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Finance for Europe

Resolution aspects of the EU Risk Reduction Measures Package

October 2018

Association for Financial Markets in Europe
www.afme.eu

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Introduction

The Association for Financial Markets in Europe (AFME) [1]welcomes the efforts of the co-legislators to move ahead to the trilogue phase in the Risk Reduction Measures (RRM) package. This paper sets out our views on the resolution aspects of the proposals following the European Parliament's Final Report, and the Council of the European Union's General Approach. There are several key topics relevant to resolution within the package, including the implementation of the FSB Total Loss-Absorbing Capacity (TLAC) Standard, [2]amendments to the Minimum Requirement for own funds and Eligible Liabilities (MREL), and other issues such as the provisions for a new pre-resolution moratorium tool.

Key considerations

AFME has been very supportive of the development of an effective recovery and resolution framework in Europe and closely involved in the implementation of the BRRD, development of TLAC and related issues. We strongly support the objectives of the proposals to ensure there is an effective and credible resolution regime in place in the EU. We encourage co-legislators to take into consideration several principles when approaching trilogue discussions to help ensure this objective is met, these include:

i. **Avoiding excessive requirements:** It is vital that the objective of the legislative package is achieved with only the requirements that are necessary to achieve it. It is essential that MREL is calibrated to implement the TLAC Standard for GSIBs and provide an appropriate calibration to support resolvability under the group resolution plan. Setting MREL beyond the levels necessary to achieve resolvability, e.g. to ensure access to the Single Resolution Fund, or requiring more subordination than is needed, is excessive. Placing unnecessary burdens and costs on the industry, and in turn ends users, will have a negative impact on the wider European economy.

ii. **Minimising fragmentation:** There are significant requirements proposed within the internal MREL framework that risk increasing fragmentation of banking groups across Member States despite their participation in the Single Market. This is a further concern with regard to limitations on the use of waivers, especially where these are not automatically applied within the Banking Union. It is in the co-legislators' interests to not damage the competitiveness of European financial institutions by increasing such fragmentation across both the Banking Union and European Union as whole[3].

iii. **Considering the global context:** The proposals that implement a resolution framework within the EU should also reflect upon the requirements being placed on similar entities in other key jurisdictions. Going beyond what is required globally will unnecessarily undermine the competitiveness of European financial institutions. Where global requirements have been agreed these should be faithfully transposed, such as the requirements for internal TLAC for third country GSIIs operating in the EU. Doing so will also help strengthen cooperation amongst global authorities and regulators.

iv. **Simplicity:** Co-legislators should seek to deliver a final legislative text that is not overly complex. It should provide clarity for firms within scope of the requirements, so that they are able to anticipate their requirements and plan ahead accordingly. It should also be simple enough for other market participants to understand easily, particularly investors that will seek to develop views on MREL and MREL requirements to inform investment decisions and pricing. The final text must also be clear enough for authorities to deliver on the intentions of the requirements without any divergence of application as a result of differing interpretations of the law.

[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 listed on the EU Transparency Register, registration number 65110063986-76.

[2] See Financial Stability Board, TLAC Principles and Term Sheet available at http://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf

[3] As expressed also by EBA Chairperson Andrea Enria in his speech on fragmentation in banking markets – see EBA https://www.eba.europa.eu/documents/10180/2353431/Andrea+Enria+speech+on+Fragmentation+in+banking+at+BCBS-FSI+High+Level+Meeting+170918.pdf

v. **Timeliness:** It is essential that an agreement that delivers on all of the above is met in a timely fashion. In particular the transposition of the FSB TLAC Standard where initial requirements are due to be met on 1 January 2019. It is vital that these requirements are accompanied by other necessary measures to aid firms in meeting them, specifically the provision of adequate grandfathering from 1 January 2019 for eligible liabilities and capital instruments in light of the additional criteria that are envisaged beyond those set out in the FSB TLAC Term Sheet**.**

We hope that the co-legislators and relevant authorities share these objectives. In this context, we set out below key priority issues which we believe should be addressed in trilogues by the co-legislators:

i. **External MREL – calibration**

AFME supports the Pillar 1 calibration of external MREL in line with the TLAC Standard, and the proposed calibration of Pillar 2 external MREL based on the concepts of loss absorption and recapitalisation.

Key concerns under the proposals to calibrate MREL levels include the possibility to benchmark MREL calibration at the 8% Total Liabilities and Own Funds level, as well as the inclusion of a mandatory Market Confidence Buffer (MCB). These elements seek to artificially increase MREL above and beyond the levels necessary to ensure resolvability and may be interpreted as minimum levels of Pillar 2 MREL, ignoring the specific circumstances of the individual firm in question. Our concerns on these issues, and others, are set out under Section 2.

ii. **External MREL – subordination**

The contrasting positions put forward by the co-legislators with regards to MREL subordination represent potentially the greatest difference in approaches across the entire package, and this is not without significant concern. The highly complex and strict approach suggested by the Council in particular is one that AFME does not support. We believe that the Parliament approach that has been put forward offers a preferable approach to subordination compared to the Council position. This is further elaborated under Section 3.

iii. **Internal MREL**

One of the more technical but certainly one of the most fundamental aspects of the resolution framework, internal MREL requirements are far reaching in scope and impact. We highlight below our key concerns regarding the calibration of internal MREL both under the CRR and BRRD – specifically on the need to scale the requirements, as well as to ensure the usability of guarantees and waivers. There are also a number of technical matters that need to be addressed in the final legislation. These are explained further under Section 4.

iv. **Eligibility Criteria**

The determination of the criteria that will define what is MREL eligible is key not just for external issuances, but for meeting internal MREL requirements also. Specific criteria that go beyond those set out in the FSB's TLAC Standard create problems that are yet to be fully addressed (e.g. on the prohibition of acceleration rights), and elements of the criteria need to be further refined to ensure a sensible approach is taken forward for internal MREL instruments. These elements are set out under Section 5, with the closely linked topic of grandfathering following it under Section 6.

v. **Moratorium tools**

The proposals to include a new pre-resolution moratorium tool continue to concern the industry, as well as many authorities around the globe. The proposals put forward by co-legislators represent movement by both in the right direction. However, only the Council text fully delivers an acceptable compromise on both the proposed duration of the new tool, and the need to ensure the tool cannot be used in conjunction with existing stays. We comment on the proposals put forward in Section 7.

Other issues can be found beyond these key concerns, including on proposals for the contractual recognition of stays (Section 8), Article 55 requirements (Section 9), MDA restrictions (Section 10), MREL redemptions (Section 11), MREL cross-holdings (Section 12), and MREL reporting and disclosures (Section 13). Attached to this paper you will also find an annex related to the issue of MREL eligibility – specifically with regard to issuer call options and observed maturity.

1 Pillar 1 External MREL calibration

AFME supports the proposed calibration for the external common minimum requirement for GSIIs in line with the TLAC Standard (i.e. Pillar 1 External MREL), as reflected in both the approaches of the Council and the European Parliament. Transposing the calibration as per the FSB TLAC Term Sheet will ensure that the EU keeps to its commitment of implementing TLAC requirements.

However, it is important that clarity is provided elsewhere in a number of areas that accompany and build-upon this Pillar 1 External MREL requirement, as set out below. Examples include the eligibility criteria and transitional arrangements; not least because of the initial requirement coming into effect from 1 January 2019, but also to ensure the requirements are applied consistently throughout the EU, and with consideration given to the impact on European banks operating internationally.

2 Pillar 2 External MREL calibration

When considering the framework for the calibration of Pillar 2 firm-specific MREL:

- It is essential that MREL is calibrated to implement the TLAC standard for GSIIs;
- It is essential for calibration to be focused on the resolvability of the group under its preferred resolution strategy including the expected nature of the post-resolution entity;
- We do not believe that it is appropriate to include a reference to 8% Total Liabilities and Own Funds;
- Any Market Confidence Buffer needs to be carefully considered and clearly framed;
- It is important to consider the overall calibration and impact on the competitiveness of European banks in the global market place;

We believe that the Pillar 1 MREL requirement should be sufficient to achieve this for GSIIs and in any case, in order to avoid any level playing field issues with institutions outside the EU, the calibration of MREL should not lead to situations where institutions are required to have higher levels of MREL compared to requirements for comparable institutions in third countries.

Reference to 8% Total Liabilities and Own Funds (TLOF): The Council amendments to the original European Commission proposal include references to 8% TLOF when calibrating individual Pillar 2 MREL requirements. Referencing to this metric is not currently a target level when setting MREL under the existing BRRD, and nor should it become one. Pillar 2 requirements should not be subject to a minimum or target threshold and instead must be calibrated to the preferred resolution strategy of the specific firm – as is the nature of a Pillar 2 requirement. Taking an 8% TLOF target forward in the BRRD would prejudice a resolution authority's approach to setting Pillar 2 MREL requirements, the preferred resolution strategy of the firm, and risks setting a market expectation for Pillar 2 MREL requirements that may not fully reflect the circumstances of the individual resolution group.

Such an approach also fails to take into account what the 8% TLOF reference is for and what it refers to. Whilst the BRRD requires 8% TLOF to be written-down or bailed-in prior to an institution in resolution being able to have limited access to the Single Resolution Fund, this is not restricted to the write-down or bail-in of only MREL eligible instruments. All liabilities that are not explicitly excluded from write-down or bail-in under Article 44 of the BRRD are eligible to count towards this 8% metric were they to be written-down or bailed-in. It is therefore an error of logic to suggest that MREL needs to be calibrated to this level to secure access to the SRF, which is not itself a necessary prerequisite to ensuring a firm has a credible and effective resolution plan.

Expressing the 8% TLOF metric as some form of benchmark for this purpose is therefore likely to undermine the efforts made in the first BRRD to make clear all non-excluded liabilities are bail-in able and will be bailed-in or written down where necessary in the event of a resolution. Setting requirements and creating an environment that generates a market expectation that only MREL is to be written-down or bailed-in is inconsistent with the broader intentions of the framework and will reduce the market discipline that is sought in removing any implicit guarantee on bank issued liabilities.

The MREL requirement is to be set in terms of total risk exposure (i.e. Risk Weighted Assets), or the total leverage exposure measure (i.e. the Leverage Ratio). The use of TLOF as a metric to calibrate MREL requirements is inconsistent with this approach and is not consistent with the FSB term sheet.

Market Confidence Buffer (MCB): A key underlying element to this aspect of the calibration is the distinction between resolution and resurrection – MREL is not there to revive a failed bank that will be carrying identical risks, it is there to limit the impact of failure on the wider financial system and protect tax payers from the costs of handling – be that winding down, selling or recapitalising a failed institution into a viable business. As such the entity will be smaller after resolution, and this should rightly be factored into the MREL calibration in line with the preferred resolution strategy.

