

11 July 2014

European Commission

SPA2 04/056

1049 Brussels

Belgium

## **Public consultation on the contributions of credit institutions to resolution financing arrangements**

Dear Sir / Madam

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment in respect of the risk adjustment of contributions to resolution financing arrangements in light of the Commission's work on the delegated acts under Article 103(7) of the Bank Recovery and Resolution Directive (BRRD) and the Commission's development of a proposal for Council implementing acts under Article 66(3a) of the Single Resolution Mechanism Regulation.

We note the online questionnaire published by the Commission which raises a number of questions relating to these issues. However, the limited scope of these questions and the survey being restricted to multiple choice answers without the ability to upload documentation is insufficient for AFME to provide constructive and reasoned input. A full consultation would be appropriate and careful consideration should be given to the application of the proposed assessment in practice. Therefore, we would like to emphasise some key points relating to the issues raised by the Commission in its consultation in the attached written response. These include:

- a) the need to give greater consideration to the resolution strategy when assessing contributions for each institution;
- b) the need to give greater consideration to the likelihood that the resolution fund would suffer losses in the event of failure; and
- c) that the assessment should be applied to all banks in a consistent, predictable, and non-discriminatory way.

We hope that, while not submitted via the online questionnaire, this will provide some valuable input from the industry on this important topic. We would of course be very pleased to discuss these issues further with you or your colleagues.

Yours faithfully

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Director, Advocacy

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Cc. Commission Expert Group on Banking, Payments and Insurance

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## Consultation response

### Public consultation on the contributions of credit institutions to resolution financing arrangements

11 July 2014

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The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment in respect of the European Commission's public consultation on the contributions of credit institutions to resolution financing arrangements. 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.<sup>1</sup>

AFME has been very active on resolution issues for a number of years and has played a leading role in the industry efforts, at European and global level, aimed at achieving effective and credible recovery and resolution frameworks.

AFME prepared a detailed position paper on the risk adjustment of contributions to resolution funds dated 17 March 2014 (Position Paper). This paper set out our views on how the risk adjustment of contributions to resolution funds under the BRRD and the Single Resolution Fund (SRF) under the Single Resolution Mechanism (SRM) should be determined. A copy of this position paper is enclosed and it can be found on our website at <http://www.afme.eu/WorkArea/DownloadAsset.aspx?id=10547>.

We address below a number of important points in relation to the determination of contributions of credit institutions to resolution financing arrangements under the BRRD and SRM.

#### Risk of loss to the fund

As emphasised in our Position Paper, we believe that the risk adjustment of contributions should be focused upon ensuring that an institution's contributions reflect the risk of loss that it poses to the relevant fund. This should be calculated based upon an assessment of the following components:

- (i) the probability that the institution fails;
- (ii) the probability that the institution is placed into resolution in the event of failure; and
- (iii) the risk of loss to the resolution fund in such event.

The Commission's public questionnaire requests views on the relevance of a range of indicators for assessing the risk adjustment for a firm. Many of these appear to be aimed at assessing the financial position of an institution (per BRRD Article 103(7)(b), (c), and (d), for example), but do not provide adequate consideration of the probability that the particular institution enters resolution in the event of failure or the risk of loss to the fund (related to the institution's resolvability, per Article 103(7)(f)).

Currently, little consideration appears to be given to the likelihood that in the event that the institution enters resolution, the relevant resolution fund would need to be used and would be likely to suffer losses. As set out in our Position Paper, in the vast majority of cases there should be no need for use of the fund to absorb losses, as these would be imposed upon shareholders and creditors of the group in accordance with

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<sup>1</sup> 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.

the resolution framework and the group resolution plan. The risk of loss to the resolution fund should therefore take account of whether, in the event that the institution fails, it is likely that the resolution fund would be used.

Resolution fund contributions should accordingly reflect an institution's loss absorbing capacity. An appropriate way of assessing this would be based upon the proportion of liabilities which are eligible to be included in the minimum requirement for eligible liabilities (MREL). This would reflect the fact that the greater the level of liabilities eligible for MREL that a bank holds, the greater the loss absorbency available and therefore the lower the likelihood that a resolution fund would be used for loss absorption.

However it is measured, the risk of loss to the fund in the event of failure should be given significant weight in the risk assessment. As well as reducing moral hazard, this would provide positive incentives for banks to increase their loss absorbing capacity and improve their resolvability, which would help create a stronger and healthier financial system.

