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European Banking Authority
Tower 42
25 Old Broad Street
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Submitted via the EBA website

Consultation paper on draft guidelines on the specification of measures to reduce or remove impediments to resolvability and the circumstances in which each measure may be applied under Directive 2014/59/EU

Dear Sir / Madam

Please find enclosed AFME's response to the EBA consultation paper on draft guidelines on the specification of measures to reduce or remove impediments to resolvability and the circumstances in which each measure may be applied under Directive 2014/59/EU (EBA/CP/2014/15).

Please do not hesitate to contact us if you have any questions.

Yours faithfully

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Consultation response

EBA consultation paper on draft guidelines on the specification of measures to reduce or remove impediments to resolvability and the circumstances in which each measure may be applied under Directive 2014/59/EU (EBA/CP/2014/15)

3 October 2014

The Association for Financial Markets in Europe ("**AFME**") welcomes the opportunity to comment on the European Banking Authority ("**EBA**") Consultation Paper (the "**CP**") on draft guidelines on the specification of measures to reduce or remove impediments to resolvability and the circumstances in which each measure may be applied under Directive 2014/59/EU (the "**BRRD**") (EBA/CP/2014/15).

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.[1]

AFME has been very active on resolution issues for a number of years and has played a leading role in the industry efforts, at a European and global level, aimed at establishing credible and effective recovery and resolution frameworks and addressing the problem of "too-big-to-fail".

We set out below our comments in response to the CP. We set out some general comments on the draft guidelines in the first section and answer the specific questions raised by the CP in the following section.

I. General comments

We support the proposed approach of a case by case analysis of measures to address impediments to resolvability within a clear framework to ensure consistency of the application of measures to address impediments throughout the European Union.

We are therefore supportive of the objective of the guidelines. However, we have some concerns that the guidelines could, in practice, create a de facto checklist and apply pressure on resolution authorities to explain how they have considered every measure discussed in the guidelines for each institution. It should be clarified to resolution authorities that they are only required to comply (or explain why they have not complied) with the guidelines as a whole and

[1] AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

not required to explain why they have not imposed a particular measure on each institution where impediments to resolvability are identified.

Alignment with the level 1 text

While the draft guidelines refer to "substantial" impediments in several places, the guidelines should make it clear throughout that measures should only be required to address "substantive" impediments as required by the level 1 text. We note that some paragraphs in the draft guidelines currently refer to impediments that "may hamper" or measures that would "improve" resolvability, for example in paragraph 12(a), but article 17 of the BRRD does not provide the authorities with powers to pursue such goals.

It would also be helpful for the guidelines to make reference to the process for identifying appropriate measures as set out in the level 1 text, including the initial step of the institution proposing measures that would address any impediments identified by the resolution authority. The guidelines should make it clear that only where the measures proposed by the institution do not effectively address or remove the substantive impediments may the resolution authority require an alternative measure to be taken.

Impediments to liquidation

We note that paragraph 5(c) of the draft guidelines refers to impediments to a liquidation of an institution. The guidelines should make it clear that impediments to liquidation should only be considered where the institution would be placed into liquidation in the event of its failure and not where it is likely to be placed into resolution.

Proportionality

We strongly support the proposed requirements for measures to be "suitable, necessary and proportionate". The draft guidelines should clarify in paragraph 5 that *any* measures to address impediments to resolvability under the BRRD, including those set out in Title II of the guidelines, *must* be suitable, necessary and proportionate. The draft guidelines only refer to the measures listed in article 17(5) but this is a non-exhaustive list. Therefore we suggest that the wording "Each of the measures listed in Article 17(5) of Directive 2014/59/EU may be applied" at the beginning of paragraph 5 is replaced with "Any measures to address impediments to resolvability under Article 17 of Directive 2014/59/EU may only be applied".

When assessing what measure might be appropriate, resolution authorities should have regard to the capacity of the relevant institution to implement the measure. Measures should only be applied where it is within the powers of the institution to take the required action to implement them. We suggest that the requirement for measures to be "suitable" should include a reference to the capacity of the institution to implement them. This could be reflected in the following revised wording for paragraph 5(a) of the guidelines:

"A measure is suitable to reach the intended goal if <u>it is capable of being implemented by the institution and</u> it is able to materially reduce or remove the relevant impediment in a timely manner."

