MREL: SRB Policy Under the Banking Package – Consultation

AFME Comments

6 March 2020

Introduction

The Association for Financial Markets in Europe (AFME)[1] welcomes the publication of the Single Resolution Board's (SRB's) draft policy applying Minimum Requirements for Own Funds and Eligible Liabilities (MREL) following the finalisation of the Banking Package. 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 Bank Recovery and Resolution Directive (BRRD), development of Total Loss Absorbing Capacity requirements (TLAC) and related issues.

We strongly support the objectives of the final Banking Package, to implement TLAC in the EU for Global Systemically Important Institutions (GSIIs), align the existing framework for MREL more closely with that of TLAC, and address certain practical challenges such as achieving subordination and the application of Article 55 BRRD requirements on contractual recognition of bail-in. The SRB's draft policy implements many of the key aspects of the Banking Package and provides further clarity in a number of areas on how the transition will be made to a steady state.

The legislative text that delivers a number of changes to the existing framework binds the SRB in its policy approach in several areas, which we recognise. Whilst we do not fully agree with the approach taken in some areas of the final Banking Package, for example the introduction of a minimum 8% Total Liabilities and Own Funds (TLOF) subordination requirement, we acknowledge that the SRB is required to apply the legislation. We therefore limit our comments in response to the consultation to areas that we see as subject to the SRB's discretion or are policies that the SRB has taken forward absent guidance under the existing framework or incoming Banking Package. In some instances, we believe that these may represent deviations from the Level 1 texts.

We hope that you find these comments helpful and invite any questions you may have on our response. Please find below our general comments on the draft policy, followed by specific comments on the sections themselves and answers to the questions raised therein.

General Comments

We welcome the SRB's draft policy, which we believe sets out the broad framework that applies under the Banking Package as per our expectations, and is aligned with the communication made by the SRB at the 9th Industry Dialogue of December 2019. There are a number of areas that we would like to ensure are retained

[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.

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in the final policy that will assist institutions in progressing to compliance with the fully-loaded MREL requirements. We highlight these in the respective sections below.

We fully support the SRB's policy aims, i.e. for the proposed provisions to be effective, efficient and proportionate, whilst also promoting a level playing field across banks. It is through this lens that we believe there are a small number of areas where the proposed policy could be enhanced further. These are visited fully and in more detail in their respective sections below. However, it may be beneficial to highlight up-front those we deem as a high priority, as follows:

1. **Transitional arrangements:** Whilst we recognise the level one text requiring a linear build-up of MREL up to the 2024 compliance deadline, we believe the SRB's stance with regard to institutions already meeting MREL requirements to be disproportionate. In particular, setting the end-state MREL level as the current required target penalises those institutions that have sought to meet MREL levels sooner. This may hamper these institutions unnecessarily if they were to seek any redemption of MREL, for example to more efficiently manage their liability stack and minimise costs to the group. This also does not acknowledge the need for such an institution to seek the SRB's permission to redeem or repurchase MREL and the continued presence of MREL eligible liabilities regardless of the target level set.

2. **Eligibility of liabilities issued under third country law:** It is very important to clarify the policy regarding the impact of the changes to Article 55 BRRD on existing Additional Tier 1 (AT1) and Tier 2 (T2) instruments. In particular it is important to emphasise that the amended provisions only apply to liabilities issued or entered into after the date of application under Article 55(1)(d). While reference is made to this in a footnote stating that liabilities issued before the date referenced would not be impacted, we are concerned that this is not sufficiently clear and could be missed by investors. Given Article 55 (1)(d) and also the grandfathering that applies to AT1 and T2 instruments under Article 494b of CRR2, we would welcome the SRB's confirmation that only new issuances would be considered[2].

   As reflected in our previous comments on the 2018 MREL Policy – second wave, we remain concerned that the SRB's policy setting out the minimum requirements for legal opinions that accompany the use of Article 55 clauses is overly prescriptive.