AFME notes that both co-legislators have removed the concept of MREL Guidance from the legislative proposal to amend the BRRD, which has consequently resulted in the MCB becoming a part of the calibration of the Pillar 2 MREL requirement.

We continue to believe that market confidence concerns should be adequately addressed by the recapitalisation meeting the applicable post-resolution entity's Pillar 1 and Pillar 2 capital requirements.

The approach taken to calibrate the recapitalisation amount, reflected in Article 45c, already provides a high level of conservatism as it assumes that losses will exhaust all capital prior to resolution. We therefore regard it as unnecessary to create a new buffer within the requirement which only serves to increase requirements. The proposals to introduce a MCB requirement fail to acknowledge that firms will run a management buffer on top of MREL requirements to ensure that they have an ongoing operational buffer that avoids any breach of the requirements.

Despite this, if the co-legislators decide to retain a MCB in the calibration framework, it is important that:

i. Any MCB is not mandatory and can be adjusted by resolution authorities to reflect the resolution strategy for the group;

ii. there should be a clear set of criteria for its application, depending on which it might be necessary to define a suitable limit or a cap on the level of the MCB as suggested by the European Parliament (i.e. at the Combined Capital Buffer Requirement minus institution-specific countercyclical capital buffer element), rather than having a predetermined level at which the MCB would begin; and,

iii. any application of an MCB should be required to be accompanied by a full justification for the level at which it is set, and an explanation of why an MCB has been required. It is crucial that this information is provided by the resolution authority, in order to ensure that resolution authorities are accountable for their decisions and transparent, that the regime is clear and applied consistently across the EU by different resolution authorities, but also that firms are able to understand why requirements are being placed on them.

We call on co-legislators to give greater consideration to this issue, especially in considering the value of any added benefit of an MCB for the purpose of maintaining market confidence in comparison to the ongoing burden it will place on institutions by inflating MREL requirements. This should also be considered more broadly as a part of the overall level of MREL required, particularly in comparison to other jurisdictions' calibration of TLAC requirements and the impact this has on the competitiveness of European banks.

Recognition of the post-resolution entity: AFME supports the changes that have been made in the proposals by both co-legislators to give recognition to the post-resolution entity when calibrating the recapitalisation element of Pillar 2 MREL. It is important to understand that the entity leaving resolution is likely to be smaller than the one which entered into it. The capital requirements required of that entity are therefore likely to be lower as a result, and this should be factored into the calibration of the MREL requirement. Failure to do so would have lead to artificially higher levels of required MREL, alongside the already conservative assumptions that no loss-absorbing capacity would remain.

By ensuring that the calibration of the recapitalisation element of Pillar 2 MREL is based on the consolidated capital requirements of the resolution group after the preferred resolution action (as is the Parliament position), a more accurate MREL requirement can be determined. The Council text provides for an adjustment, up or down, to deliver a similar result, however we would question when a post-resolution entity would attract a higher capital requirement.

Stacking order: We are concerned that a necessary clarification with regards to the stacking order of MREL has not been made by either of the co-legislators ahead of trilogue discussions. We urge the European Parliament and Council to consider this issue as one of technical importance given the possible implications for firms who have MREL calibrated to the leverage exposure measure.

As previously stated, we agree that CET1 should not be double-counted between the combined capital buffer and MREL. The TLAC Standard provides that the combined buffer requirement must be met in addition to the TLAC RWA Minimum, but not the TLAC leverage exposure minimum. This approach should be reflected in the European legislation and we believe that the combined buffer should not "sit on top" of the Pillar 1 and Pillar 2 MREL requirements when calibrated in accordance with the leverage ratio exposure measure. Only Leverage Ratio buffers should sit on top of leverage calibrated TLAC where they are applied. This approach would also be consistent with the purpose of the leverage element of MREL, as acknowledged by the EBA in its report on MREL[4].

3 Subordination of external MREL

Subordination under the Pillar 2 MREL requirement: It has always been AFME's view that clear criteria should be established for the determination by the resolution authority as to whether subordination of Pillar 2 MREL should be required to ensure a consistent approach across the EU. It should also be clarified that subordination should only be required to the extent necessary to support a credible resolution strategy and achieve the resolution objectives. We believe that the Pillar 1 MREL requirement should be sufficient to achieve this for GSIIs and in any case, in order to avoid any level playing field issues with institutions outside the EU, this subordination requirement should not lead to situations where institutions are required to have higher levels of subordinated MREL compared to requirements for comparable institutions in third countries. We set out below our views on the proposals put forward by the Council and European Parliament on this issue.

AFME does not support the Council's use of the 8% TLOF metric as a target or reference for the calibration of MREL – this includes calibrating subordination within the total MREL requirement. Further to the arguments already set out against using the 8% TLOF measure for such purposes, we would add that the level of subordination required for MREL should be guided by the need to ensure the firm's resolvability, by addressing any impediments that may exists as a result of having un-subordinated MREL, if they exist.

[4] As a consequence, we believe that it is necessary to amend article 141a(1)(d) CRD to refer to the Pillar 1 and Pillar 2 MREL requirement calibrated through the risk-based methodology only. This would also be consistent with the capital framework, as article 141a(1) of CRD5 does not refer to the leverage ratio referred to in article 92(1)(d) CRR2.

Subordination is only envisaged to be required for this purpose and it is therefore necessary that the amount of subordination be set on a firm-by-firm basis with this in mind.

We also do not support the ability for the maximum subordination requirement to be set at the level put forward by the Council in the so-called 'prudential formula':

2 x (Pillar 1 capital requirements + Pillar 2 capital requirements) + Combined Capital Buffer

This alternative limit to the amount of subordination goes beyond the levels of MREL that are envisaged to be set under Article 45c. It can therefore be interpreted as a formula that is envisaged to provide a maximum level of subordination in excess of the total MREL that may be required of a firm. If this is the case, a maximum level of subordination in excess of 100% of estimated MREL does not act in the way that a cap is meant to. Subordination requirements are therefore not limited to the level necessary to ensure the firm's resolvability. Further to this it is not clear how this approach to subordination interacts with the overall calibration, specifically whether it is binding on the calibration of MREL. It is AFME's view that this is not, and should not, be the case. However, further clarity is required in the text.

We are concerned that the Council proposals set an overly conservative approach to subordination which goes significantly beyond what is likely to be necessary to achieve resolvability. It is important to take into account the capacity of the markets for these amounts of subordinated debt and the impact on bank profitability. The high level of subordination foreseen is likely to be excessive and will make the roll-over of this debt more expensive, particularly if funding conditions are strained.

The framework should be simple enough to support firms' planning and help market participants understand what is required of firms. Clear framing of the amount of subordination required is vital to ensure a level playing field between the Member States and internationally. The Council has presented a highly complex method setting a cap at a significantly higher level than expected, with considerable discretion for resolution authorities, which could lead to diverging methods of application both within the Union and compared to third countries.

The Parliament approach provides a clearer mechanism to frame the setting of subordination requirements. It does this by utilising the existing FSB TLAC Standard which has been calibrated to a level that is deemed appropriate to ensure a globally systemically important bank can be credibly resolved. It has also undergone impact assessment analysis and is endorsed by the G20 to address the need to end too-big-to-fail concerns. This includes the possibility to utilise the exemptions to subordination provided under the FSB Term Sheet where appropriate.

The Parliament approach promotes wider market discipline by ensuring that there is no built-in expectation that only MREL will be bailed-in and/or written down in resolution. This may be the case, if MREL – particularly subordinated MREL – is calibrated to a level that would ensure access to the SRF in resolution. It is important to maintain in the framework that only excluded liabilities are immune to write-down or bail-in, and that liabilities outside those are at risk of loss in the event of resolution. Requiring excessive subordination requirements to this end ignores the broader range of liabilities that may be written-down and/or bailed-in to access the SRF, not least formerly MREL eligible liabilities that are less than 12 months from the date of maturity.

As a result of these considerations AFME does not agree with the Council proposals for a limit on the level of subordination by reference to 8% TLOF, or the so-called prudential formula. We believe that the Parliament approach that has been put forward offers a preferable approach to subordination compared to the Council position.

Exemptions to subordination under the Pillar 1 MREL requirement: AFME continues to support the inclusion of the exemptions to subordination, as per the FSB TLAC Term Sheet, under the Pillar 1 MREL requirement[5].

The European Parliament and Council have retained the provisions that implement these exemptions but have made amendments to the relevant text[6]. Both the Council and Parliament approaches now make the use of either of the exemptions contingent on the approval by the relevant resolution authority. The European Commission's original proposal permitted the use of either of the two exemptions without the need for the institution to seek approval from authorities, but with criteria around when either exemption could be utilised.

Whilst we accept the additions that have been made by both co-legislators to give greater assurance to the use of the exemptions not giving rise to material risks of legal challenge or valid compensation claims and recognising national specificities with regards to statutorily subordinated excluded liabilities, we would encourage greater consideration to the process to ensure the exemptions are usable. We have a clear preference for the original European Commission text which provides resolution authorities the ability to challenge the use of either exemption and assess the impacts of their use. This is in our view an appropriate implementation of the exemptions, particularly given the broader context in which subordination requirements may be set materially higher than was otherwise expected. We maintain that the exemptions should be mutually exclusive in their use.

However, if resolution authority approval is to be required to make use of either exemption, we recommend that a clear and timely process is provided for such that intuitions can obtain the necessary approvals without undue delay. This is important to ensure that where the exemptions can be utilised they are, without imposing additional costs to the relevant institutions.

4 Internal MREL

The internal MREL framework within the RRM package is split between the Pillar 1 internal MREL requirements as set under the CRR (i.e. for material subsidiaries of third country GSIIs operating in the EU), and the Pillar 2 internal MREL requirements that are set under the BRRD (for all entities in scope of the BRRD, not just material subsidiaries). AFME wishes to highlight its strong support for aspects of the approaches taken by the European Parliament (e.g. the full transposition of the FSB Term Sheet scalar range), and the Council (e.g. the recognition of the need to accommodate flexible issuance strategies).

However, beyond this there are a number of significant concerns with aspects of the proposed framework that are included in some of the positions taken or are missing altogether. We firmly believe that some of the proposed provisions, particularly in the Council General Approach go so far as to undermine the objectives of internal MREL and potentially the financial resilience of cross-border banking groups. In particular it fails to fully acknowledge the EBA's findings that "prepositioning constrains banks in centrally managing liquidity and financial resources at the group level, including in dealing with asymmetric shocks"[7]. In this section we will expand upon our views regarding the internal MREL framework, as well as visit individual elements of the package that implements these requirements in turn.