Of particular importance is the requirement for measures to be "necessary" as proposed in paragraph 5(b) of the guidelines. We strongly support the requirement for there to be no less intrusive measures that are capable of addressing the impediment.

We suggest that when considering whether there are any less intrusive measures, the resolution authority should be required to consider whether there are any actions that it could take to address the impediment, for example through an amendment to the preferred resolution strategy or by improving cooperation and sharing relevant information with other resolution authorities. This approach would mitigate the risk of imposing unnecessary measures on institutions which could be addressed by action by the resolution authorities themselves.

We also strongly support the requirement for measures to be proportionate. In particular, we are very supportive of the requirement in the final sentence of paragraph 5(c) for measures to only be applied where the impediments cannot be addressed at the point of failure or in resolution. The focus should be on addressing impediments to the stabilisation of the bank over a short period of time and not extend to matters which can be addressed once the bank is in resolution. This principle should be reflected in other areas of the guidelines, for example paragraphs 10(a), 10(b), 12(a) and 12(b).

Paragraph 5(c) of the guidelines could also helpfully include reference to the following requirements which are set out in the level 1 text to ensure alignment:

- the need to take into account the effect of the measure on the "the business of the institution, its stability and its ability to contribute to the economy" (see article 17(4) of the BRRD);
- to "duly consider the potential effect of those measures on the particular institution, on the internal market for financial services, on the financial stability in other Member States and the Union as a whole" (see article 17(7)); and
- to "consider the impact on the institution's business model and recommend any proportionate and targeted measures" (see article 18(2)).

These are important factors to be taken into account when considering whether a measure is proportionate.

Emphasis on the relevance of a measure to the resolution strategy

Several of the proposed measures are only likely to be relevant to certain types of resolution strategy, for example only SPE style strategies or only MPE style strategies and this should be set out clearly in the guidelines.

For example, paragraph 7(b) is only likely to be relevant where the resolution strategy involves the group being be split up. Paragraph 7(c) of the draft guidelines should be re-worded to clarify that this applies only where (as opposed to "in case") the resolution strategy envisages a separation of the group or business of the institution. We suggest that paragraph 7(c) begins in a similar manner to paragraph 8(a) i.e. "where necessary to support a strategy involving a separation of legal entities within the group..." Similarly the measures discussed in paragraphs 11(a) and 13 are also only likely to be relevant to resolution strategies involving the group being split up.

Paragraph 11(b) is only likely to be relevant where the resolution strategy relies upon resolution powers being applied in the jurisdiction where these are not present. Therefore a

direct link should be made in the paragraph between the absence of a resolution power in a jurisdiction and the undermining of critical functions in a Member State.

We do not believe that paragraphs 11(d) and 13(c) which refer to the specific case of institutions that are subject to legislative or supervisory separation requirements are necessary. There is a general power for resolution authorities to take measures to address impediments to resolvability. Including these paragraphs could imply that different treatment is required for entities that are subject to such separation requirements, which we do not believe to be the case.

Measures requiring changes to legal or operational structure (paragraph 13)

The measure of requiring changes to the legal or operational structure of an institution addressed in paragraph 13 of the draft guidelines should be clearly focused on addressing substantive impediments to the preferred resolution strategy. It is not the purpose of this measure to reduce complexity or interconnectivity generally as these issues are addressed by other areas of regulation. We believe that the intention of the guidelines is to address substantive impediments but this could helpfully be clarified, for example in paragraph 13(a).

Location of subsidiaries: We do not believe that paragraph 13(d) which requires resolution authorities to "ensure that subsidiaries which are material to the continuity of critical functions are located in EU or third country jurisdictions that do not pose impediments to resolution" is necessary or helpful because it appears to suggest categorisation of third country jurisdictions that are themselves impediments to resolution. It is unclear how this assessment would be done and such a designation is unlikely to encourage progress in cross-border cooperation. The continuity of critical functions is adequately addressed by the other measures considered.