3. **Calibration – identification of 'Resolution Groups':** While the policy is clear in its definition of Resolution Group, we understand that many, if not all, institutions under the SRB's remit are still yet to have formal confirmation of the Resolution Group(s) within their bank. It is essential that this is confirmed as a matter of urgency, as a number of requirements clearly flow from the determination including the location and calibration of MREL, but also more broadly in the implementation of the SRB's Expectations for Banks and aligning capabilities that banks are building up to enhance resolvability with the SRB's preferred resolution plan.

4. **NCWO risk tool:** We strongly support the SRB's intention to apply a quantitative tool to assess NCWO risk. However, we deem it key:

   (i) to get full disclosure on the methodology underlying such a tool, in order to allow banks to run internal simulations of possible outcomes to help improve their resolvability. We would recommend that the model itself is released in consultation with industry.

   (ii) with respect to the quantitative inputs disclosed in the draft policy, we would like to have more clarity and explanation on the underlying rationale of the 0.25 price to book

[2] Were this not the case such exclusions as envisaged in the policy would trigger a paradoxical discrepancy in the treatment of the same liability towards MREL on one side and Own Funds on the other. We do not expect this to be the case but would nevertheless encourage the SRB to make this clearer in their final draft policy.

value for the shares resulting from the conversion of liabilities in resolution. Whilst it is reasonable to assume that banks under strain or with low profitability will see their shares trade below book value, there remains a strong case to consider a bank, after the application of the resolution tools, to not be in the same (or a worse) situation. Losses will have been absorbed, loss-making parts of the business will have been fully (and prudently) accounted for and much uncertainty will have been addressed, so there would be less reason to suppose that the bank would trade at such a significant discount to book value. The 0.25 proposal may prove to be excessively pessimistic and may unnecessarily impact banks through the application of the NCWO risk tool.

(iii) to understand how the new tool will interact with the existing approach. In these respects, we firmly oppose the automatic subordination add-ons which the policy makes reference to, but which it remains unclear if this practice will continue or not.

5. **Clarity on the application to material subsidiaries of third country resolution entities:** It is important that the SRB clearly sets out its policy with respect to internal MREL for material subsidiaries of third country resolution entities established in the Banking Union. In particular, if and where requirements beyond Article 92b CRR are to apply to such entities, the SRB should set out how these requirements will be considered in the appropriate fora (i.e. Crisis Management Group / Resolution College) and how they will approach communicating these requirements to such entities. Whilst the current application of Article 92b CRR2 is clear, there remains uncertainty over the SRB's application of internal MREL requirements for material subsidiaries of third country resolution entities and how they will consider the need to cooperate with the home jurisdiction authorities in determining the final requirement. We strongly believe that the SRB support cross-border cooperation given its record, and would therefore welcome further information on the SRB's approach.

   In finalising their policy we recommend that the SRB make reference to the FSB guiding principles on internal TLAC, and ensure that sufficient dialogue with home resolution authorities are considered as part of their approach.

6. **Enhanced clarity to support market understanding:** Whilst the proposed SRB policy does provide further detail on the direction of travel for MREL calibration going forward, there remains areas of uncertainty. In particular there are aspects of the calibration and subordination approaches that do not give a clear indication of the approach the SRB will apply to specific types or sizes of entity, beyond that which is provided in the level one legislation. As market analysts and researchers will consider the SRB's draft and final policy to inform likely MREL and subordination requirements, the lack of further detail may lead to market expectations being set absent sufficient information from the SRB. We therefore encourage the SRB to be as precise as it publicly can be to help avoid circumstances arising whereby market expectations diverge from the realities of the SRB's policy in its application. We specify particular areas for clarification in our detailed comments below.

We hope that the SRB is able to appropriately consider our comments. While we recognise the time constraints regarding implementation, we would have hoped for a longer consultation period given the significance of the policy, and in future suggest that a more appropriate window for consultation be afforded to stakeholders. . We may approach the SRB bilaterally with further points to raise beyond the 6 March deadline, should any arise. Please find below our comments on the sections in the order they appear in the draft document.

Calibration

1. Do you agree that the proposed calibration is consistent with a level playing field across resolution approaches and bank business models?

