessary, and agree that this should be achieved by narrowing the scope of the requirement while maintaining the effectiveness of contractual recognition for MREL instruments. We propose that the scope should be narrowed to include MREL and other debt instruments in line with the FSB

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	guidance on cross-border effectiveness of resolution actions. In addition to the limitation in scope, which should be the primary objective, consideration should also be given to providing resolution authorities with express powers to grant waivers where they believe that this is appropriate based on certain criteria eg impracticability, proportionality and not threatening resolvability, so as to take into account the variety of bank structures and national insolvency regimes across the EU. This is the approach that should be adopted through the forthcoming legislative proposal.

In addition to the above areas, we have taken the opportunity to provide feedback on the following additional issues discussed in the Interim Report:

a) **Approval for redemption of MREL-eligible liabilities**:

We do not believe that it is necessary or proportionate for regulatory approval to be sought for every redemption of MREL-eligible instruments where the institution retains sufficient eligible liabilities to meet its requirements. Instead we support the approach provided for in the TLAC Standard for approval to be required only if the redemption would lead to a breach of MREL requirements.

b) **Intra-group issues**:

While we welcome the EBA's discussion of intragroup issues in the Interim Report and commitment to include a fuller discussion in the final report, this is an important area which merits further consideration and greater clarity is required on the EBA's proposed approach.

It should be a core principle of the framework that MREL requirements are calibrated in accordance with the resolution strategy for the group and this should be given greater emphasis than under the existing RTS. We strongly support the adoption of the concepts of resolution entity and resolution group, and external and internal MREL as applied in the TLAC Standard and these should be expressly incorporated into the MREL framework. As discussed further below, the scope, calibration and eligibility criteria for internal MREL should be aligned with the TLAC Standard.

Each of these issues is addressed in greater detail below.

1. Reference base for MREL requirement (denominator)

We agree with the EBA's provisional view that the preferred option should be to change the reference base of MREL to RWAs and leverage ratio exposure with respect to GSIBs. This would be consistent with the TLAC Standard and avoid GSIBs having to monitor compliance with three different reference bases.

We also agree that, in the event that the definition is not changed, clarification of the definition of total liabilities is necessary and that this should be clarified in Level 1 legislation. We support the introduction of a definition of liabilities reflecting the full recognition of netting rights (full contractual netting as discussed at page 34 of the Interim Report), which better reflects the value of such instruments in resolution. Netting should apply not only to derivatives, but also to other securities financing transactions where including the gross value of liabilities would not provide an accurate measure of the liabilities of the institution.

2. Relationship between MREL and other regulatory requirements

AFME welcomes the EBA's provisional recommendations regarding the relationship between MREL and other regulatory requirements. We agree that capital buffers should "sit on top" of MREL. This approach should apply to all banks to ensure the usability of each firm's capital buffers and to enable the buffers to serve their purpose of absorbing losses in periods of stress without breaching MREL or capital requirements. As identified in the Interim Report, taking such an approach across the EU will bring the treatment of CET1 for these purposes in line with the internationally agreed FSB Principles on Loss Absorbing and Recapitalisation Capacity of GSIBs in Resolution (the "TLAC Standard") and be consistent with the US and Swiss approaches.

However, when adopting this approach it is necessary, as noted in the Interim Report, to lower the calibration of MREL levels to take into account the elimination of double-counting. Specifically, neither loss absorbing, nor recapitalisation components of the MREL calibration should include capital buffers. As discussed further below, we encourage the EBA to recommend appropriate changes to the calibration methodology to address this issue in their final report.

As highlighted in the Interim Report, it is important to carefully consider the interaction between the stacking of buffers on top of MREL and automatic restrictions on distributions which, absent any change could occur at very high levels of capital and potentially as a result of a failure to refinance maturing MREL-eligible liabilities due to idiosyncratic or market-wide stresses. We agree that it is "*necessary to evaluate … if and under what conditions, it is still appropriate to impose automatic MDA restrictions as soon as a bank breaches its [combined buffer]*".

Were an MREL shortfall to occur, e.g. due to market conditions restricting the ability of a firm to roll-over maturing MREL instruments, absent any changes the stacking order proposed would imply that CET1 capital used to meet the combined buffer requirement would be used to fill the MREL shortfall, potentially triggering a breach of the combined buffer and automatic MDA restrictions. This would

be counterproductive and could make it very difficult for the institution to issue further MREL eligible liabilities to enable it to remedy the situation, particularly in stressed conditions.

Accordingly, while we support the view that CET1 should not be double-counted and that a breach of MREL should be treated seriously, in our view it would be inappropriate for MDA restrictions to be automatically imposed by virtue of a bank breaching its combined buffer solely as a result of CET1 being used to meet a temporary MREL shortfall. This could occur, for example, due to a temporary debt refinancing issue rather than the bank facing any immediate solvency issues and would result in a substantially higher threshold at which MDA could apply.

The different potential causes of a breach of capital buffers are likely to require different action from firms and authorities depending on the reasons for the shortfall. For example, Tier 1 instruments are perpetual in nature, and a breach through reduction of Tier 1 capacity will, in most instances reflect the emergence of losses in a bank, whereas debt instruments with fixed terms are subject to refinancing risk. Market conditions can and do fluctuate rapidly, following economic and/or regulatory stimuli, and it is perfectly feasible that a breach of MREL through non-renewal of maturing debt may reflect market conditions, and not be a translation of under-performance from a given bank.