Separability: Paragraph 13(e) requires resolution authorities to consider measures to ensure the separability of business lines with non-critical functions that would be wound down under an SPE resolution strategy. However, such a resolution strategy would not necessarily involve any separation of such business lines which could be wound down within the existing structure and therefore we suggest that this requirement is removed.

FMI access: We note the proposed measure in paragraph 13(g) of requiring institutions to renegotiate contracts with financial market infrastructures to ensure continued access in resolution. This is an industry-wide issue where a coordinated approach by the authorities might be necessary to facilitate changes because individual banks might not be able to successfully negotiate such changes bilaterally. Therefore we believe that this requirement should be substantially reworded to reflect the fact that firms may not be able to make such changes unilaterally or removed.

Operational continuity: It is important to acknowledge in the guidelines that operational subsidiarisation is one method of achieving the objective of ensuring continuity of access to shared services that are required to support critical functions where the resolution strategy involves a break-up of the group, but it is not the only solution for achieving this objective. Paragraph 13(f) of the draft guidelines correctly focuses on the objective and refers to operational subsidiarisation as one option for achieving this. However, paragraph 13(h) is less clear in this regard. We suggest that paragraphs 13(f) and 13(h) are merged as they appear to address the same issue.

Paragraph 13(i) of the draft guidelines requires resolution authorities to consider preventing any member of a group from having "critical dependencies" on services under contracts not under the jurisdiction of EU Member States that permit termination upon the resolution of group entities. Such a requirement would have far-reaching implications and is likely to be very challenging for global banks to meet. Further guidance should be provided on what is deemed to be a "critical dependency". In particular this paragraph should be clarified to ensure that it does not extend to entities outside the EU. It should also require resolution authorities to take account of cross-border cooperation agreements and powers in other jurisdictions to override such termination rights, either under local resolution powers or through the recognition of EU resolution powers in that jurisdiction.

Funding of subsidiaries: Paragraph 13(j) of the draft guidelines introduces requirements relating to the funding of subsidiaries. These should be phrased in a similar manner to the other paragraphs, namely "resolution authorities should consider requirements if necessary for the effective implementation of the preferred resolution strategy..." Such requirements also to some extent potentially overlap with aspects of setting the minimum requirement for own funds and eligible liabilities ("**MREL**"). We therefore suggest that a more general reference, for example, "resolution authorities should consider requiring capital and liquidity arrangements within groups to support the resolution strategy" would be more appropriate in paragraph 13.

Availability of staff: We are unclear as to what measures are anticipated under paragraph 13(k) requiring institutions to *"ensure the availability of key staff to substitute the top management during the resolution"* and how this could be achieved in practice. For example it is not possible to prevent employees from leaving if they should choose to do so. Additionally it is not necessarily the approach that key staff would "substitute" senior management. If any potential measure is retained in relation to key members of staff, it could be better expressed as requiring institutions to take reasonable precautions to retain key staff where this is necessary to implement the preferred resolution strategy.

Complexity and size of trading book: Paragraph 13(m) of the draft guidelines also raises some concerns. It is also unclear what is meant by "complexity" for these purposes and when this measure might be necessary. If this paragraph is to be included, it should clarify when it is anticipated that this measure might be appropriate and when, for example, the measure should be applied as opposed to another measure such as ensuring that there is sufficient loss absorbing capacity in place. These issues should also be addressed by other areas of regulation such as the Fundamental Review of the Trading Book.

Measures requiring the establishment of a parent financial holding company

We consider it unlikely that the absence of an EU holding company would be a substantive impediment to resolvability. We also consider it highly unlikely that a measure requiring an EU holding company to be put in place would ever be a proportionate response to a finding that a resolution plan is not feasible or credible. There are myriad other measures that are likely to represent a more proportionate response to such a finding, for example ensuring that entities in the EU have an appropriate level of MREL. We consider paragraph 14 of the guidelines further in our response to question 4 below.

Interrelationship with MREL requirements

We believe that MREL under article 45 of the BRRD should be focused on resolvability and facilitating the group resolution plan. We therefore support MREL being considered as part of the resolvability assessment process. However, it should be clarified how these guidelines interrelate with article 45 and the forthcoming regulatory technical standards ("**RTS**") on the assessment of MREL under the BRRD. It should be clarified in paragraphs 15 and 16 of the draft guidelines that these do not create a new additional requirement for loss absorbing capacity in addition to MREL. In particular it is unhelpful to introduce a new definition of loss absorbing capacity in these guidelines and this should instead refer to MREL.