Whilst we broadly agree with the SRB's intended approach to calibration, there are a number of issues that will believe need addressing in the SRB's final policy.

RCA adjustments: We broadly agree with the SRB's draft policy on calibration. In particular we welcome the confirmation from the SRB that they will continue their approach to assessing, on a case-by-case basis, the possible need to make adjustments to the recapitalisation amount (RCA). We support maintaining the balance sheet depletion, binding restructuring plans and recovery options adjustments which helps to further tailor requirements to each institution's preferred resolution strategy. Utilising the prevalence of credit risk in a bank's risk profile is in our view an appropriate 'yardstick' for considering the balance sheet depletion effect. These adjustments are not currently envisaged by the SRB under the Leverage Ratio Exposure measure (LRE) and 8% Total Liabilities and Own Funds (TLOF) calibrations. We consider that the assumptions should apply regardless of the basis of calibration, as the post-resolution entity assumptions would not change on the basis of how MREL is measured. Clarification that the SRB will consider such adjustments under these calibrations would therefore be welcome.

We believe that it is of great importance for the SRB to work to implement the appropriate adjustments to the RCA considering the post-resolution entity – including the post-resolution entity's Pillar 2 Requirement (P2R) – as soon as possible. The SRB state that this is not to be taken forward for the 2020 resolution cycle which is disappointing, but if this is to be the case, we would encourage the SRB to commit to introducing these adjustments in the proceeding resolution cycle. Typically, these adjustments are expected to be downward, given the limited areas where an increase in P2R for a smaller, less-risky post-resolution entity would arise. The SRB may wish to consider utilising a proxy downward adjustment during the transitional period until it is able to confidently tailor case-by-case post-resolution P2R impacts. This would replicate the similar approach that the SRB has taken vis-à-vis the 125bps reduction from the Combined Buffer Requirements (CBR) in the existing SRB policy to MREL calibration. The Banking Package concluded with clear indications that MREL should be calibrated such that the RCA metric better consider the post-resolution entity, not only in terms of foreseen RWA depletion, but also in terms of a reduction of risks that need to be captured under Pillar 2, and a potentially reduced systemic nature of the bank post-resolution as captured under the revised CBR framework of CRD V. The post-resolution entity is the starting point for RCA and MCC calibration and failing to reflect this in policy would represent a significant departure from the legislative texts.

In addition, the impact of balance-sheet depletion is different if you reduce credit activities or market activities and should be considered on a separate basis. A reduction of credit activities would impact the TREA, but reduction of market activities would reduce the LRE and the TLOF bases. Therefore, the balance sheet depletion adjustment should be calibrated to impact not only the MREL-TREA but also the MREL LRE and TLOF measures. For large and diversified groups, the scope and variety of recovery options should also be taken into account, and we question the SRB introduction of conditions such as 'in exceptional cases' and 'implementable immediately'. This second notion of immediacy was removed from the legislative texts when the Banking package was finalised. To this this extent, the 5% cap (paragraph 28) is far too conservative.

MCC phase-in: We note that the SRB proposes to phase out the current 125bps reduction in MCC over a period of 4 years. Although this will be partially offset by the removal of the Countercyclical Buffer (CCyB) from the MCC, the order of magnitude of the two elements is very different, and this phase-out will lead to an automatic increase in MREL calibration across the board. The 125bps reduction was introduced, at its discretion, by the SRB following the split of Pillar 2 into P2G and P2R. As this split remains current, the rationale for the existence

of the 125bps reduction remains valid, and we would encourage the SRB to maintain the 125bps reduction, adjusted simply to reflect the new deduction of the CCyB. The SRB retains discretion in the fixing of the MCC, and we believe that this discretion can be used to maintain the 125bps reduction.