For all these reasons AFME does not believe that buffers should operate in such a way that using part of a buffer to satisfy MREL should automatically trigger MDA restrictions. For these reasons it is not appropriate for article 141 of the CRD to be amended to include MREL breaches as a reason to implement such restrictions.

Finally, the interaction between capital buffers and MREL needs to be considered not only at group level, but also at a resolution group and subsidiary level, for example how consolidated group capital buffers interact with MREL at another entity in the group. This is particularly important for banks subject to a multiple point of entry ("MPE") resolution strategy. Specifically, under MPE, in accordance with the TLAC Standard and as discussed further below, MREL would be expected to apply to resolution groups and not on a group consolidated basis. It is therefore important to clarify the interaction between the regulatory capital requirements which currently apply on a consolidated basis with the MREL requirements which are expected to consist of aggregated local requirements applicable to resolution groups. For MPE banks, it would not be appropriate to apply group buffers at each resolution entity level especially where they are not relevant, e.g. where a group systemic buffer is applied to a resolution group that is not deemed to be systemic in its own right.

While it would not resolve our concerns above, one additional measure that could be considered is the concept of MREL guidance. While we do not believe that it makes sense to "copy across" the Pillar 2B capital concept for MREL, by having a portion of MREL set as a 'buffer' or guidance sitting on top of capital buffers, this could reduce the impact of buffers sitting on top of all MREL. In the event that MREL guidance is introduced, a clear framework and set of harmonised criteria for any such guidance is necessary to ensure the consistency of application across the EU. Its purposes and operation would also need to be clear to investors.

However these issues are addressed it is essential that there is a clear and consistent framework which is well understood by investors. While we acknowledge that these issues also relate to the capital framework, we encourage the EBA to consider them further in their final report in light of

their importance to the MREL framework and the consequences of a breach of MREL, as discussed further below.

We agree with the EBA's provisional view that interactions between MREL and the NSFR at the consolidated level do not give rise to a need for policy change at the current time. This should be kept under review as the MREL framework is finalised and implemented. However, it is important to carefully consider the relationship between internal MREL and the NSFR. For example, internal MREL requirements could result in stable funding being trapped in subsidiaries, which could not be deployed elsewhere in the group, reducing flexibility and potentially increasing overall requirements for stable funding. The EBA should therefore consider the interaction between the NSFR and internal MREL further in its final report.

3. Breach of MREL

AFME supports the view that a breach or likely breach of MREL should be treated seriously. The ongoing need for firms to have sufficient resources to implement their resolution strategy should be met at all times, but the response of the authorities should be tailored to address the cause of the breach.

As discussed above, a breach of MREL may result from different causes to a breach of capital and there should be appropriate flexibility for the authorities to respond appropriately to the relevant situation. A breach of MREL can occur because of a failure to rollover debt and does not necessarily result from losses or signal a situation where the solvency of the bank is threatened.

Where a breach of MREL occurs alongside a breach of capital requirements, the existing legislative framework provides authorities with sufficient powers to address this. Where a breach of MREL does not involve a breach of capital requirements, resolution authorities should assess the cause of the breach and agree a plan with the institution to remedy the breach, in close coordination with the competent authority. Such a plan should provide an appropriate timeframe in which the institution should restore its MREL position, taking into account the cause of the breach, market conditions and the availability of other bail-in-able liabilities. This timeframe should allow the institution time to remedy the breach without threatening its resolvability as it is likely that there will be a significant amount of liabilities with a maturity of less than 12 months but which are otherwise eligible for MREL. The minimum 12 month remaining maturity for MREL instruments should provide the authorities with, in effect, a "maturity buffer" during which the MREL position can be restored. While it could be clarified, we consider that the existing powers under article 17 BRRD are sufficient to enable this.

It is crucial that competent and resolution authorities closely coordinate in relation to any actions to avoid any inconsistency or duplication and we support the EBA's provisional recommendation that they should closely cooperate and coordinate.

In answer to the consultation question as to whether and when the competent authority should be able to assess whether a firm is failing or likely to fail, we believe that the current BRRD provisions and EBA guidelines on failing or likely to fail should be sufficient. We do not believe that there should be an automatic trigger for such a determination and while a breach of MREL could clearly be a factor that the authorities wish to consider, it should not automatically result in a determination that the

institution is failing or likely to fail. Responsibility for the assessment of this should primarily rest with the competent authority, which would be required to closely coordinate with the resolution authority.

4. Approval for redemption of MREL-eligible liabilities

We do not believe that it is appropriate to extend the existing approach for approval of redemptions, repurchases, or reductions of capital to non-capital instruments.

If introduced, we support the approach provided for in the TLAC Standard that approval for redemption should only be required if the redemption would lead to a breach of TLAC requirements and propose that this approach should be adopted for MREL to supplement the existing approval requirements for own funds under the CRR. This would provide banks with greater flexibility to manage their issuances and facilitate the ability of banks to be market-makers in their own eligible instruments, which is important to support a liquid market. It would also be more manageable for the authorities given the volumes involved. We do not believe that it is necessary or proportionate for regulatory approval to be sought for every redemption of MREL-eligible instruments where the institution retains sufficient eligible liabilities to meet its requirements.

5. Eligibility

We support the alignment of the MREL eligibility criteria with the TLAC Standard, subject to the discussion of subordination requirements below. This would provide greater clarity and consistency as to the eligibility criteria, enhancing comparability and market discipline.