Further comments on measures not addressed by the questions in the CP

Paragraph 4(b) of the draft guidelines states that there is no requirement for an institution to have breached any legal requirements for the powers to address impediments arise. We suggest that this could be clarified to refer to "prudential regulation requirements" which is the language used on page 7 of the CP rather than "any legal requirements".

We assume that paragraph 8(b) of the draft guidelines is aimed at intra-group exposures, but the drafting is currently unclear as it could currently include exposures to external counterparties. This should be clarified.

It would be helpful to clarify what is meant by a "systemic" entity in paragraph 9(b). Paragraph 9(c) should be amended to provide that resolution authorities "should consider requiring..." rather than "should require" the relevant information. This would be consistent with the wording of other paragraphs and avoid any suggestion that this paragraph overrides the requirements set out in paragraphs 4 and 5.

Cost of removing impediments

Finally, while we accept that it is difficult to estimate the costs of removing impediments to resolvability and that these will vary substantially depending upon the firm and the particular measure, we regard the estimate referred to in the impact assessment of an average of €14,629 as extremely low. We expect that in practice the costs to institutions of implementing measures will far exceed this and while we note the caveats included in the analysis, using this estimate as the basis of the cost benefit analysis is thoroughly misleading.

II. Comments in response to specific questions

Question 1: Should there be further specification on variant strategies? Do you think the guidelines should differentiate between more or less important critical functions and provide for a fallback strategy to ensure the continuation of the most essential critical functions?

As we have raised in our response to the EBA consultation paper on draft Regulatory Technical Standards on the content of resolution plans and the assessment of resolvability (EBA/CP/2014/16), we have some concerns regarding the concept of "variant strategies". This appears to be a new concept which is not contained in the BRRD or FSB guidance. The

distinction between a "variant" of a strategy and a separate resolution strategy is unclear. While we agree that a resolution plan can and should make provision for different circumstances that might arise, use of this term could create confusion.

Measures should be focused on addressing substantive impediments to the preferred resolution strategy. Impediments to additional resolution strategies should not be required provided that the preferred resolution strategy is feasible and credible. Impediments to "variant strategies" should therefore only be addressed in the event that the preferred strategy is not feasible and/or credible. In that case the variant strategy should become the preferred resolution strategy and the provisions in the draft guidelines on impediments to variant strategies are unnecessary.

We suggest that this should be clarified in the guidelines. It should also be emphasised that provided that an institution is resolvable under one resolution strategy, there is no need (or indeed any power) to require the institution to take measures to address any impediments to a "variant" or any other resolution strategy.

As we have suggested in our response to the consultation paper on the content of resolution plans and resolvability assessments, the issue of resolution plans needing to be able to adapt to specific circumstances could be better addressed by expressing any "variants" as being *part of* the preferred resolution strategy where alternative actions may be taken in response to certain key risks and therefore subject to a single resolvability assessment. Provided that one or more variants of (or options within) the strategy is credible and feasible, the institution is resolvable. Similarly any measures to address impediments should be limited to impediments to the preferred resolution strategy.

We do not believe that the guidelines should create a distinction between "more critical" or "less critical" critical functions. Such a distinction would be inconsistent with the approach reflected in the BRRD which requires the maintenance of all critical functions in resolution.

Question 2: Do you see further cases for applying this measure (requirement to divest specific assets)? How can the asset structure of institutions be improved?

We are unclear on the circumstances in which this measure might be necessary to address substantive impediments to resolvability. It is more likely to be a step that could be taken in the recovery phase under an institution's recovery plan. One of the objectives of resolution is to provide a framework for an orderly resolution and avoiding a "fire sale" of assets which would destroy value and could cause financial instability. The resolution tools under the BRRD have been established for this very purpose. It is not clear what types of impediments the measures discussed in paragraph 10(a) of the draft guidelines are seeking to address.