One element of the MCC that should also be given further consideration is the base CBR that is utilised in the calibration. As the MCC is a component of the RCA it should be based on the post-resolution entity. This is detailed under SRMR2 Article 12c(3) and BRRD2 Article 45c(3) in the seventh sub-paragraph, i.e. "*…the amount referred to in that subparagraph* [the MCC] *shall be equal to the combined buffer requirement that is to apply after the application of the resolution tools…*". A bank could be foreseen as being less systemic post-resolution and therefore subject to reduced CBR requirements, taking into account the revised buffer framework under CRD V. Therefore, we would strongly encourage the SRB to clarify in its final policy that the CBR utilised in the calculations is that which the SRB envisages applying to the post-resolution entity, not the current CBR that applies.

Where the SRB makes reference in paragraph 30 to the potential need for a higher MCC to enable the bank in resolution to attract funding after resolution, we believe that this needs to be demonstrated before such adjustments should be applied.

CBR within the LRE calibration: Clarity that the SRB will allow the utilisation of CET1 used to meet the CBR when MREL is calibrated under the Leverage Ratio Exposure measure (LRE) is welcomed. This expectation was set by the SRB as their intended policy approach at the 9th Industry Dialogue, and it is welcome to see this now translated into the proposed policy.

Formalising the Resolution Group: As highlighted in our general comments, it is important that the SRB further enhance the level of understanding within institutions by communicating to them a formal definition of the resolution group for each resolution entity. As the proposed policy states, the resolution group may not in all cases directly replicate the prudential perimeter. Whether this is or is not the case should be formalised and communicated to institutions as a matter of urgency.

Clarifying how the resolution groups will be defined is essential, as it informs MREL requirements as determined by the resolution strategy of the group. Where identified entities are expected to be wound-up or transferred this should be appropriately reflected in the calibration of MREL requirements.

Where institutions are able to identify entities within their resolution group that they would expect to enter insolvency proceedings and would not be recapitalised in a group resolution (as envisaged under paragraph 24), they should have the opportunity to communicate this to the SRB such that this can be adequately considered within the SRB's resolution plan. This would enable the SRB to fulfil its duty, as expressed under paragraph 14, to determine the Loss-Absorption Amount (LAA) and RCA for those entities that would not be wound up in normal insolvency proceedings. Where the SRB's current scope of a resolution entity's resolution group does not match the expectations or plans of an institution (as per paragraph 24) then the SRB should be able to adapt this scope in order to recalibrate MREL targets.

It should therefore be possible for resolution entities to have excluded from the consolidated calibration of MREL requirements the subsidiaries of the prudential perimeter that are expected to enter into insolvency, including those that are not themselves regulated entities. We do not agree with the view as expressed in paragraph 24 that the external MREL, calibrated on a consolidated basis, should not take into account the consequences of the possible liquidation of specific subsidiaries. This would represent a clear breach of the level playing field as this will lead to MREL being calibrated above that which is necessary to recapitalise the resolution group.

Third country subsidiaries of EU banks: The draft policy briefly touches upon the issue of third country based entities of EU resolution groups. To the extent the SRB may exclude such subsidiaries from the EU

resolution group, we would welcome further information and clarity on a number of underlying elements that would inform this decision-making. In particular, given the impact this may have on existing resolution strategies, we ask the SRB to set out the grounds for, or criteria that would, determine whether or not such third country subsidiaries should or would be excluded; whether this decision will be communicated to the relevant resolution entity; and, whether this decision will be taken and/or communicated to the relevant authorities of the third country subsidiary? These decisions may very well have significant implications on the resolution group, particularly if a Single Point of Entry (SPE) is currently envisaged as the overarching resolution strategy.

We implore the SRB to not take such decisions in the absence of discussion with the relevant resolution entity and members of the relevant Crisis Management Group, including the local authorities in the jurisdiction where the third country subsidiary is established. As set out in the FSB's guiding principles on internal TLAC[3], cross-border cooperation is a key tenet of the post-crisis framework that has been worked on at the highest level through the G20, Financial Stability Board (FSB), and many other international fora. We strongly believe that the SRB supports cross-border cooperation given its record, and would therefore welcome further information on the SRB's approach to third country subsidiaries of EU banks.