[5] The FSB TLAC Term Sheet (Section 11) states that subordination of eligible external TLAC is not required if, amongst other things, the amount of excluded liabilities on the balance sheet of the resolution entity that rank pari passu or junior to the TLAC eligible liabilities does not exceed 5% of the resolution entity's eligible external TLAC.
It also makes clear that in jurisdictions where the resolution authority may, under exceptional circumstances specified in the applicable resolution law, exclude or partially exclude from bail-in all of the liabilities excluded from TLAC, the relevant authorities may permit liabilities that would otherwise be eligible to count as external TLAC but which rank alongside those excluded liabilities in the insolvency creditor hierarchy to contribute a quantum equivalent of up to 2.5% RWA of the resolution entity's Minimum TLAC requirement when the TLAC RWA Minimum is 16%, and up to 3.5% RWA when the TLAC RWA Minimum is 18%.
In light of this and the powers provided to EU resolution authorities under Article 44(3) BRRD, the exemptions to subordination as set out above should be implemented though the MREL framework.
[6] As drafted by the European Commission under paragraphs 3, 4 and 5 of Article 72b of the CRR.
[7] See EBA Final Report on MREL, 14 December 2016, at p.137.

We would also like to highlight our separate paper on this topic cited below, which goes into further depth on this very important aspect of the resolution framework[8].

Pillar 1 Internal MREL for material EU subsidiaries of non-EU GSIIs (Article 92b CRR)

It is essential that the calibration, location, and issuance strategy of loss absorbing capacity within a group supports the group resolution strategy. However, the proposed internal MREL requirement under article 92b of the CRR requires a number of important changes including to its scope, calibration and eligibility criteria to increase consistency with the FSB TLAC Standard and the final FSB principles on internal TLAC. Given that the EU has committed to implementing the agreed international standard, we strongly advocate for the final legislative text to reflect the standards agreed by the FSB.

Where elements of the TLAC Standard are not yet fully reflected in the proposals put forward by co-legislators, we strongly believe that these should be provided for to ensure global consistency, and to provide the various resolution authorities within the EU the full flexibility they are afforded by the TLAC Standard to set such requirements. The particular areas that require amendment are visited below.

Calibration (scaling): the position taken forward by the Council maintains the original European Commission proposal to require material subsidiaries of third country GSIIs (that are not resolution entities themselves) to meet an internal MREL requirement equal to 90% of the requirement that would have applied had the entity been a resolution entity (i.e. an external MREL requirement). However, the TLAC Standard clearly sets out, under Section 18, that this requirement be set between 75-90% of the external TLAC requirement. The agreed range of 75-90% should therefore be fully transposed, in part to ensure a faithful transposition of the international standards, but also to ensure that the requirements for individual material subsidiaries are able to reflect the firm's resolution strategy. Providing a range would also provide an important incentive for third country resolution authorities to strengthen their cooperation and coordination with the EU authorities.

AFME strongly supports this being reflected in the European Parliament proposals entering the trilogue discussions. The recognition of the need to implement the full scalar range is welcomed, and we encourage the co-legislators to take forward this approach into the final legislative text.

The considerations to provide this full range should also take into account that the 75-90% range does not preclude resolution authorities from seeking to apply a 90% requirement, as per the original European Commission proposals. It is therefore difficult to understand why a range should not be taken forward as it accommodates the position of the Council whilst also providing flexibility for resolution authorities to set internal Pillar 1 MREL requirements. It should also be taken in to account that similar requirements in the U.S., which impose a 90% internal TLAC requirement on third-country GSIIs operating there, are being considered for review and potential revision such that the 75-90% range is available to U.S. authorities in calibrating the requirements, as publicly stated by Vice-Chairman Randal Quarles of the US Board of Governors of the Federal Reserve System[9].

Calibration (determination): the final legislative text should also fully incorporate the process of calibration, i.e. that the requirement should be determined in consultation with the home authority of the resolution entity as part of the resolution strategy agreed in the Crisis Management Group or resolution college. Cross-border co-operation is a key tenet of ensuring financial stability in the event of a failing cross-border group given that clients too are global, and as such this should be emphasised in the European framework. This is important to ensure not only that requirements for internal MREL are consistent with the overarching resolution strategy, but also that they are consistent – and do not exceed – the level of external MREL that has been deemed appropriate to fulfil that resolution strategy.

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[8] See AFME: Internal MREL in the Risk Reduction Measures package (October 2017) - https://www.afme.eu/globalassets/downloads/briefing-notes/2017/afme-rrn-internal-mrel-in-the-rrm-package.pdf

[9] Randal K. Quarles, Trust Everyone–But Brand Your Cattle: Finding the Right Balance in Cross-Border Resolution (May 16, 2018) (stating that the US "should consider whether the internal TLAC calibration for IHCs could be adjusted to reflect the practice of other regulators"), available at https://www.federalreserve.gov/newsevents/speech/quarles20180516a.htm

Distribution and restrictions on issuance to a 3rd country parent undertaking: the legislation should be less restrictive on the distribution of intra-group liabilities to meet the internal MREL requirements and the restriction which requires issuance to a 3rd country parent undertaking should be removed. Both co-legislators have recognised and reflected this in their BRRD proposals. However, neither co-legislator has made similar amendments to equivalent requirements in the second sub-paragraph of Article 92b (1) CRR. We believe it would be consistent for the co-legislators' approach under the BRRD to be carried forward to Article 92b (1) CRR also. Therefore, we encourage this issue to be considered when discussing the final legislative text.

Greater flexibility should be provided for the distribution of liabilities between entities within the same resolution group to enable an efficient and effective means of transferring losses to the resolution entity without disrupting existing business or funding models. The legislation should provide greater flexibility to resolution authorities to agree an appropriate structure, including not restricting issuance of internal MREL directly to resolution entities or through the ownership chain. This would bring the EU legislation in line with the FSB principles on internal TLAC which recognise the need for firms to be able to issue internal TLAC through multiple legal entities in a group without requiring this to flow through the ownership chain. Direct issuance of internal MREL to a resolution entity or issuance through the group, whether through the direct ownership chain or through affiliates, are all legitimate methods of issuing internal MREL[10].

Joint triggers: it should be clarified that internal MREL will only be written down or converted with the consent of the home resolution authority for the resolution entity, but that the host retains the power to subject internal MREL to its own resolution bail-in should the consent not be forthcoming. This is in line with the TLAC Standard and is important to foster cross-border cooperation and reflect agreements made in Crisis Management Groups.

In the co-legislators' proposals, no text is put forward to set out how Pillar 1 internal MREL would be triggered. AFME feels it is a key part of the framework to not just have internal MREL in place, but also the mechanisms by which a bail-in or write-down may be triggered. It is important that the formulation of triggers is clarified at the EU level to ensure equal treatment for subsidiaries of third-country banking groups operating in the EU. If different approaches are taken by different resolution authorities, this will have implications for any level playing field within the EU. AFME therefore encourages this aspect of the framework to be given full consideration, and we would strongly recommend that the TLAC Standard approach is fully adopted.

Scope of application of Article 92b: it should be clarified that the minimum internal MREL requirement set by Article 92b only applies to material subsidiaries of non-EU G-SIIs at the highest level of consolidation in the EU (i.e. the Union parent undertaking). The requirement should not apply at the individual level of the material subsidiary (unless, of course, this subsidiary is the only entity the non-EU G-SII has in the EU)[11].

Interaction with internal MREL requirements in the BRRD

The minimum internal MREL requirements established by Article 92b are expected to operate as a floor, with resolution authorities setting a Pillar 2 add-on in line with the powers provided by the BRRD. As stated above, this additional requirement should apply at the highest level of consolidation in the EU (i.e. the Union parent undertaking). Where a Pillar 2 add-on is required, it should also be subject to the relevant scalar. This is not currently clear in either of the co-legislators' texts and should be clarified. The FSB TLAC Term Sheet is very clear in this regard, as it provides that the requirements for internal TLAC should be calculated such that an appropriate and agreed scalar is applied to the requirements that would have applied to the entity were it to have been deemed a resolution entity in the host jurisdiction.

[10] This would also align to the US implementation of internal TLAC rules for covered IHCs of FBOs which are able to issue internal TLAC to any affiliate. The internal issuance strategy selected by the firm will largely depend on the business and funding models and, importantly, the resolution strategy of each individual group, and as such they should all be permitted. The current restrictions create a risk that G-SIIs will be required to adopt an internal MREL issuance strategy which would not be in line with their resolution strategy in turn reducing the resolvability of some firms.

[11] Whilst this has been made clear in the Council approach for any additional Pillar 2 internal MREL requirement that may apply to Union parent undertakings that are not resolution entities themselves and that are subsidiaries of third-country entities under Article 45g(1) of the BRRD, this is still not clear from the current text under Article 92b of the CRR in either of the co-legislators' approaches. AFME therefore encourages the European Parliament and the Council to make the necessary amendments such that the intended approach to apply the requirements at the consolidated level be clear under Article 92b of the CRR.

Internal MREL within the EU: The TLAC Standard contemplates internal TLAC at material sub-groups located in a different jurisdiction from the resolution entity. It is important to carefully consider how these principles should be applied within the single market and Banking Union (as discussed further below).

It is important to support the principles discussed above and that the legislation provides sufficient flexibility for resolution authorities to put in place effective internal MREL arrangements to support resolution plans and avoid excessive requirements which could increase overall external MREL requirements and increase cost and fragmentation. Currently we are concerned with aspects of the approaches that have be taken forward that do not fully achieve this and consider that several changes are required in trilogues.

Calibration: where internal MREL is deemed necessary within the EU, greater flexibility is required in relation to the determination of the requirement. Currently there is no scaling of internal MREL under the BRRD in the Council approach. This is in contrast to the scaling that is provided for by the European Parliament proposals, which we strongly support.

The Council position is also inconsistent with the approach it takes for material subsidiaries of third country GSIIs under the CRR (where some, albeit restrictive, scaling is permitted – as discussed above). It is important that the BRRD framework includes appropriate scaling of internal MREL. The European Parliament approach replicates the FSB TLAC Term Sheet range of 75-90%, which we welcome. However, we also believe that the scaling range between institutions in the EU should be significantly lower than the 75-90% internal TLAC requirement to reflect the group resolution planning process, close cooperation and information sharing within resolution colleges, the automatic recognition of resolution actions and the single supervisor and resolution authority within the Banking Union.