One area that we encourage the EBA to consider further is the treatment of structured notes. We believe that certain structured notes are clearly loss absorbing and the operational and valuation challenges can be overcome such that there should not be a blanket exclusion from MREL. Structured notes comprise an important source of unsecured funding for many banks and can provide an additional source of loss-absorbing capacity, potentially assisting banks in meeting the shortfalls identified in the EBA's quantitative analysis. In the event that structured notes are treated as excluded liabilities, appropriate transitional provisions are required as discussed below.

We acknowledge the rationale for subordination of MREL where appropriate to support a credible and effective resolution strategy, increasing clarity for investors and avoiding potential no-creditor-worse-off-than-liquidation ("NCWOL") concerns. We support the implementation of the subordination requirement for GSIBs in accordance with the TLAC Standard.

We also support the EBA's provisional recommendation that subordination requirements should focus on establishing to which other liabilities MREL-qualifying liabilities need to be subordinated, rather than specifying the legal form of subordination and option (b) considered on page 60 of the Interim Report.

The scope of liabilities to which any subordination should be required should be aligned with the TLAC Standard, i.e. excluded liabilities. Unlike the TLAC Standard, the BRRD does not include a definition of "excluded liabilities" and importantly the scope of excluded liabilities under the TLAC Standard is different from liabilities that are not eligible for MREL under the BRRD. For example,

liabilities with a remaining maturity of less than 12 months, but which are not excluded from bail-in under article 44(2) BRRD should be permitted to be held *pari passu* with MREL, as they would be bailed in alongside MREL and would not give rise to any NCWOL issues. Accordingly, the concept of excluded liabilities should be incorporated into MREL and we encourage the EBA to recommend this in its final report.

As part of the implementation of the TLAC subordination requirement, the EU should implement the exemption from subordination of up to 2.5%/3.5% RWAs and the allowance for resolution entities to hold excluded liabilities of up to 5% of their external TLAC ranking *pari passu* with MREL as provided for in the TLAC Standard. In addition we propose that any additional excluded liabilities in excess of the 5% allowance should be assessed in accordance with article 3 of the MREL RTS.

It is also important for the EU to adopt the approach anticipated in the TLAC Standard of permitting existing capital issued by subsidiaries of resolution entities to be included towards the external TLAC of the resolution entity until 1 January 2022, in order to assist with implementation. In light of banks' existing structures and the proposed subordination requirements, failure to adopt this approach is likely to require a substantial volume of new issuance from holding companies in a compressed period during 2017 and 2018. Further transitional arrangements/grandfathering should also be considered. Without some grandfathering of "ineligible" instruments e.g. structured notes, some firms may inadvertently fall foul of the subordination requirements, which apply retrospectively to existing ineligible instruments with long maturities. The EBA's quantitative analysis highlights the transitional issues and the impact of subordination requirements on the financing needs. We therefore encourage the EBA to recommend the implementation of these provisions in its final report.

It should be ensured that any subordination requirement can be met through any of structural, statutory, or contractual means. We support the objective of seeking greater harmonisation of the creditor hierarchy for banks across the European Union to support an integrated single market and Banking Union. The objective should be the harmonisation of the outcome of subordination in a manner that can be clearly understood by investors, that provides for the least negative impact on funding costs and that supports the rapid creation of a deep and liquid European market for subordinated liabilities.

We also strongly support the EBA's provisional recommendation that "*regardless of whether additional subordination requirements are introduced, ... relevant information should be available to bank creditors on banks' creditor hierarchies and the effects of national insolvency law*."

As noted in the GFMA/IIF response to the Basel consultation on Pillar 3[3], we agree that the disclosure of MREL will be important to enable investors to have greater clarity regarding the likely resolution strategy and the impact that a resolution is likely to have on them. Greater clarity is required to support market discipline and enable ratings agencies and investors to appropriately price risk, which will ultimately be reflected in the price of banking services and products to end users. Appropriate disclosure is necessary to support the market for MREL issuance, particularly in the current market conditions. However disclosure requirements should only apply once the final framework and requirements are clear. Disclosure prior to this point could be unhelpful and be

[3] Available at, http://afme.eu/WorkArea/DownloadAsset.aspx?id=14232

misinterpreted by investors. For this reason an appropriate transitional period for disclosure is required.

We encourage the European authorities to apply the international disclosure standards once finalised by the BCBS to avoid divergence between the EU and other jurisdictions. The finalisation of disclosure standards for MREL should take into account the comments provided by the industry during the Basel consultation process. The EBA together with European institutions and authorities should work with the BCBS and the industry to determine how to coordinate disclosures regarding the creditor hierarchy, regulatory capital stack and the quantum of eligible MREL.

In relation to the availability of standardised information on statutory creditor hierarchies, we suggest that resolution authorities should be required to explain the creditor hierarchy in a simple and uniform manner to assist investors.

6. Third country recognition of resolution powers

We welcome the consideration of third country recognition of resolution powers in the Interim Report. We have been highlighting our concerns regarding the scope of Article 55 for some time.[4] We strongly support the EBA's provisional recommendation that a reduction of the burden of compliance with third country recognition requirements is necessary. We also broadly agree with Option iii set out in the consultation, namely that this should be achieved by narrowing the scope of the requirement while maintaining the effectiveness of contractual recognition for MREL instruments. This is the approach that should be adopted through the forthcoming legislative proposal.

We summarise below a number of the areas of practical difficulty arising from the current scope of Article 55 and our proposed approach to address these issues.