Transfer tool (full vs partial): The SRB policy is clear that it will seek to continue to apply reduced MREL requirements for resolution entities that primarily rely on a transfer tool. Whilst the continuation of such adjustments is welcomed, we believe that this application should apply proportionately across resolution entities that may envisage the application of a partial transfer and not only applied to small and medium sized entities that only follow a full transfer strategy. Whilst recognising that the full downward adjustments may not be justified if a full transfer strategy is not being pursued, partial strategies that resolution entities are required to prepare for should nonetheless be met with partial downward adjustments. This is a level playing field issue for groups if, at local level, their subsidiaries do not benefit from adjustments while their standalone competitors may have a reduced MREL despite both potentially being subject to a transfer strategy. In order to apply requirements proportionately, groups should benefit from such reductions to account for the transfer of any such subsidiaries.

Legal certainty on previous MREL requirements: We would welcome that the SRB confirm that the MREL decisions that will be provided on the basis of the final policy in 2021 will replace any applicable previous decision on MREL requirements issued under the previous legal framework from the moment of its communication to the given institution.

Data sources: We would encourage the SRB to confirm in their final policy that, as per SRMR2 Article 12d (6) fifth sub-paragraph point (a), that the most recently reported values for the TREA and LRE will be utilised in calibrating the MREL requirements, and not as may have been suggested, year-end 2019 figures where more recent data should be available to the SRB. Otherwise, this would be a breach of the level one text and would see out-of-date information inform decisions that may fail to capture an institution's current risk profile.

2. Do you agree that the approach proposed represents the most adequate way to calibrate MREL in support of MPE strategies from a resolvability perspective?

The SRB's proposed policy approach regarding MPE resolution groups is broadly agreeable in our view, however there are some areas where additional consideration or clarity is needed.

MPE and SPE considerations: It is important that the SRB make clear in their final policy that groups will not be penalised on the basis of the overarching resolution strategy being pursued, i.e. SPE or MPE. Whilst

[3] See FSB, 24 July 2017. - https://www.fsb.org/wp-content/uploads/P250717-2.pdf

different considerations do need to be made for each approach it is important that one approach is not deemed punitive over the other, and instead that the resolution strategy that is taken forward is a function of several factors inherent within the banking group, as set out by the FSB in their guidance[4].

MPE issuances: The SRB under point 44 explains that "*in principle, [any resolution group in a MPE group] hold MREL eligible instruments issued in the market, external to the banking group, in order to avoid contagion effects between resolution groups of the same banking group*".

While in general this would apply, it would be helpful to clarify that under certain circumstances, some MPE resolution groups subject to host supervision by the SRB will be allowed to issue both internally (to the resolution entity parent in a third country) and to the market according to the preferred resolution strategy of the banking group. The home country intragroup TLAC policy may already foresee adequate safeguards that limit contagion risk and double counting of TLAC resources by way of a deduction regime at the parent resolution entity level (similarly to the policy proposal of point 45).

Similarly, there are situations beyond this general principle, where issuances to third parties are impracticable due to market issues (such as the lack of a sufficiently developed local capital market).

MPE LRE adjustment: We would welcome from the SRB confirmation that an MPE adjustment on the LRE basis is not intended as the LRE measure serves as a backstop only, and therefore does not require an MPE specific adjustment. Clarity in the final policy on this specific point would be welcomed.

Subordination for Resolution Entities

3. For resolution entities that are not subject to Pillar 1 subordinated MREL requirements, do you agree with the SRB's proposal to determine subordination requirements taking into account the NCWO risk assessed with the NCWO assessment tool?

4. Do you agree that the aspects considered in the tool encompass the main drivers of NCWO risk? Should the SRB consider any additional factors influencing NCWO outcomes? Do you have specific suggestions on how to further refine the methodology?

There are a number of considerations that we believe need to be taken forward regarding the subordination requirement applying to resolution entities. The SRB's approach to assessing No Creditor Worse Off than in Liquidation (NCWO) risk through the use of a quantitative tool is most welcome and is strongly supported. There is however the ned for further information regarding this new proposed tool which we comment on alongside other considerations below.