In the absence of such scaling, the calibration of internal MREL would provide for higher requirements between institutions within the EU than for material subsidiaries of third country G-SIIs and does not give appropriate recognition to the factors that materially reduce the need for internal MREL within the EU and Banking Union. The current Council approach which appears to assume fully distributed internal MREL could reduce flexibility to use resources where they are needed in the group, potentially increasing fragmentation and reducing resilience. As stated in the FSB guidance on internal TLAC, "there must be sufficient flexibility to use loss-absorbing capacity within a GSII where needed"[12] and to ensure that resources are distributed within the group according to the resolution strategy.

Setting internal MREL at 100% of the calibration as if a subsidiary is a resolution entity at every institution in the group is also highly likely to increase overall external MREL requirements due to consolidation effects (i.e. cross-group exposures will be double counted). This should be included in the factors to be considered when calibrating internal MREL within resolution colleges to ensure that the sum of the internal requirements does not exceed or increase the external requirement at the resolution entity. This principle should be set out in the legislation.

We welcome the approach taken by the European Parliament and encourage this approach, or one that provides flexibility for a scaling range lower than the 75-90% range proposed. As set out above, there is a real and material risk that calibration of the internal MREL requirement under the BRRD undermines the objectives of internal MREL, increases overall MREL requirements unnecessarily, and increases fragmentation and 'brittleness' across European banking groups.

Inclusion of the Market Confidence Buffer (MCB): As a result of the Council and Parliament proposals to include an MCB into the calibration of MREL requirements, this also impacts the requirements that apply to non-resolution entities, i.e. internal MREL. As previously flagged, the lack of differentiation between external and internal MREL requirements in the texts leads to the inclusion of an MCB in the calibration of internal MREL requirements. This further inflates the amount of resources that will be required at subsidiaries, which will currently apply to all subsidiaries regardless of materiality to the group, or whether or not critical

[12] **See FSB -** http://www.fsb.org/wp-content/uploads/Guiding-Principles-on-the-Internal-Total-Loss-absorbing-Capacity-of-G-SIBs.pdf

economic functions are provided by the entity. Where this is also not subject to scaling (as per the Council proposals), this amounts to a further unnecessary increase in internal MREL requirements, and increased fragmentation of resources.

We have already explained why an MCB is not appropriate or necessary for external MREL. The case for applying an MCB for internal MREL is even harder to justify, particularly since the entities subject to internal MREL will not be placed into resolution themselves. Internal MREL acts as a mechanism to transfer losses to the resolution entity, which will itself be the subject of resolution where the relevant conditions have been met. Entities subject to internal MREL requirements will not enter resolution and so should not require additional capital to provide for greater levels of confidence in their continued operation. AFME therefore recommends that co-legislators review the intended purpose of the proposed MCB and assess whether and, if so, why it would ever be necessary at non-resolution entities.

The so-called 'Safe-Harbour Clause': Further to the co-legislators shared position to include an MCB in the determination of internal MREL requirements, the Council have proposed the inclusion of text[13] that permits host resolution authorities to increase, by no more than 2% of the relevant entity's RWAs, the amount of internal MREL required. Such an increase as permitted by the Council text would not be subject to EBA binding mediation, and does not require home authority consent or consultation.

This power to arbitrarily increase internal MREL requirements by 2% of RWAs without consulting the home – or indeed other host – resolution authorities completely disregards the need for a coordinated approach to cross-border resolution, including resolution planning and the setting of internal MREL requirements. This will have implications for all other entities in the banking group and the resolution authorities responsible for them. It provides only an incentive for every host authority to make use of this power to secure pre-positioned resources ahead of other host authorities. The provision of this power also gives no consideration to the implications for the total amount of MREL available and risks the internal MREL requirements exceeding external MREL issuance[14].

Minimising fragmentation: Maintaining a level of loss-absorbing (and recapitalisation) capacity at the resolution entity, available to be directed to ailing parts of a group, should increase the resilience of the group and provide comfort to host authorities that if there is a shortfall in an institution in their jurisdiction, additional resources can be called upon, supporting group recovery and resolution plans. The more capacity that is prepositioned in parts of the group, the less will be available to be deployed in response to turbulent conditions. If required internal MREL levels were to match – or even exceed – the total amount of capacity deemed necessary for the resolution strategy, this would amount to a failure in the calibration of internal requirements that risks damaging the success of the desired resolution plan, fragmenting the resolution group, and constraining the availability of resources to help in the recovery phase.

It would therefore be prudent to include in the legislative framework a principle that internal requirements should not lead to an uplift in external requirements (which have been set according to the resolution strategy), nor should internal requirements be set at a level that leaves only minimal spare capacity at the resolution entity to respond to deteriorating conditions. It is not in anyone's interest to hinder the ability of a group to implement recovery options and, where necessary resolution plans. It should therefore be clear that this principle improve a bank's ability to withstand stress scenarios, as compared with a situation where the resources are fragmented across the resolution group.

Internal MREL waivers: The original European Commission proposal set out the ability for resolution authorities to apply waivers for internal MREL, but to a limited scope of entities, i.e. between entities located

[13] Article 45h (5) – third sub-paragraph (a) and (b) of the Council General Approach.

[14] The amount permitted is also not immaterial. A 2% RWA increase on a 13.5% RWA internal MREL requirement (an estimate of a low-end internal TLAC requirement that may be expected of a material subsidiary of a GSII (0.75 x 18% RWA)), represents a possible increase of the requirement by 14.8%. This is a sizeable increase that the Council proposals seeks to permit in the absence of any consultation with the home resolution authority, outside the joint decision process, and without recourse to the EBA for binding mediation. AFME sees this addition as excessive and wishes to highlight that the lack of accountability and transparency surrounding the use o this power is deeply worrying considering the broader objectives of encouraging cross-border cooperation. We therefore strongly encourage this proposal be removed at trilogues.

in the same Member State. AFME continue to believe that this is too restrictive and does not give recognition to the progress that has already been made in the resolution space within the Banking Union, i.e. in light of the automatic recognition of resolution actions, the joint process for resolution planning, cooperation and information sharing within resolution colleges and the single supervisor and resolution authority. As such, waivers should be available between institutions within the European Union and at a minimum within the Banking Union. Waivers should apply automatically within a Member State where the relevant criteria are met, and for entities within the scope of a cooperative mutual solidarity system that protects the solvency and liquidity of the affiliated institutions.

The European Parliament have recognised the progress that has been made in the Banking Union by permitting waivers to apply where entities in the same resolution group are subject to the supervision by the same competent authority or are both located in participating Member States of the Banking Union. AFME welcomes this and supports the inclusion of text giving effect to this in the final legislative text. The Council position does not give this recognition and limits the use of waivers to entities in the same resolution group where they are established in the same Member State. In either case however, waivers are not automatically applied. We would encourage both co-legislators to investigate this opportunity further to better ensure internal MREL requirements are only set where they are required for the effective execution of the preferred resolution strategy.

Application of internal MREL waivers to third-country groups: Further to the general application of internal MREL waivers to subsidiaries of institutions established in the EU, we welcome the Council proposals to permit the use of internal MREL waivers to subsidiaries of third-country resolution entities, in respect of their Union parent undertaking. There are no reasons why this waiver should not be available to both EU and non-EU headquartered firms within the EU. AFME therefore supports the additions made under the proposed Article 45g (5a) of the Council General Approach. We recommend that this approach is maintained in the final legislative text.

Use of collateralised guarantees: The ability to meet internal MREL requirements, where set, with collateralised guarantees is a feature of the European Commission's proposed amendments to the BRRD2 that AFME broadly supports. The Council now propose that the use of such collateralised guarantees can only be considered where the relevant subsidiary is located in the same Member State as the resolution entity to that subsidiary[15]. This is highly restrictive and further reflects the broader positions in the Council approach that fail to recognise the progress made in the EU both under the single resolution framework, and within the Banking Union. Nevertheless, the Council's retention of the concept of collateralised guarantees is in of itself supported by AFME, particularly in light of their removal from the European Parliament approach.

The ability to use guarantees to meet internal MREL requirements should provide groups with a degree of additional flexibility to manage their funding while providing additional comfort to host authorities and providing a mechanism to upstream losses. Greater flexibility as to the types of instruments that could be used to meet internal MREL requirements should also be accommodated where agreed between authorities. For example, capital contribution, uncollateralised guarantees or other arrangements may achieve the objectives of internal MREL.

EU headquartered firms that have third-country subsidiaries: EU headquartered firms may face local external or internal TLAC (or equivalent) requirements imposed on subsidiaries located in third-countries by local host authorities. When applying internal MREL at a consolidated level, it is important to consider the scope of the consolidation with respect to subsidiaries in a third country. Third-country subsidiaries may be designated to be either part of (or as the resolution entity of) a separate third-country resolution group, or instead be part of a resolution group with an EU resolution entity. The current proposals from co-legislators[16] do not provide adequate acknowledgment of these different possibilities and how they may impact MREL

[15] Article 45g (6) of the Council General Approach
[16] Articles 12, 45f, 45g, 45h and Title VI of the BRRD and Articles 11, 12 and 18 of the CRR

requirements. It is necessary to clarify how EU resolution authorities should interact with host authorities of third-country subsidiaries in the context of MREL/TLAC.

AFME calls on the co-legislators to address this issue in trilogues[17], else the framework as currently proposed will lack any clear details as to how third-country subsidiaries of EU headquartered institutions are to be treated, in particular where they already attract local external or internal TLAC (or equivalent) requirements.

Interaction with the large exposures framework: We welcome the acknowledgment of the need to address internal MREL in the large exposures framework. As discussed above, there should be flexibility for internal MREL to be issued to entities other than the resolution entity. Accordingly, the exemption from large exposures provided in Article 400(1)(l) CRR should be provided for not only resolution entities but for every institution as internal MREL could be held at other entities in the group. It should therefore be clarified that any exposures resulting from internal MREL are exempt from large exposure limits.

We welcome the changes that have been made to this end in the Council proposals. However, we note this issue has not been recognised in the European Parliament's final report. We encourage the co-legislators to take forward the Council approach to support the shared position taken by both co-legislators with regards to providing the necessary flexibility for internal MREL issuances strategies.

5 Eligibility Criteria

The European Parliament and Council have brought forward suggested amendments to the European Commission's original proposed legislative text surrounding MREL eligibility criteria for both external and internal MREL. We set out below our views on the co-legislators' changes focussing on the relevant provisions for external and internal MREL separately.

Eligibility criteria – external MREL

Retail client holdings: The European Parliament have put forward new eligibility criteria that restrict instruments from counting as eligible, specifically where they are purchased by retail clients unless certain conditions are met[18].