We are very supportive of the development of an effective cross-border resolution framework and the need for resolution to be effective in respect of liabilities governed by the law of another jurisdiction. It should be borne in mind that a framework for statutory recognition of foreign resolution actions, as required by the FSB Key Attributes of Effective Resolution Regimes for Financial Institutions and the FSB Principles of Cross-border Effectiveness of Resolution Actions[5], should be the primary objective. However, we recognise that until such a statutory framework or binding agreements are put in place in the key jurisdictions, contractual recognition plays an important role in ensuring an effective cross-border resolution strategy.

AFME and other associations have sought to assist with the implementation of Article 55, for example by developing model clauses[6] meeting the requirements of Article 55 and the relevant Regulatory Technical Standards. Our members have also undertaken very extensive exercises to implement the

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[4] See, for example, AFME paper on contractual recognition of bail-in, April 2014; AFME paper highlighting concerns with the scope of article 55 BRRD, 18 June 2015; AFME letter to resolution authorities and Member States regarding implementation of article 55 BRRD, 30 October 2015; AFME response to EBA consultation on draft RTS, February 2015.

[5] See http://www.financialstabilityboard.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf

[6] See http://www.afme.eu/documents/AFME-Model-Clause-for-the-contractual-recognition-of-bail-in/

requirements of Article 55. However, despite these efforts a number of practical difficulties arise from the scope of Article 55 which extends significantly beyond MREL instruments and includes a number of categories of contracts where the lack of a contractual recognition clause would not affect the resolvability of the bank.

AFME's members have undertaken a thorough analysis of the contracts which are within the scope of Article 55 and identified the following categories as presenting particular challenges:

a) contracts where there is no realistic possibility of inserting the relevant provisions – and in some cases, it is not clear what these would achieve. Examples include trade finance and membership of financial markets infrastructure which are discussed further below; and

b) contracts where there is resistance from the local regulatory authorities to any change in the terms, for example uninsured corporate deposits of a branch of a bank outside the EEA, which are governed by local law.

Numerous categories of contracts can fall within the current scope of Article 55. Some examples of the types of agreement which cause the greatest difficulties include:

a) Trade finance, which since 1933, has been governed not by national laws but by protocols developed by the International Chamber of Commerce. As highlighted by the UK Treasury: "*The use of international standard documentation and rules, the practice of having no express choice of governing law of contracts, the legal nature of certain finance liabilities and the inability to impose unilateral changes to a contract because of the dominant bargaining position of non-customers makes it practically impossible for banks to add contractual bail-in terms to some types of trade finance liabilities. This may affect the ability of EU banks to offer trade finance to clients, or the attractiveness of that trade finance to investors, and therefore reduce the number of transactions. The impact on SMEs is likely to be disproportionate as they are less likely to be in a position to access trade finance solutions from non UK/EU banks or other market participants. Compliance with the contractual documentation will also require banks to renegotiate tens of thousands of contracts with little corresponding financial stability benefit ... it is therefore questionable whether bailing [trade finance liabilities] in would contribute to the recapitalisation of the bank. Attempting to bail-in trade finance liabilities is therefore unlikely to have a significant positive impact on recapitalising a firm and would damage the provision of trade finance. A requirement to include contractual clauses of the type required by Article 55 could lead to a fall in the number of trade finance transactions that can be undertaken by EU banks, as it is not possible to add contractual bail-in terms to certain trade finance liabilities.*"[7] Trade finance provides a vital form of financing for the real economy and is important to support growth.

[7] See HM Treasury response to the European Commission Call for evidence on the EU regulatory framework for financial services, February 2016, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/496887/PU1903_HMT_response_to_EU_consultation.pdf at p.4.1

b) Agreements with financial markets infrastructure outside the EU, including central counterparties ("CCPs"): it is not possible for banks to unilaterally amend the membership rules for CCPs outside the EU. It is also likely that bail-in of such liabilities could in any event be counterproductive and inconsistent with the goal of maintaining access to financial markets infrastructure and the resolution objective to continue critical economic functions. Again, as highlighted by the UK Treasury, "*EU banks are required (by Article 55) to seek to amend their contracts with non-EU CCPs to include a clause acknowledging that the contract may be subject to bail-in. As it is very likely that liabilities to a non-EU CCP would be subject to a discretionary exclusion by the resolution authority, this has limited benefit and comes with considerable costs to the European bank. It may also cause non-EU CCPs to examine more closely the risks that they are exposed to in the case of bank failure and reassess their appetite for accepting European banks as clearing members*."[8] The Bank of England has also stated that as a consequence of Article 55 "*There is a risk that access of European firms to clearing, payment and settlement systems in third countries - and thus to the markets they serve - would be restricted.*"[9]

c) Contracts and other arrangements that give rise to a contingent liability eg letters of credit, guarantees, commitments to lend, undertakings and indemnities. This potentially extends to a very broad range of agreements. In practice, contingent liabilities are unlikely to be bailed in because of their contingent nature and their uncertain value.

d) Operational and administrative liabilities that cannot be readily negotiated such as contracts for supply of goods and services entered into on a counterparty's standard terms, contracts governed by standard terms under local law (eg purchases of land, leases, utilities etc) or with foreign public authorities, and underlying documentation in respect of debt securities traded on the secondary market.

e) Challenges also arise in relation to liabilities that are documented through SWIFT messages, are agreed verbally (such as spot currency payment vs delivery obligations) or arise under market conventions which would be difficult to amend.