Reduction to 8% TLOF calibration: We welcome the SRB's policy on subordination for resolution entities, particularly in that it provides clarity on the SRB's intention to consider institution requests for reductions to the 8% TLOF subordination requirement. The level one text is limited in its guidance as to how resolution authorities are to consider and apply this discretion, however we believe the SRB's approach to be a sensible one. We do question however the exact conditionality that is referenced in paragraph 70. Article 72b(3) CRR does require that such a reduction not create NCWO risk, however it does not apply the second suggested criterion, i.e. that it be subject to satisfactory progress of the bank towards resolvability.

Whilst we understand the intention behind these criteria, we would suggest that the SRB sticks with the criterion established within the level one text, i.e. that no NCWO risk is generated from such a reduction. The need for subordination within MREL requirements is primarily to combat NCWO risk, and in order to apply efficient and proportionate requirements, subordination should only be required to the extent NCWO risk

[4] See FSB, 16 July 2013, 'Guidance on Developing Effective Resolution Strategies' - https://www.fsb.org/wp-content/uploads/r_130716b.pdf

needs to be mitigated. Therefore, where none would be generated by a reduction in subordination requirements, a reduced target level should be set.

Where banks structurally subordinate all MREL issuances by virtue of the resolution entity being a Holding Company, we suggest that the SRB factor this approach into their considerations on the total MREL requirement. The SRB have commented on the need to factor in the quality of MREL issued against the quantity required previously, and we believe this should be made explicit in the SRB's final policy. Resolution entities that issue greater amounts (or all) MREL as subordinated, should be subject to a lower total MREL requirement than they otherwise would have received.

NCWO risk tool: We are strongly supportive of the SRB's intention to apply a quantitative tool to assess NCWO risk, which we believe to be a significant step forward for both the SRB and institutions. Applying a more risk-sensitive approach and less automaticity is strongly encouraged.

However, we deem it necessary that institutions to which this will be applied receive a full disclosure of the methodology underlying such a tool, in order to allow them to run internal simulations of possible outcomes to help improve their resolvability. We would recommend that the model itself is released in consultation with industry.

We would question two of the model metrics indicated, and would welcome further insights into the background of how these were calculated:

(i) The insolvency haircut of 10%, which seems intuitively very low. As against the yard-stick of haircuts applied on asset sales in stressed circumstances in bank's recovery plans, this discount appears to us to be underestimated, in particular for the most significant and complex banks; and,

(ii) The price to book ratio proposed of 25% for the bank in resolution. Whilst it is reasonable to assume that banks under strain or with low profitability will see their shares trade below book value, there remains a strong case to consider a bank, after the application of the resolution tools, to not be in the same (or a worse) situation. Losses will have been absorbed, loss-making parts of the business will have been fully (and prudently) accounted for and much uncertainty will have been addressed, so there would be less reason to suppose that the bank would trade at such a significant discount to book value. The 0.25 proposal may prove to be excessively pessimistic and may unnecessarily impact banks through the application of the NCWO risk tool. We encourage the SRB to develop a more appropriate and realistic approach on this topic.

We would further welcome clarity from the SRB as to how these metrics will be applied, in particular to which base metrics these will apply. A greater explanation as to what these metrics truly mean will be key to allowing industry and other stakeholders to consider how realistic these assumptions are. For example, will the 0.25 PtB ratio multiplier be applied to the current or post-resolution entity's balance sheet? Where the SRB can provide greater information this would be most appreciated. In particular we would welcome further communication with institutions to which the tool would apply to understand which data will be utilised for these purposes.

Regarding the NCWO complementary information in Annex 2, we would like to make the SRB aware that the second example in Annex 2, that concludes that the NCWO rule would be breached if the market value of the equity held by holders of bail-inable senior debt, is not consistent with the applicable texts, and is not consistent with the second paragraph of Box 1.

The example does not follow through the procedure that leads from Article 10(5) of Commission Delegated Regulation 2018:345 to Article 50 of BRRD, and the EBA guidelines (EBA/GL/2017/3) Articles 1.16, 1.21, 1.22.

To ensure accurate information is provided to readers, we would encourage the SRB to deliver a fuller example considering the procedures as above.