Whilst AFME recognises the intention behind the new eligibility criteria, and the concerns that some Parliamentarians have on this topic, there are fundamental flaws behind the suggested approach that would make it impossible for firms to comply. This is largely due to an asymmetry of information between and amongst financial institutions and the retail client in question. An issuing institution does not, and will not, have the information necessary to calculate the retail client's total financial investment portfolio to be able to be assured that no more than 10% has been invested in aggregate. Obtaining such information is not possible, nor is it possible for a firm to verify any claim by the retail client investor that this is the case were such a declaration made. Further to this, whilst the text is not entirely clear whether purchase relates only to the primary issuance or not, institutions will not be able to monitor this threshold in the secondary market. For these reasons we see the suggestion put forward by the European Parliament as unworkable and recommend the removal of this text in the trilogue process.

Nevertheless, AFME is aware of the broader concern with regard to retail client holdings of MREL eligible instruments. Retail clients are free to invest in appropriate instruments, including CET1 eligible items (e.g. stocks and shares), that are eligible for both capital requirements and MREL. Inserting the suggested eligible criteria as above is inappropriate for legislation setting prudential requirements for relevant institutions.

[17] The legislation should require resolution authorities to take into account the effects of any third-country internal or external TLAC (or equivalent) requirements when determining internal and external MREL requirements for the entities under their remit. It should also be clarified that the scope of consolidation of EU resolution groups does not extend to third country subsidiaries which are part of another resolution group.

[18] Inserted as Article 72b (2)(b)(iia) of the CRR, the provisions permit retail client purchases of MREL only where they invest an aggregate amount not exceeding 10% of the financial investment portfolio, and the amount invested is at least €10,000.

AFME believe, in line with the EBA's and ESMA's recently published paper[19], that retail holdings of banks' debt is not a European-wide issue, but where such holdings become disproportionate to a bank's balance sheet or business model, that this should be assessed on a case-by-case basis in the context of an institution's resolvability assessment. AFME therefore supports the Council General Approach in the BRRD (as per Recital 9a) to address this issue, which broadly reflects the need to assess this in the context of bank resolvability and the application of the relevant existing powers to address any impediments to this.

Issuer call options and instrument maturity: Both the European Parliament and Council texts have proposed the insertion of additional language surrounding the maturity date to be observed where issuer call options and an incentive to redeem are present in an MREL eligible instrument under Article 72c of the CRR. Whilst this text goes some way to clarifying the defined maturity of the instrument where both an issuer call and an incentive to redeem are present, it does not provide the necessary clarity where only an issuer call is present.

We are concerned by the lack of clarity in this instance and encourage both co-legislators to make clear that where only an issuer call is present, the original stated maturity of the instrument should remain the observed maturity date. An institution may not action any redemption option in the absence of approval from the relevant authority, and as such the presence of an option should not shorten the observed duration of an otherwise MREL eligible instrument in a way that undermines the resolvability of the institution.

Where this approach is not taken forward there is a risk of a material impact on the amount of MREL firms may need to issue. This issue is set out in more depth in the attached Annex A.

AFME strongly encourages this issue to be addressed by co-legislators. It should be made clear under Article 72c that where only issuer call options, in the absence of incentives to redeem, are present, this should have no impact on the observed maturity with regard to the original maturity of the instrument.

Restrictions on acceleration rights: the proposed restriction on acceleration rights[20] goes beyond the TLAC Standard and could unnecessarily hamper the market for debt which is eligible to satisfy MREL requirements, making it more difficult and more expensive for banks to issue such debt. Standard acceleration rights such as upon non-payment of principal and interest should be permitted. This is necessary to introduce a clear distinction between regulatory capital and eligible liabilities. Specifically, senior debt investors invest in securities with lower coupons than capital securities due to their relative position in the creditor hierarchy. However senior debt issued by banks offer no covenants to protect senior investors' rights. As a result, investors take comfort from the fact that they can accelerate payment under normal circumstances in the event that a bank withholds payment. If this acceleration right is withdrawn then the senior investors will be left with more limited acceleration rights, similar to those granted to investors in lower ranking securities. It is unclear whether senior debt investors will continue to accept lower coupons than junior debt investors if they are taking similar risks[21].

It is worth noting that powers under the BRRD allow the resolution authority to essentially over-ride the terms of existing liabilities if an entity enters resolution, including the power to over-ride the acceleration provisions noted above. The presence of such safeguards are also accepted by the FSB, as addressed in the FSB Key Attributes[22] which explicitly recognises that should contractual acceleration or early termination rights be exercisable, the resolution authority should have the power to stay temporarily such rights where they arise by reason only of entry into resolution or in connection with the exercise of any resolution powers.

[19] See EBA & ESMA joint statement on the treatment of retail client holdings of debt financial instruments subject to the BRRD - https://www.eba.europa.eu/documents/10180/2137845/EBA+ESMA+Statement+on+retail+holdings+of+bail-inable+debt+%28EBA-Op-2018-03%29.pdf

[20] Article 72b(2)(l) CRR as per the Council General Approach / Article 72b(2)(m) CRR as written in the European Parliament Final Report

[21] This is important for both external and internal MREL as in addition to the impact on the market, the proposal also increases the risk that debt instruments would be viewed as equity rather than debt for taxation purposes. This could impact the tax deductibility of interest payments and have a material impact on the cost of issuing both external and internal MREL. Should the co-legislators determine that acceleration rights should be restricted, we would strongly urge them to consider a rule which allows acceleration for non-payment subject to a 30-day cure period, in line with the approach taken in the final US TLAC rules.

[22] See section 4 of FSB, Key Attributes of Effective Resolution Regimes for Financial Institutions

AFME urges both co-legislators to review this criterion for MREL eligible liabilities under Article 72b and encourages them to consider the impact of inaction in this area, in particular on the costs to firms of issuing MREL eligible instruments in the absence of adequate acceleration rights. In this respect, AFME encourages the co-legislators to take into account that firms will need to issue MREL in a range of market conditions (bearing in mind that current market conditions and the low interest rate environment have been relatively favourable for MREL issuances).

Reference to set-off and netting arrangements: Whilst a more technical point, it is one of importance that we want to highlight to co-legislators. Due to the automatic application of set-off and netting in agreements between civil law jurisdictions, there may not be an explicit arrangement, but one may exist nevertheless. It is therefore necessary for the legal text under Articles 52 (1)(r) and 63 (p) CRR to make clear that instruments should not be subject to express and explicit set-off or netting agreements. This is further elaborated on in the attached Annex B.

Eligibility criteria – internal MREL

Direct holdings vs flexibility of issuance: the requirement for Additional Tier 1, Tier 2 and eligible liabilities to be held by "the parent undertaking of the institution in a third country" under Article 92b CRR remains unclear in both of the co-legislators' approaches. As explained above, instruments should be eligible to meet Internal MREL if they are ultimately held (directly or indirectly) by the resolution entity and if the approach to issuing those instruments supports the resolution strategy and the passing of losses to the resolution entity. It is critical that the final legislation provides banks with the flexibility to issue instruments to meet internal MREL in a way that allows them to efficiently fund their operations. The CRR should provide for AT1, Tier 2 and eligible liabilities to be eligible to meet internal MREL if they are issued directly to the resolution entity, indirectly through the ownership chain to the resolution entity and indirectly to the resolution entity through wholly owned affiliates.

It is also unclear how the requirement to issue internal MREL to a parent undertaking outside the EU could be implemented by banks which are owned by an EU-based intermediate holding company (IHC), and how this aligns with the proposal to require certain third country headquartered banks to establish an IHC, as it appears that subsidiaries could not issue internal MREL to an EU-based IHC. As previously set out above, it is important that the final legislative texts reflect an internal MREL requirement at the consolidated level, as well as provisions for the necessary flexibility in issuance strategies to avoid any conflict between requirements, and ultimately to ensure they can be met.

Applicable eligibility criteria under Article 45g BRRD: AFME welcomes the recognition in the Council General Approach of the need to clearly define eligibility criteria specific to internal MREL, including in respect of Pillar 2 internal MREL requirements under Article 45g of the BRRD. AFME endorses this Council approach and encourages the co-legislators to ensure that the same approach and criteria are also carried across to Pillar 1 internal MREL under Article 92b CRR, as explained below.

Applicable eligibility criteria under Article 92b CRR: The current eligibility criteria for Pillar 1 internal MREL under Article 92b are too restrictive. Unlike Article 45g BRRD, Article 92b CRR does not provide specific eligibility criteria for internal MREL, and so it seems that the eligibility criteria currently under Article 72b CRR would apply. However, several of these criteria would make eligible issuances of internal MREL impossible and others are inappropriate for internal MREL[23]. Therefore, we strongly encourage the co-legislators resolve this issue by taking the same approach as the Council has proposed with regard to eligibility criteria for internal MREL under Article 45g BRRD.

[23] In particular, Article 72b(2)(b) and (c) (restrictions on issuance within a resolution group) and the requirements in article 72b(3)-(5) should not apply to internal MREL. These restrictions run counter to the very purpose of internal MREL and should be removed to ensure that internal MREL can be issued between entities in the resolution group. The requirements of Article 72b(3)-(5) are only relevant to external MREL and should therefore not apply to internal MREL.

Restrictions on acceleration rights (internal MREL): AFME supports the Council approach under Article 45g(3) of the BRRD, which disapplies the restrictions on acceleration rights for internal MREL.

As discussed above, the restriction on acceleration rights should be removed and should not apply to internal MREL due to the risk of recharacterization as equity for tax purposes which would impact the tax deductibility of interest payments on internal MREL and, in certain circumstances, the treatment of repayments of principal. This could negatively affect financial results and have a material impact on the cost of compliance, resulting in a material increase in the cost of issuing internal MREL.

Standard acceleration rights, such as upon non-payment of principal and interest, should be permitted for internal MREL. These acceleration rights do not present a risk to the effectiveness of internal MREL in passing on losses from an operating entity to a resolution entity and do not present a risk to recapitalisation. If an entity does trigger an acceleration clause due to non-payment, it is highly likely that the entity would be in distress and that its parent would need to recapitalise the entity in order the preserve the franchise value and to execute the resolution strategy.

AFME encourage both the European Parliament and Council to take forward this approach in the final legislative text.

6 Grandfathering

The amendments to the CRR and BRRD make significant changes to the eligibility criteria for eligible liabilities and also introduces new criteria for Additional Tier 1 and Tier 2 capital instruments. It is essential that transitional arrangements are provided to grandfather issuances made before the new legislation comes into force. AFME considers that a permanent grandfathering provision for all issuances (i.e. all liabilities, AT1 and T2 instruments, including issuances under UK law) prior to the revised CRR coming into effect is necessary to provide clarity for banks on their current shortfall and enable them to continue issuing MREL-eligible instruments over the next months[24].