Any measures requiring the divestment of assets should be considered in combination with liquidity stress testing and other stress tests carried out by banks. The impact of any divestments should also be considered, particularly if applied across the industry where extensive divestments could create a depressed market and possibly a bubble in other assets that would be used to replace them.

In relation to the broader question as to how the asset structure of institutions can be improved, it is important that the guidelines are focused on addressing substantive impediments to the

preferred resolution strategy and not a general "improvement" of the structure of institutions' assets. The latter is not the purpose of these powers, nor would it desirable given the homogeneity in balance sheets and systemic rigidity that could result. The requirements for measures to be "suitable, necessary and proportionate" including that there are no less intrusive measures available are also of particular relevance here.

Question 3: Do you see further cases for applying the measures considered in paragraphs 11 and 12 (limiting or ceasing certain activities and restricting or preventing the development or sale of new business lines or products)? Are there specific types of activities or products that can constitute impediments for resolvability? How can these activities or products be identified in a targeted way?

The measures considered in paragraphs 11 and 12 of the draft guidelines are potentially far-reaching powers which interfere with institutions' businesses. The guidelines should emphasise that they should only be imposed where they are suitable, necessary and proportionate to address specific substantive impediments to the feasibility and/or credibility of the preferred resolution strategy and that no less intrusive measures are available. Numerous other areas of regulation deal with issues referred to in the draft guidelines, for example rules on large exposures, conduct of business, clearing of derivatives etc. Therefore we do not see these measures as likely to be necessary in the vast majority of cases or any further cases for applying these measures, but fear that requiring that these measures be considered will create a de facto checklist with pressure on resolution authorities to explain how they have dealt with each. We suggest that instead the main focus of these measures should be to address any activities or products that are structured with the purpose of avoiding the application of the resolution tools.

The proposed measure in paragraph 11(b) of the draft guidelines which contemplates requiring institutions to limit their activities in third countries raises some concerns. We do not believe that it is helpful to introduce a concept of an "insufficient resolution regime" in these guidelines. If the objective of paragraph 11(b) is to ensure that critical functions within the EU can be maintained, it would be better to state this as the objective. We suggest that this objective is likely to be better addressed by the measures to address operational continuity and cross-border cooperation agreements rather than limiting activities in third countries. Consideration of these issues should also be done in the context of the global group resolution plan. For example the inability of a particular jurisdiction to exercise resolution powers may be irrelevant where the group can be recapitalised through a resolution of a point of entry in a jurisdiction where the necessary powers are available.

As discussed above in our general comments, paragraph 12(a) should be clarified to refer to restrictions where this is necessary to address substantive impediments to resolvability, rather than products that "hamper" or "make [resolution] more difficult". A distinction should be made between products that might make resolution "more difficult" and products where they have specifically been structured with the purpose of circumventing the application of the resolution tools.

Similarly, the restrictions on products that may be complex to value in paragraph 12(c) refers to liabilities being "hard to assess" or the valuation being "significantly more difficult". Again the

reference should instead be to products that create a substantive impediment to the ability to conduct a valuation.

We understand the need to ensure that resolution powers under the resolution strategy are legally effective. This issue is addressed by article 55 of the BRRD and therefore we do not believe that it needs to be included in the draft guidelines. If it is to be retained in the draft guidelines, the wording should be aligned with article 55. In particular we do not believe that the reference to resolution authorities considering the restriction of sales of products to investors in foreign jurisdictions is necessary. We fail to see why the residence of investors would create a substantive impediment to resolvability where the relevant liability contains an effective contractual recognition of resolution actions.

Question 4: Do you agree with the description of the potential advantages of a financial holding company structure? Do you see any disadvantages of this structure as regards financial stability?

We note that the purpose of the guidelines should not be to identify potential advantages and disadvantages of different structures, but rather to consider measures that might be necessary and proportionate to address impediments to resolvability.

An EU intermediate financial holding company structure should only be required where this is necessary to implement the worldwide group resolution strategy. As set out in our general comments above, we consider that this is highly unlikely to be a proportionate measure. The fact that a group is headquartered outside the EU does not necessarily mean that a holding company located in an EU Member State would be helpful or appropriate.