Clarity on the current approach to NCWO risk: We do not agree with the existing approach whereby an automatic add-on is applied once the 10% threshold[5] is breached. The SRB should instead undertake the required assessment to ascertain whether or not there are indeed any NCWO issues in relation to the write-down and/or conversion of liabilities within the offending class, as per the BRRD. The SRB's efforts to put in place a new NCWO risk tool is therefore viewed as a very positive step, which we strongly support. An explicit confirmation within the final policy that the current approach will no longer apply would therefore be welcomed.

CBR within the 8% TLOF calibration: The SRB's draft policy is helpful in clarifying that CET1 used to meet an institution's CBR will be permitted for inclusion against the 8% TLOF measure. We believe that this is the correct approach given that TLOF is not a risk sensitive metric, and properly reflects the CBR in its role as subordinated loss-absorption capacity. We therefore support this being made explicit in the final SRB policy.

Increase of the 8% TLOF subordination requirement: The SRB policy in paragraph 66 sets out where a higher subordination requirement up to the prudential formula (if higher than 8% TLOF) can be applied to G-SIIs, Top-Tier and Other Pillar 1 banks. What is not clear however is how and when banks will know if they are to be subject to an increased subordination requirement. Further detail on the SRB's approach to assessing the three criteria included in SRMR2, for example how they may assess the credibility and feasibility of the resolution strategy, is necessary for institutions to fully understand the process that may be applied. The SRB currently proposes to base its assessment on the banks' progress on resolvability, itself "*first and foremost assessed against specific work priorities communicated to each bank by the SRB*". This interpretation in our view goes beyond the level 1 text and should be reconsidered.

In particular, institutions will need to be informed if they are to find themselves categorised into the bucket of the top 20% of resolution entities by P2R size, and whether this will lead to an increase in the subordination requirement. The SRB's approach in this regard should be made clear. We would encourage the SRB to continue to only calibrate subordination requirements to the extent they are necessary to overcome NCWO risk, and not to apply automatic increases in subordination requirements where banks' P2R see them sit in the top 20%. As per the proposal to introduce a NCWO risk tool, the SRB should apply a risk sensitive approach, considering strictly NCWO risk. Automatic increases via other routes should not form part of the SRB's policy.

Internal MREL for non-resolution entities

The SRB's proposed policy on internal MREL is welcome given the additional clarity that it is able to provide to banks, building on the existing policy for individual MREL. Whilst we appreciate that this is a developing area of policy, in particular regarding the setting of binding targets for institutions under the SRB's remit, there are areas where further clarity could be provided.

Expansion of RLEs: The SRB's intention to continue to expand the scope of entities subject to internal MREL requirements reflects the policy previously outlined in the '2018 MREL Policy – second wave' document[6]. As stated in our response to that policy, we believe that where the SRB envisage needing to expand the scope, this should be set out initially in the form of indicative, and not binding, guidance. This is so that any subsequent individual MREL shortcomings can be addressed in the banks' capital planning procedures ahead of time. This would provide for a proportionate approach that avoids substantive and sudden increases in individual MREL requirements across a resolution group whilst maintaining flexibility during the transitional

[5] Where the ratio of mandatory exclusions in the first senior class (ranking senior to subordinated and senior non-preferred liabilities)
[6] I.e. to continue to expand the definition by reducing the percentage threshold by 1% each cycle, until all entities are defined as an RLE.

period. Similarly, as mentioned above, it would be helpful for the SRB to make clear to banks which entities within the resolution group would need to be supported in resolution. Especially were the scope for individual MREL to be expanded beyond RLEs.

Nonetheless, whilst we believe only material entities or those otherwise providing critical functions within a resolution group should attract internal MREL requirements, we recognise that the SRB is bound by the level one text in this area[7]. As such we do welcome the intention of phasing-in the requirements in their totality, giving due regard for the most material entities first. We do, however, recommend that the SRB make clear in their final policy that, as per the level one text, the entities for which an internal MREL requirement is mandated are only those defined as 'institutions' as per the level one texts and not necessarily all legal entities within a resolution group[8].