AFME broadly welcomes the proposed grandfathering provisions that give recognition to this issue in both the European Parliament and Council approaches, subject to some further necessary amendment.

The importance of a transitional period has been acknowledged by the EBA[25] and a number of European resolution authorities. The US has provided for grandfathering of liabilities issued prior to its Final Rule and the EU should also adopt this approach and signal clearly that there will be grandfathering for liabilities issued prior to entry into application of the new requirements.

The final legislative text should make clear that this grandfathering *shall* apply, and that is it not contingent on other factors, as could currently be interpreted by the language that states grandfathering *may* apply. Providing such clarity would ensure there is certainty in these necessary provisions applying.

However, with regard to the grandfathering of Additional Tier 1 and Tier 2 capital instruments, we observe a less encouraging approach. Specifically, within the European Parliament proposals there are no express transitional arrangements for such instruments, which we consider to be most concerning. The potential impact, not just on the available levels of eligible MREL, but also on regulatory capital instruments, would be far reaching and substantially impactful on the European financial sector. Whilst there is some provision for grandfathering in the Council approach, the 6-year time limit on this does not provide an appropriate level of transition, and in any case is inconsistent with the approach to grandfathering taken previously. AFME

[24] A significant volume of liabilities has been issued over the past few years based on the expectation that the European eligibility criteria would follow the international TLAC Standard, with a view to meet the ambitious 1 January 2019 target. These existing liabilities do not comply with the proposed new criteria in their entirety (e.g. restrictions on acceleration, contractual recognition requirements and set-off arrangements) and absent transitional provisions MREL shortfalls would increase significantly. In light of the short time frame to meet the minimum requirements by 1 January 2019 it is critical that banks have clarity on their shortfall and are able to proceed with issuances to increase their loss absorbing capacity prior to finalisation of the legislation. It is important to note however, that transitional provisions alone would not resolve a number of important concerns with the proposals where we strongly believe changes are required.
[25] See EBA Final Report on MREL, 14 December 2016, at p.22

supports the Council approach to grandfathering but believes that the 6-year time frame provided for AT1 and T2 instruments should be extended to at least 10 years.

7 Moratorium tools

AFME broadly supports and welcomes the approaches that both the European Parliament and Council have taken with regard to the proposed new moratorium tools under the original European Commission proposal.

AFME does not believe that the introduction of the European Commission's proposed moratorium powers is necessary or appropriate, as previously set out in our paper[26] on this issue, and our letter to Vice-President Dombrovskis[27] on the matter.

The key issue to be considered by co-legislators is – in case AFME's preferred option of full deletion is not taken forward - the shape of a possible compromise which is able to minimise the impacts set out in our papers on the matter. Key elements of such a compromise are the duration of the new moratorium tool and its interaction with existing stay power under the current BRRD. In this respect, alignment with the FSB Key Attributes of Effective Resolution, which limit stays to 48 hours, must be ensured.

The Council and European Parliament both limit the duration of the new moratorium tool, which would be applied only after the determination has been made that an institution is failing or likely to fail. However, only the Council appropriately considers the need to address the interaction with existing stays under Articles 69, 70 and 71 of the BRRD. The European Parliament position permits the use of existing stays, after a 10-day grace-period, which we find deeply concerning. Primarily the use of the new power under Article 33a of the BRRD (in both Council and Parliament approaches) should be mutually exclusive to the existing set of stay powers. Permitting the use of both sets of stay powers is not only a concern with regard to the behavioural incentives this provides counterparties, but the presence of a 10-day gap in between would further raise concern over the actions that may be taken between use of the two tools.

AFME therefore believes that whilst both the European Parliament and Council have been moving in the right direction, e.g. limiting their duration to a maximum of 2 days, only the Council General Approach adequately restricts the use of additional stay powers.

8 Contractual recognition of resolution stays

The Council in its General Approach put forward proposals for a new Article 71a ('Contractual Recognition of Resolution Stay Powers'). Whilst in principle AFME acknowledges the value that contractual recognition may have for the operability of such stay powers; certain aspects of the suggestion need to be further clarified as per the below.

Scope: The Council's text indicates that the scope of the requirement includes financial contracts governed by third country law. This can include such contracts entered into by third country subsidiaries of EU parent undertakings that are themselves credit institutions, investment firms (or would be if they had a head office in a Member State), or financial institutions.

To the extent this applies to third country subsidiaries we believe that a clarification should be made, in that this should only apply to third country subsidiaries to the extent they may be subject to a resolution stay under EU law. This would exclude the need for this requirement to be fulfilled by subsidiaries that actually fall outside the jurisdiction of the EU and therefore the BRRD. This is true for MPE firms that have a separate resolution group whose resolution entity is not based in a Member State.

[26] See AFME: Moratorium tools in the Risk Reduction Measures package (June 2017) - https://www.afme.eu/globalassets/downloads/briefing-notes/2017/afme-rrn-moratorium-tools-in-the-rrm-package.pdf

[27] See AFME: Need for reconsideration of the proposed introduction of new moratoria tools (October 2017) - https://www.afme.eu/globalassets/downloads/briefing-notes/2017/afme-rrn-need-for-reconsideration-of-the-proposed-introduction-of-new-moratoria-tools.pdf

Further to this, it should be recognised that extending this requirement to third country subsidiaries of EU resolution entities more generally may bring about cases where local requirements do not permit for the recognition of certain stays. This is particularly the case for crisis management stays as drafted under Article 33a. We therefore recommend that this be taken into consideration, as we elaborate on further below.

As for the contracts that fall within scope of this requirement we understand that this only applies to financial contracts that contain termination rights or rights to enforce security interests – the exercise of enforcement of which could be suspended or prevented were a stay in place.

We note that there is no specific derogation from Article 71a in respect of the contractual recognition of Article 33a stays (even though the Article 33a stay is technically a pre-resolution crisis prevention measure not a resolution measure). Our separate opposition to the moratorium power, as now proposed under Article 33a and set out previously, is well known. However, we wish to flag that the requirement to recognise this power may also provide another means of negatively impacting on the global competitiveness of European banking groups and may prove one particular area where impracticability of fulfilling the requirements in encountered, particularly because it is a pre-resolution stay power that is generally not provided for in other jurisdictions. Therefore, and as discussed further below, we would strongly encourage the co-legislaotrs to provide a derogation or impracticability waiver under Article 71a to address these issues.

Interactions with existing requirements: Such requirements are already in place in a number of Member States, and we would encourage these existing national regimes to be considered, alongside existing industry initiatives that also provide such recognition (e.g. the ISDA Resolution Stay Protocols), when finalising any legislative text surrounding this proposed requirement. A proportionate approach should be sought to ensure a significant repapering exercise is avoided, especially where existing clauses provide recognition for the resolution stays.

Acknowledgment of mutual recognition with third countries: To the extent this is already provided for within article 55 requirements for the contractual recognition of bail-in under third country governed law contracts, AFME firmly believes that there should be an automatic waiver to this new requirement where mutual recognition between authorities exists[28]. This is already an important feature within article 55 that reflects the conclusion of the Financial Stability Board, that statutory recognition of resolution actions is the end goal. Contractual provisions can only be deemed a solution in the short term. Overlooking the inclusion of this would undermine that intention.

Timeline for implementation: We note that the text does not provide a timeline for implementation and asks that the requirement be met only where a new obligation is created, or an existing obligation is materially amended after the date on which a Member State applies the relevant provisions. Whilst this recognises the difficulty in repapering the impacted volume of contracts by only requiring that this apply to existing contracts to the extent that they are materially amended, we would also like to highlight the need to ensure that market participants are sufficiently educated and aware of the recognition clauses and the legal requirement to implement them.

If communications to markets are not managed carefully the incidents of counterparty refusals to accept the changes may be higher than if time had been provided to sufficiently inform counterparties of the reasons behind the clause. We would therefore recommend that a date of application of at least one year from the application of the BRRD amendments is provided for, in order to enable firms to properly manage a roll out of the clauses where they are required thus minimising incidents of impracticability. This is in line with the timeframe provided for the application of Article 55 in the original BRRD.

Impracticability: As has been observed through the challenges in meeting the requirements under article 55 of the BRRD, there can be cases of impracticability, in particular where there is a conflict between these

[28] Specifically, where the resolution authority of a Member State determines that in-scope contracts can be subject to the relevant stays pursuant to the law of a third country or to a binding agreement concluded with that third country.

requirements and counterparties obligations under third country law. We therefore do not wish to see actions to implement this article's requirements plagued with similar difficulties and burdens as that observed in the past under article 55.

We therefore encourage a waiver be provided for within this article from the offset, to ensure where the requirement cannot be fully met the need to meet those aspects deemed impracticable can be waived. In particular this may be the case for the recognition of specific tools, e.g. that proposed under Article 33a which is strictly a crisis prevention measure and not a resolution action.

AFME strongly recommends that these issues be discussed in the trilogue negotiations. It is important that lessons are learnt following similar requirements being placed on firms under the BRRD (article 55) but also from the experiences of firms already subject to similar requirements under relevant national laws.

9 Article 55

AFME continues to welcome the acknowledgment of the practical challenges with the implementation of the existing scope of article 55 of the BRRD and the need to address these. AFME has highlighted these issues on numerous occasions[29] and also assisted banks with implementation through developing model clauses.[30] It is essential to address these issues in order to provide a workable solution while not threatening resolvability. It also remains important to encourage the development of statutory recognition in other jurisdictions.

As proposed by the European Commission, an approach that provides for a waiver (or exemption) from the requirements has been retained by both the European Parliament and Council. Amendments have been proposed to the original European Commission text, including on the grounds for impracticability being set out as having to be 'legally or otherwise' in both of the co-legislators' approaches, the inclusion of a cap on the use of any exemption (under the European Parliament proposals – which we strong oppose), and language relating to the liabilities that may benefit from such an exemption or waiver. We visit these changes in turn below proving our views on each.

'Legally or otherwise' impracticable: AFME welcomes the changes that provide for a broader scope of impracticability, as there are many sources for the problems that have been faced by firms in attempting to fulfil the requirements as they stand today. AFME interprets the use of the term 'otherwise' as a catch-all term that avoids the risk that the level one text is too prescriptive, as may have previously been the case by making reference to '*legally, contractually, or economically impracticable*'. It is important for firms that encounter cases of impracticability to not be excluded from utilising the proposed waiver by virtue of the choice of potentially narrow language in the text of the BRRD.