Banks are unable to unilaterally impose contractual terms in relation to many of these categories of liabilities. Including contractual recognition provisions in contracts governing secured liabilities, liabilities which are likely to be excluded from bail-in under discretionary exclusions and operating liabilities also sends a confused message to counterparties and could cause undue concern as to the risk of bail-in, particularly in jurisdictions where bail-in is a foreign concept. It is important to note that other jurisdictions outside the EU do not require contractual clauses for this broad range of liabilities, potentially leaving European banks at a significant competitive disadvantage. Moreover, the scope of Article 55 as currently drafted includes liabilities that are very unlikely to be bailed-in

[8] Above, at p.60.
[9] See Bank of England response to the European Commission Call for evidence on the EU regulatory framework for financial services, February 2016, available at: http://www.bankofengland.co.uk/financialstability/Documents/regframework/detailedanswers010216.pdf at p.12.

in practice and do not contribute significantly to the loss absorbing capacity of the bank. There is therefore a lack of proportionality between the operational challenges of implementing the clause for certain types of liabilities and the benefits in terms of loss absorbency and resolvability, which are, ultimately, the objectives of Article 55.

A number of resolution authorities have recognised these problems and have taken a pragmatic approach to implementation. This has been very welcome but there remains significant uncertainty and potential for divergent approaches being taken in different jurisdictions within the European Union. In addition, the current scope of Article 55 and the relevant RTS give rise to a number of areas of legal uncertainty as to which contracts are within scope and areas of difference in implementation between Member States.

Therefore, while helpful, the steps taken by resolution authorities are not a substitute for the changes to the BRRD which would be necessary to address the acknowledged problems with the scope of the requirement. A clear and consistent approach across the European Union is required to provide banks and counterparties with a clear and workable solution.

We suggest that the focus of the regulators should be to ensure the credibility and feasibility of banks' resolution plans. Accordingly, the scope of Article 55 should be considered in this context and the rather than a broad requirement which is applicable to every liability that could theoretically be bailed in. This context should be considered in light of the MREL framework which will provide a substantial quantity of high quality loss absorbing and recapitalisation capacity and we wouldn't expect contractual recognition requirements to extend to excluded liabilities as defined in the TLAC Standard, for example. The current scope goes beyond what may be required to ensure that a firm is resolvable and such additional scope is, we suggest, inconsistent with the principle of proportionality.

Article 55 should therefore be amended to align it with the scope proposed in the FSB Principles for Cross-border Effectiveness of Resolution Actions and the TLAC Standard.[10] These principles, together, provide that contractual recognition of bail-in requirements should apply to relevant liabilities in order for them to be eligible for TLAC and any other "debt instruments".

We therefore propose that the scope of Article 55 should be limited to MREL and any other debt instruments that can be bailed in.

When considering the scope of contractual recognition requirements, it should be borne in mind that such requirements are in addition to the general powers of resolution authorities to require firms to address impediments to resolvability. These powers include requiring firms to include contractual recognition clauses in any other contracts where they believe that this is necessary to ensure the resolvability of the firm. Our proposal would therefore mean that the scope would include (save where the resolution authority is satisfied that recognition can be achieved under the law of the third country or a binding agreement):

a) all liabilities that are eligible for MREL which are governed by non-EU law;
b) all other debt instruments which are governed by non-EU law; and

[10] See paragraph 13 of the TLAC Standard.

c) any additional liabilities identified by the resolution authority where the absence of contractual recognition requirements creates an impediment to resolvability.

The need to consider cross-border recognition in the context of the resolution plan is also highlighted in the recent FSB Report to the G20.[11] Our proposed approach, similar to option iii discussed at page 62 of the Interim Report, would provide a much clearer scope of liabilities and significantly reduce the burden on firms while meeting the objective of ensuring resolvability and bringing the European Union into line with the FSB guidance. Alignment with the internationally agreed scope is particularly important where inconsistencies in approach could severely impact the competitiveness of EU banks operating in global markets.

In addition to the limitation in scope, which should be the primary objective, consideration should also be given to providing resolution authorities with express powers to grant waivers where they believe that this is appropriate based on certain criteria eg impracticability, proportionality and not threatening resolvability, so as to take into account the variety of bank structures and national insolvency regimes across the EU. Amending the scope is essential and a supplementary waiver regime would ensure that the requirement can be properly tailored to a bank's resolution strategy whilst still ensuring resolvability. However, the power to grant waivers should not been seen as a substitute to the proposed amendment to the scope of Article 55. A waiver regime alone could not address all the burdens identified. If, despite our strong recommendation that the scope of Article 55 is not limited, alongside the provision of powers to grant waivers as we suggest, it is very important that these practical difficulties are minimised and that resolution authorities are provided with express powers to grant waivers where they believe that this does not threaten resolvability.

The EBA, European Commission, FSB and national authorities should also encourage other jurisdictions to introduce powers to recognise and give effect to EU resolution in those jurisdictions, similar to the power to recognise and enforce third country resolution proceedings under article 94 of the BRRD or through cross-border agreements as contemplated in article 93 BRRD. Where such recognition has been achieved, this should be clearly announced and communicated to industry so that firms are fully aware of the exemption that applies under the second subparagraph of article 55(1). These efforts should support the implementation of the Key Attributes and the FSB Principles for Cross-border Effectiveness of Resolution Actions. This is important to support cross-border resolution and the implementation of recognition powers in the major jurisdictions would go a long way towards addressing these issues.