For example where a group has a global SPE resolution strategy such that no European subsidiaries would enter resolution or where a group has an MPE resolution strategy with several points of entry within the EU, the suggestion of requiring an EU intermediate holding company implies the insertion of a point of entry. We do not believe that it would be necessary or appropriate to ring-fence EU banking operations in this way. In such cases the introduction of an EU holding company could, as well as being unnecessary, have an adverse impact on cross-border cooperation and the global resolution strategy agreed in Crisis Management Groups. It could also suggest that the EU is not committed to a global approach to resolution pursuant to the FSB Key Attributes of Effective Resolution Regimes for Financial Institutions. We therefore suggest that the guidelines raise these factors to be taken into account and emphasise that the measure in paragraph 14(a) is focused on enabling the implementation of the worldwide group resolution plan and not, for example, ring-fencing capital or liquidity in the EU.

We agree that there are some potential advantages of a financial holding company structure for EU headquartered institutions where this is necessary to carry out the resolution strategy. However, again this measure this needs to be considered in the context of the relevant group resolution plan and whether the absence of such a holding company is a substantive impediment to the feasibility and credibility of the resolution strategy. When assessing whether such a measure is necessary and proportionate, consideration should also be given to whether the relevant impediment could be addressed in a less intrusive manner such as through contractual subordination of certain liabilities. The draft guidelines require the authorities to

consider applying the measure where the lack of a holding company "substantively reduces the feasibility or credibility of the implementation of the resolution strategy." Again, the focus of the measures is not to address matters that "reduce" resolvability but only those which form substantive impediments to resolvability and this should be reflected in the guidelines.

In relation to paragraph 14(c) of the draft guidelines, significant branch activity in the EU should not simply by its existence be considered for inclusion within any financial holding company under point (a). The suggestion of measures to be considered with respect to significant branch activity should be limited to circumstances where a resolution authority does not consider that a firm's resolution plan adequately provides for the resolution of the branch and therefore poses a risk to financial stability in the EU or a Member State. Further, any such measures should not be linked to any financial holding company under paragraph 14(a). There may be circumstances where a financial holding company under point (a) is not necessary, and yet a resolution authority could have concerns about the resolution plan of a significant branch. In such circumstances a subsidiary in the Member State could be a sufficient and more proportionate solution.

Question 5: Do you agree with the description of loss absorption in groups? Should there be additional specification regarding how loss absorption is implemented?

As discussed above, we support MREL being considered as part of the resolvability assessment process. However, it should be clarified in paragraphs 15 and 16 of the draft guidelines that these do not create a new requirement for loss absorbing capacity in addition to MREL. We are concerned that the inclusion of a new definition using the terminology "loss absorbing capacity" is likely to create confusion and could be interpreted as introducing a new concept in addition to MREL and the standards on loss absorbing capacity currently being developed by the FSB. We therefore suggest that this terminology is changed to avoid such confusion, perhaps referring to "qualifying eligible liabilities or any other liabilities that would absorb losses". The definition of loss absorbing capacity could then be deleted.

The requirements for setting MREL should be dealt with under article 45 of the BRRD and the RTS under that article. Please refer to our separate paper on MREL, a copy of which is included in the annex to this response. That paper includes our views on the location of MREL within a group and the need for this to be tailored to the relevant group resolution strategy.

We suggest that the guidelines on measures to address impediments to resolvability should be limited to addressing circumstances in which a lack of MREL is a substantive impediment to the preferred resolution strategy. When such an impediment is identified, we suggest that the guidelines cross-refer to article 45 and the RTS on the assessment of MREL for the principles that apply to address this issue.

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Annex

AFME Paper on MREL level 2 issues

Bank Recovery and Resolution Directive

Minimum requirements for own funds and eligible liabilities

11 September 2014

Introduction

This paper sets out AFME's views on the important issue of the minimum requirement for own funds and eligible liabilities ("MREL") under the Bank Recovery and Resolution Directive (the "BRRD") with a particular focus on the assessment criteria to be developed in the Regulatory Technical Standards ("RTS") under article 45(2) of the BRRD.

We strongly support the efforts by the authorities and the industry to put in place credible and effective resolution plans that enable banks to be resolved without systemic disruption or exposing taxpayers to loss. MREL requirements play an important role in achieving this.