We observe the mandates that have been provided to the EBA to further specify the conditions of impracticability under the terms '*legally or otherwise*', as well as the introduction under the Council proposals for resolution authorities to specify (where it deems necessary) the categories of liabilities among which the waiver may be applied for the reasons of such impracticability. Whilst this additional information from the EBA will be helpful in providing firms additional guidance to give greater certainty as to when they can utilise the waiver, it is important to ensure that subsequent resolution authority decisions do not lead to a 'patchwork' approach when specifying which categories of liabilities can be subject to the waiver. It is vital that a harmonised approach is taken forward that learns from the difficulties firms have faced in trying to fulfil the overly burdensome requirements.

Proposed cap on the use of the exemption: The European Parliament proposals to include a cap on the amount of liabilities that can be subject to the proposed waiver is strongly opposed by AFME. It is not clear

[29] For example, http://www.afme.eu/globalassets/downloads/consultation-responses/afme-paper-highlighting-concerns-with-the-scope-of-contractual-recognition-of-bail-in-under-article-55-brrd.pdf;
[30] http://www.afme.eu/globalassets/downloads/industry-guidelines-standard-forms-and-documents/afme-model-clauses-for-contractual-recognition-of-bail-in.pdf

how the cap has been calibrated, and there is no assessment of the impacts on different European banks. It is also not entirely clear how the denominator for the proposed cap is to be assessed as it deals with a hypothetical figure that firms would not currently monitor.

The suggestion to include a cap does not take into consideration the various safeguards that are maintained, both to ensure the waiver cannot be utilised were it to impede the resolvability[31] of the relevant institution and to disincentivise its use as any waived liability cannot be counted towards meeting a firm's MREL requirements.

Further to this there are implications were such a cap taken forward. This includes the issue of contingent liabilities – which are one such source of impracticability – and the manner in which they would be calculated against the cap. Contingent liabilities only exist once a pre-determined event occurs, such as a breach of contract, and as such lack a monetizable value until this state of the world is realised (if ever). Were the proposed cap to be met the question as to what firms would have to do regarding activities that generate liabilities with issues of impracticability (such as trade finance activities) comes into question – i.e. should firms simply cease providing this important activity despite the fact that to obtain the waiver there would be no impediment to resolvability created. Having a cap that provides no additional benefit to a firms resolvability, by virtue of the above mentioned safeguards applying, lead to a firm withdrawing from an economically important activity is unnecessarily harmful and counterintuitive.

The proposal of a cap undermines the whole concept of excluding liabilities where it is impracticable to amend contracts: if the cap applies, institutions will be required to amend liabilities even where it is accepted that such an amendment is impracticable. This therefore limits the effectiveness of the changes that have been proposed. AFME therefore strongly opposes the inclusion of this arbitrary cap in the final legislative text.

Hierarchy restrictions: We support the condition that the waiver does not impede the resolvability of the institution. However, we do not believe that it is necessary or appropriate to restrict resolution authorities from applying the waiver to debt instruments that are unsecured liabilities. The scope of the definition of debt instruments is very broad and this restriction in applying the waiver would be overly restrictive. The scope of the definition does not only apply to bonds, but also includes instruments acknowledging a debt. For example, the definition of debt instruments may also include bills of exchange and promissory notes, which are often used in trade finance. Additionally, where firms operate through cross-border branches and rely on attracting local currency through various forms of unsecured funding transactions, in certain jurisdictions, the inclusion of contractual recognition clauses has been as impracticable as for other types of contracts. If debt instruments are excluded, and thus the necessary waivers cannot be granted, in order for the firm to be compliant with the requirements under the BRRD the branch would have to end parts or all of its local business in certain jurisdictions as local funding can no longer be relied upon. We therefore welcome the proposed language under the Council approach to the extent debt instruments are not explicitly excluded.

It is therefore necessary to address these issues in order for the waiver to be capable of achieving its objective.

Considering the changes that have been proposed AFME supports the inclusion of the Council approach to amending article 55 of the BRRD but continues to encourage trilogue discussions to deliver on the necessary changes discussed above – in particular on the inclusion of *pari passu* liabilities within the scope of the waiver.

[31] The condition in article 55(2)(c) that the resolution authority determines that the waiver does not impede resolvability provides a sufficient safeguard to ensure that any waiver that is applied does not impede the objective of resolvability.

10 MDA Restrictions

AFME welcomes the proposed changes in the Council approach to handling MDA restrictions, specifically in relation to a breach of MREL and the introduction of new Article 16a of the BRRD. As we have previously made clear, a breach of MREL should be taken seriously by the authorities. However, the response of the supervisory and resolution authorities should be tailored to address the cause of the breach in the circumstances. It would be inappropriate for Maximum Distributable Amount (MDA) restrictions to be automatically imposed by virtue of a bank using 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. Importantly, this would also generate considerable and potentially destabilising uncertainty as to the threshold at which MDA could apply.

Both the European Parliament and Council proposals, in removing the concept of MREL Guidance as a buffer, open up the question of how to handle the application of MDA restrictions. The European Parliament in its approach largely seeks to continue to apply MDA restrictions as per the original European Commission proposals under CRDV with some minor amendments that create an unlevel playing field[32].

The Council position however takes the view that MREL breaches may be better approached in a more tailored fashion under new Article 16a ('Power to prohibit certain distributions') in the BRRD. Through the introduction of the 'M-MDA' under Article 16a, the relevant authorities are able to address a breach of MREL on a case-by-case basis, understanding that the imposition of MDA restrictions may be counterproductive, in damaging the possible market appetite for further MREL eligible issuances from the firm in breach. The article sets out criteria to guide the decision-making process of regulators and ensures that adequate consideration is given to the cause of a breach were it to ever occur.

This introduction, alongside the relevant amendments to article 141a of the CRDV proposals are therefore supported by AFME, and we encourage the Council approach to be taken forward in the final legislative text.

11 Redemption restrictions

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. We support the EBA's recommendation[33] that a redemption approval regime should be introduced for eligible liabilities but should be limited to cases where the proposed redemption would lead to a breach of its MREL requirement. This approach is also consistent with the TLAC Standard. We maintain our position that the proposed extension of the capital regime for supervisory permission to eligible liabilities in article 78 CRR should be amended to limit the requirement for permission to these circumstances.

Nevertheless, we acknowledge the different views of the co-legislators as trilogue discussions are entered into on this topic. We note the splitting out of responsibilities between the competent authority and resolution authority in the Council approach – as per Articles 78 and 78a of the CRR respectively, but we are disappointed that this has also led to the removal of the general prior permission proposed in the European Commission's original text for the possible redemption of capital instruments. Whilst this is retained for MREL eligible liabilities with a limitation on the duration of such a general prior permission, we maintain that this is overly restrictive when compared to the expectations under the FSB's TLAC Standard.

The European Parliament retains Article 78 but introduces new provisions under Article 77 to better frame when permission is required for the reductions of either capital instruments of other MREL eligible liabilities. AFME welcomes the ideas put forward by the European Parliament in this respect, as whilst it is not fully in

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[32] In particular we refer to the inability of a derogation or so-called 'grace-period' for 6 months such that the application of MDA restrictions would have to apply upon any breach where the institution is a GSII, with no regard taken as to the causes of a breach, possible solutions, and the impact MDA restrictions may have on the likelihood of those solutions being taken forward and succeeding.

[33] EBA – Final MREL Report - https://www.eba.europa.eu/documents/10180/1695288/EBA+Final+MREL+Report+%28EBA-Op-2016-21%29.pdf

line with the FSB TLAC Standard, it is closer than what has otherwise been suggested by both the European Commission and Council[34].

It is vital that the final legislative framework provide banks greater flexibility to manage their issuances and facilitate the ability of banks to be market-makers in their own eligible instruments. This is prerequisite for the development and ongoing support of a liquid market in eligible liabilities. As such the closer co-legislators can come to fulfilling the transposition of the FSB TLAC Standard's approach, and the approach favoured by the EBA in their recommendations, the better.

12 MREL Cross-holdings

We support the proposed approach to the deduction of TLAC holdings from Pillar 1 MREL which takes due account of the application of the MREL framework to all institutions.

In order for banks to be able to assess the level of holdings of other GSIIs' Pillar 1 MREL, they require clarity as to whether instruments they may be holding are eligible liabilities. The timing of the introduction of the deduction should therefore be linked with the timing of relevant disclosure requirements.

13 Reporting and disclosure requirements

The European Parliament and Council approaches to reporting and disclosure requirements are of keen interest to AFME, as an appropriate disclosure framework is necessary to support the market for MREL issuances. A number of proposed amendments have been suggested under the relevant articles of both the BRRD and CRR, which we comment on in turn below.

Article 45i of the BRRD: Both co-legislators take forward proposed amendments to the article of the BRRD that governs supervisory reporting and disclosure requirements. The European Parliament propose that entities should report to their competent and resolution authorities, on at least a yearly basis (or upon request), as opposed to the Council's similar proposal on a semi-annual reporting frequency. It is AFME's view that reporting frequency should strike a balance between the burden on the firm and the benefit to authorities, as well as the consistency with public disclosure requirements (for example as required under article 433a(3) CRR). We therefore support the Council approach to semi-annual supervisory reporting.

However, we have concerns regarding the additional requirements proposed by the European Parliament text. Specifically, that the levels of liabilities that are not excluded from the scope of bail-in be reported. This is no small exercise for a bank to undertake and would burden firms with a substantial cost to meet these excessive requirements, particularly given the requirement proposed is non-exhaustive in its nature, as opposed to requiring reporting for a very specific set of assets or liabilities. AFME therefore does not support the inclusion of this substantive requirement particularly in lieu of any formal impact assessment of the task that would need to be undertaken.

Further to this the European Parliament propose a possible derogation from both reporting and public disclosures where firms meet a leverage ratio of at least 10% and are not intended to be placed into resolution. This contrasts with the Council proposal to disapply these requirements for firms that are not intended to be placed into resolution without needing to meet a certain leverage threshold. As AFME advocates for the disapplication of disclosure requirements for entities where no MREL requirement has been set, whilst we are encouraged by the approach taken forward by both co-legislators, we believe that the Council position is a more sensible approach.

[34] Key aspects of the changes suggested here include the ability of firms to exercise redemptions, repayment or repurchase of instruments prior to the contractual maturity without prior permission where they operate a management buffer of 2.5% RWAs above the applicable requirements after any redemption, repayment or repurchase, and notify the competent authority of its intended action. Whilst we would point out that this is 2.5% of RWAs away from the internationally agreed approach with regard to TLAC as per the FSB TLAC Standard, in that permission should only be required where such action leads to a breach of requirements, we support the proposal put forward by the European Parliament in principle – although we would request that the margin of 2.5% RWAs be subject to further assessment as a lower margin should be sufficient for authorities to maintain confidence in the ability of the firm to meet its requirements on an ongoing basis.