Absent an appropriate adjustment, banks could be disincentivised from raising additional loss absorbing capacity because they would perversely increase their contributions by issuing loss absorbing debt which does not class as own funds. This should be excluded, or at a bare minimum it is necessary to include an adjustment to ensure that issuing liabilities which are eligible for MREL does not increase a bank's contributions to resolution funds. A simple method of achieving this would be to conduct a parallel calculation which deducts the value of liabilities which are eligible for MREL from the basis. The difference between the calculation that includes MREL in the basis and the one that excludes it would reveal an entity's "excess burden" in its contribution that can be attributed to liabilities that count as MREL. Therefore, the risk adjustment should, to the very least, fully offset in monetary terms this anomaly.

The assessment of the risk of loss to the resolution fund should also take into account the likelihood that the relevant resolution fund would be used in the event of an institution's failure. In addition to assessing the loss absorbing capacity of the institution, this should also include consideration of the likely approach to resolving the group under the group resolution plan developed and agreed between home and host authorities and the treatment of the institution under that plan.

### Other risk indicators

We do not believe that the proposed liquidity indicator of the loan to deposit ratio is an appropriate or accurate indicator of the probability of failure or riskiness of the firm. Differences in funding strategies and business models across EU banks should be taken into account. If another liquidity indicator is required, and in order to measure the stability and variety of funding in the longer term, the Net Stable Funding Ratio could be used instead when it comes into effect.

In relation to the third risk pillar, the importance of the institution to the stability of the financial system, the proposed indicator of total assets to GDP is inappropriate. The size of the institution is already reflected in the unadjusted flat assessment base, so the variable risk factors should not replicate this. Also, a simple ratio relative to GDP is insufficient to measure the systemic impact of its failure. In particular, given all the progress in removing the sovereign bank link, GDP is no longer the most relevant reference point. There are already numerous existing methodologies for assessing the systemic nature of credit institutions which would be better equipped to assess the systemic impact of failure such as the methodologies for identifying G-SIIs and O-SIIs under CRDIV. However, in light of the single market, if size relative to GDP is to be included as an indicator for purposes of assessing the importance of an institution to financial stability, it should be assessed relative to the entire EU GDP and not just relative to the economy of the Eurozone or the non-participating Member State. Finally, account should be given to the fact that that systemic institutions must already comply with increased capital requirements to address the systemic risk. They should not be required to contribute additional amounts to the resolution fund for the same reason, which would amount to double insurance for the same risk.

Additionally, we seek clarification of how the proposed delegated act will be applied to EU branches of third-country banks. A branch is more appropriately viewed as part of a bank rather than a stand-alone entity.

Thus, many of the risk indicators, such as capital, liquidity and financial stability, would make little sense at the branch level. We would be happy to work with the Commission or the Expert Group to discuss this issue further.

### Principle of proportionality

In response to the Commission's question as to whether small banks should be treated in a different way from larger banks, we do not believe that this is appropriate, because as the Commission notes in its consultation paper, small banks benefit from the financial stability created by the whole resolution framework (including resolution funds) and it is not possible to determine *ex ante* that they will never need to use resolution funds. In addition, as explained by the BIS, systemic threat "*may arise when a number of small banks fail simultaneously or where a small bank has a critical position in a particular market segment.*"<sup>2</sup> This will in particular be the case where the small institutions are supported by the same institutional protection scheme (see also Art. 103 (7) BRRD, which stipulates that this must be taken into account). The assessment should be applied equally to all banks within the scope of the contributions.

We strongly support the principle that the risk of loss to the fund should be reflected in an institution's contributions. However, we believe that it would not be appropriate at this time to treat small institutions in a different way from larger banks on the basis of that principle. It is not clear that small institutions will indeed be wound down through insolvency and thereby not benefit from resolution fund resources. As the Commission notes in its consultation document, throughout the recent crisis many small institutions were not allowed by authorities to fail through insolvency. Proportionality will be ensured through the calculation method because the contribution is tailored to the size as well as the riskiness of the institution.

### Level of assessment

As we raised in our Position Paper, it is necessary to ensure that any assessment of contributions based upon the liabilities of each institution in a group does not result in the double-counting of intra-group liabilities.

We understand that the Commission is considering defining intra-group liabilities for this purpose as including only intra-group liabilities to another entity in the same jurisdiction or within the Banking Union. There should be consistent treatment of all intra-group liabilities and we do not understand the basis for such a distinction between entities in the same group but established in different jurisdictions, as the principle remains the same and banks should not be discriminated against on the basis of their place of domicile or funding structure.

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<sup>2</sup> Consultation on supervisory guidelines for identifying and dealing with weak banks, p.7  
<http://www.bis.org/publ/bcbs285.pdf>