7. Calibration of the MREL requirement

We strongly support the EBA's provisional recommendation that MREL should be closely linked to and justified by the institution's resolution strategy. Facilitating the resolution strategy is the primary role of MREL. As noted in section 9 of the Interim Report and discussed below, this principle should apply when considering the application within groups in the context of the group resolution strategy. Specifically, MREL should be applied on the basis of resolution groups in accordance with local requirements and their resolution strategy rather than necessarily on a group consolidated or

[11] Resilience through resolvability – moving from policy design to implementation, 5th Report to the G20 on progress in resolution, 18 August 2016, at section 3.

solo basis. This is particularly pertinent for groups with an MPE resolution strategy. We agree with the EBA's conclusion that while business models may have an impact on the resolution strategy for a group, it is the resolution strategy that should be the driver for MREL calibration.

We broadly support the current MREL assessment framework under article 45 BRRD and the MREL RTS which focuses calibration on the relevant resolution plan for the group, subject to implementation of the TLAC standard for GSIBs. We suggest that an appropriate approach to the review of MREL and any TLAC legislative proposal would be to establish a single framework applicable to all banks which implements the TLAC Standard for GSIBs and establishes a common framework for all banks. A single framework (acknowledging the need for certain factors such as calibration and subordination requirements to be set depending upon the relevant group and resolution strategy) would apply a consistent approach to loss absorbing capacity requirements across the EU and support cooperation with authorities outside the EU.

While the existing MREL calibration framework provides a good starting-point for this by assessing the quantum required to carry out the resolution strategy, we suggest that the following aspects of the existing framework should be reviewed:

a) As discussed above and in the Interim Report, the relationship between MREL and capital buffers should be clarified. We agree that "it is essential to be clear about the stacking order ... and calibration methodology" and that capital buffers should be stacked on top of MREL. However it is important that the calibration of overall MREL is reduced to take into account any elimination of double-counting of MREL and capital buffers. It is therefore necessary to amend the existing framework to expressly exclude capital buffers from both the loss absorption and recapitalisation amounts when calibrating MREL. An institution emerging from resolution should not be required to immediately meet all capital buffer requirements. This would be consistent with the purpose of buffers and reflect the fact that the institution has been through a resolution.

b) When assessing the recapitalisation amount, authorities should be required to take into account the inherent assumption that banks would have no equity remaining at the point of resolution, which even if additional losses have to be taken during resolution, remains a highly conservative starting point. The recapitalisation amount should also reflect the depletion of the size of the balance sheet that is likely to occur in the lead up to resolution. Losses suffered in advance of resolution would deplete the value of the assets of the entity, reducing its RWAs and leverage exposure and this is recognised in the US Federal Reserve's proposed TLAC implementation. The application of recovery measures is also likely to reduce the size of the balance sheet ahead of resolution, for example through disposals. Accordingly the size of the bank to be recapitalised at the point of resolution is likely to be smaller and this should be considered when calibrating an appropriate recapitalisation amount.

c) The recapitalisation amount should also reflect expected changes in group structures upon the application of recovery measures and changes in capital requirements (including Pillar 2 requirements) for the firm following the resolution. These changes should be assessed as part of the resolution planning process and in discussion with the competent authority. As a result,

existing Pillar 2 capital requirements should not automatically form part of the recapitalisation amount because Pillar 2 risks may no longer be relevant for a bank following resolution.

d) We do not believe that it is necessary for the recapitalisation amount to require an additional buffer for market confidence purposes. The resolved institution should meet minimum regulatory capital requirements, remain authorised and its assets will have been significantly "cleaned up" following the recognition of losses through the fair, prudent and realistic valuation required in resolution and this, together with appropriate statements from the authorities and confirmation of access to central bank liquidity support, should be sufficient to maintain market confidence in the resolved institution.

e) Requirements should be aligned with the resolution strategy and should take into account that some entities within a group may not be recapitalised under the group resolution strategy (for example non-material entities that would be wound up). Such entities should not contribute to MREL requirements for the group and their assets should be excluded from consolidated requirements at a resolution entity or material sub-group.

We strongly support the EBA's provisional recommendation that "*firm specific requirements should be set only at levels necessary to implement the resolution strategy*". For GSIBs, a common minimum should be aligned to the TLAC Standard and any additional requirement should be duly justified by reference to the resolution strategy for the group.

Finally, consideration should be given to the potential impact on MREL calibration arising from potentially very substantial increases in RWAs under the capital standards agreed and proposed at the Basel Committee since the TLAC Standard was finalised, for example those relating to market, credit and operational risk and output floors.

We encourage the EBA to address these issues in its final report.

8. Calibration and access to resolution funds

As discussed in the Interim Report and in relation to the RTS, we understand that some resolution authorities are considering requiring MREL to be calibrated to at least 8% of total liabilities and own funds in order to ensure that it is possible to access resolution financing arrangements for solvency support. We believe that this is the wrong starting-point for calibration and agree with the focus and structure of the existing framework and the RTS, i.e. on the delivery of the resolution strategy for the group. The focus should be on resolvability and achieving the resolution objectives without the need to use resolution funds to absorb losses. We strongly support the EBA's provisional recommendation that "*firm specific requirements should be set only at levels necessary to implement the resolution strategy*". It follows that the threshold for the use of resolution funds for solvency support is only relevant where this forms part of the resolution strategy.