The Council proposals further introduce to the mandate for EBA Implementing Technical Standards language that gives regard to the need to align the requirements under article 45i of the BRRD with the separate reporting and public disclosure requirements that entities subject to Articles 92a or 92b CRR are to meet. Consistency between these requirements is key and AFME strongly supports the introduction of this language in the final BRRD legislative text.

Article 433a(3) of the CRR: The Council propose further amendments to the CRR in relation to the supervisory reporting and public disclosure requirements for firms subject to either article 92a or 92b. Within these proposals the Council introduce a requirement to disclose on a quarterly basis the key metrics under article 447 (h) of the CRR. This change is inconsistent with the semi-annual frequency otherwise proposed, and as such we would suggest that it is inappropriate to impose this additional requirement on firms.

Annex A: Issuer call options and instrument maturity

Both the European Parliament and Council texts have proposed the insertion of additional language surrounding the maturity date to be observed where issuer call options and an incentive to redeem are present in an MREL eligible instrument under Article 72c of the CRR. Whilst this text goes some way to clarifying the defined maturity of the instrument where both an issuer call and an incentive to redeem are present, it does not provide the necessary clarity where only an issuer call is present.

We are concerned by the lack of clarity in this instance and encourage both co-legislators to make clear that where only an issuer call is present, the original stated maturity of the instrument should remain the observed maturity date. An institution may not action any redemption option in the absence of approval from the relevant authority, and as such the presence of an option should not shorten the observed duration of an otherwise MREL eligible instrument in a way that undermines the resolvability of the institution.

Where this approach is not taken forward there is a risk of a material impact on the amount of MREL firms may need to issue.

Take the example of a bank that has an issuance capacity of €30 bn, this limit coming from overall investor lines (concentration limits, credit appetite, frequency of issuance). If this bank issues €5 bn per year, with a contractual maturity of 6 years, its MREL will develop as shown below. The first issue, during Year 1, will come to maturity during Year 7, and cease to be MREL eligible during year 6, as it will fall below 12 months residual maturity.

No call	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9
Outstanding 01/01	15	20	25	30	30	30
New issues	5	5	5	5	5	5
Maturities	0	0	0	5	5	5
Outstanding 31/12	20	25	30	30	30	30
share <12 months	0	0	5	5	5	5
Eligible MREL	**20**	**25**	**25**	**25**	**25**	**25**

For an issuance capacity of €30 bn, the bank will achieve a MREL level of €25 bn. If callable instruments with no incentive to redeem are eligible until contractual maturity, the MREL development will be different. If the bank issues liabilities with a contractual maturity of 7 years, callable after 6 years (7NC6), the first issue, during Year 1, will have an original contractual maturity in Year 8, but can be called and replaced by a new issue during year 7.

Callable 7NC6	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9
Outstanding 01/01	15	20	25	30	30	30
New issues	5	5	5	5	5	5
Calls	0	0	0	5	5	5
Outstanding 31/12	20	25	30	30	30	30
share <12 months	0	0	0	0	0	0
Eligible MREL	**20**	**25**	**30**	**30**	**30**	**30**

For an issuance capacity of €30 bn, the Bank maximizes its MREL level, reaching €30 bn, or 20% more than it would without the acceptability of callable instruments.

The ability of a bank to call MREL eligible liabilities one year before contractual maturity does not weaken their MREL levels. CRR Articles 77 and 78a (Council version), or Article 77 and 78 (Parliament version), both contain dispositions that allow such calls to be exercised if and only if they do not lead to the MREL level falling

below the requirement for the bank in question. On the contrary, as shown above, for a given level of issuance, the ability to issue callable instruments increases the MREL level and lengthens the average residual maturity of MREL.

The utilisation of callable issuances can open access to new investor populations, in both short and long-term deals. In short term issuances, if callable deals are treated as having a maturity at call date, short deals such as 3NC2 become economically unviable for banks. A liability with a 2-year maturity will be MREL eligible for only half of its economic life, doubling the effective margin cost of MREL eligible debt. If callable liabilities with no incentive to redeem are considered to have a maturity date at contractual maturity, deals such as 3NC2 become economically viable, and open up a new investor population of money market funds, who are able to purchase such liabilities. This increases the overall MREL capacity of banks, by enlarging the investor population available to purchase MREL eligible liabilities.

There exists a significant investor appetite in the Far East for long-dated callable deals, such as 20NC6. If callable liabilities with no incentive to redeem are accepted for MREL until contractual maturity, such liabilities are MREL eligible until they are called, or until 12 months before maturity at the maximum if not called. US banks are significant issuers into this market, generating TLAC eligible liabilities of up to 19 years (in the case of 20NC6). If the EU rules are not clarified, EU banks issuing such liabilities will generate liabilities that are MREL eligible for only 5 years (in the case of 20NC6), meaning that they will be unable to compete in pricing terms for such investments, as the margin paid over 20 years for Non-Preferred Senior debt will be uneconomic compared to a MREL benefit of only 5 years.

Uncertainty over the regulatory treatment of liabilities with issuer calls places EU banks at a competitive disadvantage compared to their peers. US, Swiss and UK banks regularly issue callable TLAC/MREL eligible liabilities, clearly benefitting from the certainty of regulator treatment afforded to them by their respective authorities. To date, no Eurozone bank has issued a callable public benchmark liability, demonstrating that uncertainty over the MREL eligibility of such issues is a brake on building their MREL capacity. It is therefore in the interests of EU authorities to provide a level playing field by adding the necessary clarity to the final legislative text.

For these reasons AFME strongly encourages this issue to be addressed by co-legislators. It should be made clear under Article 72c that where only issuer call options, in the absence of incentives to redeem, are present, this should have no impact on the observed maturity with regard to the original maturity of the instrument.

Annex B: Reference to set-off and netting arrangements

We refer to the proposal of Regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements and amending Regulation (EU) No 648/2012 (the "Regulation").

In particular, we refer to the proposed new wording of Articles 52.1.(r) and 63.(p) of the Regulation, which, among others, include a new condition for purposes of counting additional Tier 1 capital instruments and Tier 2 capital instruments as such for regulatory purposes, respectively. The referred new condition states that instruments issued by credit entities shall not be subject to any set-off arrangements or netting rights that would undermine their capacity to absorb losses (the "Proposal").

Under civil law jurisdictions, set-off shall take place when two persons, in their own right, are reciprocally creditors and debtors of one another, being mainly required that both debts are similar and fungible (i.e. they consist of an amount of money) and that they are outstanding, due and payable. Thus, civil law legislations do not require the existence of an express agreement for the set-off to take place, since it operates automatically when all the legally required conditions are met, without prejudice to the fact that it may have to be alleged by one of the parties when satisfying one of the debts to be factually applied. Set-off is therefore an enacting provision under civil law jurisdictions that the parties shall expressly and explicitly exclude by written agreement if they wish to avoid its direct and automatic application.

The legal effect of set-off and netting is to extinguish both debts in the coinciding amount, even if creditors and debtors should be unaware of it. Thus, in compliance with the requirements established in civil law jurisdictions, as mentioned above, when two persons are reciprocally creditors and debtors and their debts are fungible, outstanding, due and payable, the set-off operates automatically and the obligations are extinguished consequently in the coinciding amount.

Bearing in mind that grandfathering would not be envisaged in this respect, we perceive that the application of the Proposal to all the issuances currently in force is a burdensome and disproportional measure for capital instrument issuances not containing set-off or netting exclusion clauses made by issuers under civil law, especially considering that we have gone through very costly legal processes to make the issuances of capital instruments in order to comply with, among others, the regulatory standards of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (CRD IV) applicable from time to time and to obtain the necessary authorizations required for regulatory purposes.

Provided that few of the referred outstanding issuances –which comply with all the legal requirements in force up to the present date- do not include any provision regarding the exclusion of set-off or netting -since at the date of their issue such requirement was not established as an express condition needed for their computability as capital instruments for regulatory purposes-, lack of grandfathering in the application of the Proposal would involve too many risks regarding the computability of additional Tier 1 capital and Tier 2 capital instruments that may jeopardize the financial system stability since the capital structures of many financial entities and other issuers would considerably be modified as a consequence of the Proposal. Therefore, assuming the definitive entry into force of the Proposal, many European issuers would be in a clearly detrimental situation provided that the majority - if not all - of the issuances subject to civil law jurisdictions that are currently placed on the market would cease to be computable as additional Tier 1 capital and Tier 2 capital elements, as the case may be, as a result of the automatic legal application of set-off, with the consequent damage that this would cause to them- in a resolution scenario, and generally to the capital structures in the banking system, its financial stability and the legal certainty. Notwithstanding the foregoing,

it should be clarified that, for the time being, the legal set-off and netting rights have not led to any detriment, obstacle or impediment to the absorption of losses in scenarios of resolution or liquidation of European issuers as, among others, the concurrence of all legal requirements at a given moment is difficult due the nature of the subjects and obligations involved.

Consequently, and in line with the Proposal –with which we agree-, we hereby request that the term "arrangement" is modified to "express and explicit (…) agreement", as expressed below and which we understand is the purpose of the Proposal, so that the new condition to be included requires that there is no express and explicit set-off and netting agreements that would undermine the capacity of the capital instruments to absorb losses in resolution -thereby not affecting current issuances, which generally do not contain provisions relating to set-off, and which without clarification of the Proposal would otherwise be materially affected- taking into account that, under civil law legislations, set-off provisions automatically applies except for an express and written agreement excluding it.

In accordance with the foregoing, we propose the new condition required in this regard to be worded as follows:

"*the instruments are not subject to any* ***express and explicit*** *set-off* ***~~arrangements~~*** *or netting* ***agreements*** ***~~rights~~*** *that would undermine their capacity to absorb losses*"

The above, for the purposes of ensuring the quantity and quality of capital in the banking system, the adequate solvency of the entities, their capital endowment for regulatory purposes in accordance with the regulations in force at the time of their issuance and, with it, the legal certainty.

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/ About AFME

The Association for Financial Markets in Europe (AFME) is the voice of all Europe's wholesale financial markets, providing expertise across a broad range of regulatory and capital markets issues.

We represent the leading global and European banks and other significant capital market players.

We advocate for deep and integrated European capital markets which serve the needs of companies and investors, supporting economic growth and benefiting society.

We aim to act as a bridge between market participants and policy makers across Europe, drawing on our strong and long-standing relationships, our technical knowledge and fact-based work.

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