Article 45 of the BRRD provides the framework for MREL and requires the European Banking Authority (the "EBA") to prepare RTS which specify further the assessment criteria on the basis of which MREL should be set. Within this context, we set out below a number of suggestions as to how these criteria should be designed.

General considerations

The purpose of MREL is to ensure that there are sufficient resources available to absorb losses and recapitalise the bank to enable it to continue critical functions without recourse to taxpayer support, i.e. to facilitate the group resolution plan. This purpose should underpin the approach to the assessment of MREL and be reflected in the RTS.

We support the development of a harmonised minimum level of MREL in due course to provide a level playing field throughout the EU. The assessment of the resources required to implement the relevant group resolution strategy should be carried out in a consistent manner to create a level playing field across banks with different businesses and this should be the objective of the RTS. As proposed in the EBA's consultation paper on the draft RTS on the content of resolution plans and resolvability assessments, MREL should be considered as part of the resolvability assessment process.

Until any harmonised minimum MREL is agreed and when considering requirements above any future minimum level, MREL should be tailored to support the relevant resolution strategy for each bank. This principle is recognised in article 45(6)(a) and recital 80 of the BRRD and should be the overarching focus of the criteria for the assessment of MREL under the RTS.

MREL should be a realistic and manageable requirement based on transparent criteria and integrated with existing and any future requirements such as Gone Concern Loss Absorbing Capacity ("GLAC") requirements for G-SIBs. This is recognised by the report under Article 45(20) of the BRRD addressing "consistency with the minimum requirements relating to any international standards developed by international fora".

While banks have already very significantly increased their loss absorbing capacity since the crisis, implementation of MREL requirements is likely to be a significant undertaking and an appropriate timeframe should be provided for banks to meet MREL requirements as they are phased in.

Assessment of the quantum of MREL for a group

The assessment of the quantum of MREL should be focused on facilitating the resolution plan for the group. The criteria set out in paragraphs (6)(a) and (b) of article 45 reflect this by considering the quantum of MREL that would be required to ensure that there are sufficient liabilities that could absorb losses and recapitalise the group in accordance with the group resolution plan. This is also an important aspect of the resolvability assessment process. This raises two questions: (i) what level of losses should be assumed; and (ii) what level of recapitalisation will be required under the group resolution plan.

The ability to recapitalise the group pursuant to the group resolution plan requires that the group has sufficient liabilities available to absorb losses at the point of resolution which could be written down or converted to equity to recapitalise the group to an appropriate level to continue to perform critical functions, sustain market confidence and regain market access. This is likely to require recapitalisation of the group to at least meet minimum capital requirements. Some authorities consider that this implies a starting-point of MREL being sufficient to ensure that even if regulatory capital was exhausted, the bank would still have sufficient resources to recapitalise and meet minimum capital requirements going forwards.

When considering such an approach for assessing the quantum of MREL, it should be borne in mind that several factors could in practice reduce the amount of recapitalisation that would be required, for example:

- Under the BRRD, resolution will be conducted at the point when the bank is failing or likely to fail and forbearance should be a thing of the past, particularly with the advent of the SSM. Resolution should therefore occur prior to regulatory capital having been exhausted. Accordingly an assumption that the bank will have zero capital at the point of resolution is very conservative because in practice some capital should remain.

- The bank is likely to have been through recovery and early intervention phases prior to resolution and the result of actions taken prior to resolution (such as deleveraging) would likely leave the bank smaller at the point of resolution, therefore reducing the amount of resources required for recapitalisation.

- For some banks it might be possible to make immediate changes to the business over the stabilisation period, for example, some non-critical functions and/or business lines could be immediately discontinued or wound down (in run-off) and closed to new

business. Where this is the case and the resolution plan reflects this, the bank is likely to require a lower level of recapitalisation to implement the group resolution plan.

These factors should be taken into account when assessing the quantum of MREL required.