We agree that, as highlighted in the Interim Report, there is no mandatory relationship between MREL and the 8% threshold and there is a significant difference in scope between MREL eligibility and the scope of "bail-in-able" liabilities. Further, resolution funds can only be used for indirect

recapitalisation and then only in certain specified "exceptional" circumstances, so this form of recapitalisation does not seem appropriate for consideration in resolution planning for a wide range of scenarios. We therefore strongly support the statement that any assessment of the relevance of the threshold "has to be made taking into account all liabilities eligible (in full or in part) for bail-in, not only MREL-eligible instruments" and this should be made expressly clear in the legislative framework. As the Interim Report highlights, "*applying the [8%] threshold on an indiscriminate basis as a mandatory floor for a large set of banks would be costly*". This is demonstrated by the EBA's quantitative analysis which estimates a shortfall of €790 billion in this scenario and states that 95% of this shortfall would fall on GSIBs and O-SIIs[12]. It is our strong view that the 8% should not be viewed as a "cap" or a "floor" for MREL and the delineation of MREL from the need to use resolution funds should be expressly set out in the BRRD.

In addition, we agree with the EBA that, to the extent that it is retained, the notion of total liabilities and own funds which is used in the BRRD requires clarification (eg for the 8% threshold). We support the introduction of a definition of liabilities reflecting the full recognition of netting rights (full contractual netting as discussed at page 34 of the Interim Report), which better reflects the value of such instruments in resolution.

9. Intragroup issues

It is essential that MREL is set in accordance with the resolution strategy for the group. We welcome the EBA's initial discussion of intragroup issues in the Interim Report and the commitment to include a fuller discussion in the final report. This is an area where the work at the FSB has significantly advanced the principles on aligning the location of loss absorbing capacity with the resolution strategy and supporting cross-border cooperation. Further work on additional guidance on internal TLAC is underway and this work should also be taken into account when finalising the MREL framework. It is vital that there is clarity on the approach for setting internal MREL requirements as this will have significant implications on the amount of overall issuance that is required.

We support the adoption of the concept of internal TLAC and the distinction between external MREL requirements at resolution entities and internal MREL at material subsidiaries/sub-groups. This would better align MREL with the resolution strategy, enhance resolvability and support cross-border cooperation. It is important to ensure that such concepts are clearly defined within the BRRD level 1 text to ensure consistency of application.

It should be a core principle of the framework that MREL requirements are calibrated in accordance with the resolution strategy for the group and this should be given greater emphasis than under the existing RTS. We strongly support the adoption of the concepts of resolution entity and resolution group and external and internal MREL as applied in the TLAC Standard and recommend that these are expressly incorporated into the MREL framework. A framework based on external MREL at resolution entities and internal MREL at material sub-groups would be much clearer than the current application of consolidated and solo requirements. The current consolidated group requirement for MREL under the BRRD is particularly inappropriate for groups with an MPE resolution strategy.

[12] See page 59 of the Interim Report.

External MREL should only be required at resolution entities in order to support the group resolution strategy and this should be expressly set out in the legislation. This, together with the adoption of the concept of internal MREL at material sub-groups as discussed below, would better align loss absorbing capacity arrangements with the group resolution strategy, enhancing resolvability and facilitating cross-border cooperation.

9.1 Internal MREL

While the allocation and calibration of MREL across groups could potentially be done under the existing MREL framework, we believe that greater clarity is required as to how MREL should be allocated and internal MREL calibrated. This would provide greater clarity for banks, investors and counterparties, and promote consistency across the EU and with third countries. We therefore propose that a concept of internal MREL should be introduced for all banking groups in line with internal TLAC.

As stated in the TLAC Standard, "the primary objective of internal TLAC is to facilitate co-operation between home and host authorities and the implementation of effective cross-border resolution strategies by ensuring the appropriate distribution of loss-absorbing and recapitalisation capacity within resolution groups outside of their resolution entity's home jurisdiction"[13].

9.2. Scope of internal MREL

The scope of internal MREL requirements should be aligned with the scope set out in the TLAC Standard i.e. at material sub-groups. As set out in the TLAC Standard, a material sub-group consists of one or more direct or indirect subsidiaries of a resolution entity that:

a) are not themselves resolution entities;
b) do not form part of another material sub-group;
c) are incorporated in the same jurisdiction outside of their resolution entity's home jurisdiction unless the Crisis Management Group (we suggest the resolution college for non-GSIBs) agrees that including subsidiaries incorporated in multiple jurisdictions is necessary to support the agreed resolution strategy and ensure that internal TLAC is distributed appropriately within the material sub-group; and
d) either on a solo or a sub-consolidated basis meet at least one of the following materiality criteria:
    i. have more than 5% of the consolidated RWAs of the group;
    ii. generate more than 5% of the total operating income of the group;
    iii. have a total leverage exposure measure >5% of the group's consolidated leverage exposure; or
    iv. have been identified by the CMG (or we suggest resolution college for non-GSIBs) as material to the exercise of the group's critical functions.

This definition should be applied in the revised MREL framework. As required by these criteria, material sub-groups are only located in a jurisdiction outside of the resolution entity's jurisdiction.

[13] See paragraph 16 of the TLAC term sheet.

Consideration should be given to how this should work within the European Union and the Banking Union in light of the BRRD framework for group resolution planning, resolution colleges and automatic recognition of resolution actions. We believe that at a minimum there should be no requirement for internal MREL between resolution entities and material sub-groups within the Banking Union in light of the single supervisor and single resolution authority which should remove home/host concerns.