Additional considerations

The assessment should reflect the risk profile of the bank, as required by article 45(6)(d). In order to better reflect the risk profile and to avoid a disproportionate impact on certain business models, the assessment should make an adjustment to reflect the reduced economic liabilities of the firm taking into account collateral and netting. This principle is reflected in the netting of derivatives as required by the level 1 text, but should also be applied more broadly to all securities financing transactions, at a minimum reflecting the recent adjustments to the Basel leverage ratio to provide greater recognition of netting. It should also exclude the value of cash held at central banks.

The requirement in article 45(6)(d) to take into account the size of the institution is adequately dealt with by the base of setting MREL as a percentage of total liabilities as required by the level 1 text. It is also one of the factors already reflected in existing G-SIB and systemic risk capital buffers. However, account should also be taken of measures that could be taken by the bank in its recovery plan, such as disposals or other deleveraging which might take place prior to resolution. Consideration should also be given to ensuring that any requirements are consistent with international standards established by the Financial Stability Board.

Location of MREL within a group

In addition to addressing the criteria for assessing the quantum of MREL that a group requires, the BRRD requires an assessment of MREL to be conducted for each institution in a group, save for limited waivers. Therefore the RTS should also address how MREL should be distributed within a group.

As discussed above, the overarching consideration when assessing MREL should be to facilitate the group resolution plan. Accordingly MREL needs to be available in those entities in the group where bail-in or other resolution tools would be applied. As FSB guidance states, loss absorbing capacity "needs to be available ... at the right location to facilitate a recapitalisation or orderly wind down."[2] This requires that MREL should be located at the point or points of entry under the resolution authorities' group resolution plan, whether that involves a "single point of entry" ("SPE") or a "multiple point of entry" ("MPE") style strategy.

Additionally, in order to have confidence that a group resolution plan will be implemented as originally planned, host resolution authorities responsible for subsidiaries which are not points of entry under the group resolution plan (which we shall refer to as "NPE Subsidiaries") will want to be satisfied that losses incurred in those NPE Subsidiaries will, where necessary, result in the recapitalisation of the NPE Subsidiary through the implementation of the group resolution plan. This should be addressed through the group resolution planning process,

[2] See FSB Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Developing Effective Resolution Strategies, 16 July 2013, para 1.1

discussions and information sharing within resolution colleges and Crisis Management Groups and institution-specific cross-border cooperation agreements. However, a level of MREL in the form of intra-group liabilities could be constructive in some NPE Subsidiaries in order to provide some additional comfort to host authorities where there are doubts over the effectiveness of the loss transfer mechanism under the group resolution plan and further incentivise their cooperation in a group resolution. There should be no need for such MREL in the form of intra-group liabilities between entities located in Member States participating in the Single Resolution Mechanism.

Excessive pre-positioning of MREL in NPE Subsidiaries could make the group more brittle and disincentivise cooperation though group resolution. High pre-positioning requirements could further reduce the group's efficiency under normal market conditions, potentially increasing costs for consumers, reduce the group's resiliency during stressed conditions by preventing funds from going where they are most needed and hinder the implementation of the group resolution strategy.

Alternative mechanisms for achieving the recapitalisation of NPE Subsidiaries include a number of intra-group mechanisms including guarantees, credit facilities or other keep-well arrangements.

A balance must be struck to facilitate cooperation and ensure that group resolution plans are credible without destabilising the group or ring-fencing funds in national jurisdictions. Thus, to the extent that authorities impose MREL requirements on NPE Subsidiaries, such requirements should be limited to the minimum amount needed to reinforce host country confidence in the group resolution plan. A balance must also be struck which supports banks' ability to lend to the real economy. As stated in FSB guidance, authorities should take into account "the potential impact of [loss absorbing capacity] requirements on the firms' financing cost and business operations".[3]

When setting any MREL requirements for NPE Subsidiaries, other forms of support from a point of entry such as guarantees, credit facilities, legal doctrines of support etc should be taken into account. In particular, to the extent that NPE Subsidiaries are self-funding and do not require intra-group funding, support which is not fully paid up should be taken into account when assessing MREL. Finally, the degree of critical functions performed by the particular NPE Subsidiary should also be taken into consideration.

We hope that you find this contribution helpful and we would be very pleased to discuss these issues further with you. Please do not hesitate to contact any of us via the details listed below.

[3]See FSB Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Developing Effective Resolution Strategies, 16 July 2013, para 1.1

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