Subparagraph iv of the materiality criteria enables resolution authorities to identify additional subsidiaries of resolution entities that are material to the exercise of the group's critical functions. This should be done through the group resolution planning process and agreed through the CMG and resolution college. Importantly the composition of material sub-groups is required to be reviewed by the home and host authorities within the CMG. Branches should not be subject to internal MREL requirements separate from any requirement applied to the legal entity of which they form a part.

It is necessary for the EU to implement internal TLAC for GSIBs and we believe that the adoption of these principles for all groups would significantly improve upon the existing MREL structure and provide an appropriate balance between the interests of home and host authorities. It would also align the European Union with the global standard and facilitate cross-border cooperation with third countries.

The EU should also implement the TLAC principles regarding cooperation with authorities in jurisdictions outside the EU, both in relation to banks headquartered outside the EU with operations in the EU and banks headquartered in the EU with operations in third countries. The generally applicable principles of the external MREL at resolution entities and internal MREL at material sub-groups should apply equally to firms headquartered within and outside the EU.

It is also important that there should be no additional external or internal MREL requirements in excess of minimum regulatory capital requirements at entities that are not resolution entities or part of a material sub-group. This should be clarified and the existing solo requirement should either be replaced or if retained, should expressly provide for this. While internal MREL at material sub-groups should facilitate the group resolution as noted in the Interim Report, additional requirements would duplicate and increase requirements without improving resolvability, reduce flexibility to enable funds to be transferred to where they are needed and could lead to greater fragmentation.

9.3 Calibration of internal MREL

The TLAC Standard requires that each material sub-group must maintain internal TLAC within a range of 75% to 90% of the external minimum TLAC requirement that would apply to the material sub-group if it were a resolution group, with the calibration within this range being determined by the host authority in consultation with the home authority of the resolution group. As stated in the TLAC Standard, internal TLAC "*should be sufficient at this level to facilitate effective cross-border resolution strategies*"[14].

[14] Paragraph 18, TLAC Standard.

We support the implementation of this requirement for the calibration of internal MREL at material sub-groups of GSIBs in the EU. For consistency we also recommend that these calibration principles are applied to material sub-groups of all groups in the EU.

Appropriate adjustments should also be applied to avoid consolidation effects which could mean that the sum of the requirements set for individual entities within a resolution group is greater than the external MREL requirement applied at the consolidated level of the resolution entity. These consolidation effects would, unless addressed, increase requirements[15].

9.4 Eligibility criteria for internal MREL

The eligibility criteria for internal MREL should generally be aligned with the TLAC principles i.e. subordinated instruments that absorb loss without the need to place the relevant subsidiary into resolution, as discussed in the Interim Report.

However the flexibility to use instruments that are not fully pre-positioned on the balance sheet of the subsidiary, such as capital contribution agreements, guarantees or other contractually binding mechanisms, should be accommodated through revisions to the existing framework. This would avoid requirements which could lead to unnecessary excess funding, for example in subsidiaries which are self-funding through deposits.

The approach to guarantees should be based upon discussions in the resolution college/Crisis Management Group taking account of issues such as the availability and quality of collateral, preference in the creditor hierarchy etc.

The eligibility criteria for internal MREL should not require instruments to be issued directly to the resolution entity. Such a requirement would prevent internal MREL being issued to, for example, an intermediate holding company, which might be necessary to hold internal MREL within a material sub-group. It is not necessary for internal MREL to be issued directly to the resolution entity in order for MREL to support the resolution strategy.

Whilst we understand that internal MREL instruments should be subject to write-down and/or conversion without the need for the subsidiary to enter resolution proceedings, it is vital to understand how this interacts with other regulatory capital that is intended to convert at the point of non-viability, namely Additional Tier 1 and Tier 2. It is important that the creditor hierarchy is preserved and therefore write-down or conversion of non-regulatory capital MREL should occur only after capital instruments. As discussed in the Interim Report, consideration should be given to the need for contractual triggers (including for guarantees) or the extension of the scope of the power under article 59 BRRD to include MREL instruments other than own funds to address this.

10. Treatment of holdings of MREL

While not addressed in the Interim Report, it is vital that the treatment of cross-holdings of MREL is considered following the finalisation of the BCBS work on the treatment of TLAC holdings. As

[15] The need for an adjustment is acknowledged in the TLAC Standard (see para. 18).

highlighted in the GFMA response[16] to the BCBS consultation, while we agree with the goal of avoiding contagion, it needs to be ensured that cross-holdings treatment does not adversely affect the market for TLAC, for example by penalising market-making in TLAC instruments. We have therefore suggested a "like-for-like" deduction from TLAC and the inclusion of an express dealer exemption for market making purposes amongst other comments. The treatment of TLAC holdings will undoubtedly have a significant impact on overall levels of MREL issuance, especially if this is intended to be deducted from Tier 2, as was proposed by the BCBS for consultation. It is necessary to gain clarity on this in a timely manner, with sufficient opportunity provided for public consultation given the implications policies in this area may have on total MREL issuance.

Such issues should be addressed in the final report to support an effective resolution framework in which contagion risk is addressed in a manner that supports a well-functioning, deep and liquid market in TLAC. We strongly encourage the EBA to consider how the final standard should be implemented in the EU following its finalisation and would welcome assessment of the impact on banks in the EU.

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[16] The GFMA/IIF response is available at http://www.afme.eu/WorkArea/DownloadAsset.aspx?id=13829. A summary of AFME's key comments is also available at http://afme.eu/WorkArea/DownloadAsset.aspx?id=14343