Where there is some level of concern with this approach, however, is with the use of the RLE definition itself to achieve the supported outcome. Strictly speaking the RLE definition is set within the Commission Implementing Regulation (EU) 2018/1624[9], and therefore adapting this definition for these purposes may be challenged and set a precedent for policy overriding level two legislation. It may also inadvertently lead to the application of broader requirements, applicable to RLEs, to the expanded scope of entities under the SRB's proposed policy. We would not support this.

We therefore encourage the SRB to reconsider the method it intends to utilise to achieve its policy aim in this area to ensure that the outcomes can be achieved in a manner in-keeping with the legal framework. This could be achieved through introducing a new definition for the expanded scope of entities to allow the phase-in of internal MREL requirements, for example, Internal MREL Entities (IMEs). We therefore encourage the SRB to clarify in its final policy statement that the expanded scope for these purposes would not be deemed RLEs[10] but rather IMEs, or a similarly new and clear definition.

Application to third country subsidiaries: To the extent Article 45f BRRD2 applies to subsidiaries of third country resolution entities, (and that are not themselves a resolution entity), the article is clear in its derogation of the requirements, and that Union parent undertakings shall comply with the requirements of Articles 45c and 45d on a consolidated basis. We would welcome clarity in the SRB's final policy that they intend to align their policy regarding subsidiaries of third country resolution entities in this regard. We do not anticipate the expansion of the definition of RLEs (or introduction of IMEs as proposed above) to impact such sub-groups, particularly given the scope of the requirements as set under Article 92b CRR2. Confirmation of this would be most welcome in the SRB's final policy statement.

We would also welcome from the SRB clarification as to how they will seek to ensure that any requirements they seek to place on such material subsidiaries are made in agreement with the relevant home resolution authorities, e.g. via the appropriate Crisis Management Group, as per the FSB guiding principles on internal TLAC. We strongly believe that the SRB support cross-border cooperation given its record, and would therefore welcome further information on the SRB's approach to material subsidiaries of third country resolution entities.

MCC application under internal MREL: Regarding the calibration of internal MREL requirements, we welcome the MCC not being set as part of an entity's internal MREL by default.

However, we note the SRB, under point 32 of the consultation, intends to set the MCC for internal MREL for "*the operating bank that is a direct subsidiary of a Holding Company identified as a resolution entity*". Footnote

[7] I.e. that individual MREL requirements are to be set for institutions that are subsidiaries of a resolution entity, or of a third country resolution entity, but are not themselves resolution entities, as per Article 45f(1) BRRD2.
[8] Article 2(23) BRRD2 defines an institution as a credit institution or an investment firm.
[9] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R1624&from=EN
[10] Paragraph 93 in the draft SRB Policy states "These are deemed RLEs", which we object to. Instead a new definition should be used to deliver on the SRB policy that we otherwise support.

39 explains that this is in order to allow the "*down streaming of the capacity raised by the Holding Company from external investors (structural subordination)*".

It is not clear whether the SRB intends to apply the MCC for an operating bank that is a subsidiary of a Holding Company that uses other means of subordination of its external MREL e.g. contractual subordination. We would welcome the SRB's clarification on this point and also whether, by applying such a requirement to groups using structural subordination, the policy proposal may lead to a level playing field issue where groups structured as Hold Co/Op Co are at a disadvantage compared to other groups with non-Hold Cos at the top level.

Applying the MCC where the entity is a direct operating subsidiary of a resolution entity holding company should be further justified on a case-by-case basis, as such an operating entity may still obtain its funding via the holding company resolution entity, and in our view would not warrant a MCC itself. Where the institution is sufficiently reliant on wholesale funding, as in the proposed SRB policy, an entity should attract an appropriately calibrated MCC.

There is a need for additional clarity as to how, if at all, this would apply or impact institutions that are material subsidiaries of third country resolution entities. Given the application of requirements at the consolidated level, we do not envisage an additional stand-alone individual MCC requirement being placed on subsidiaries of the relevant holding company in these instances. Clarity on this in the final SRB policy, or at the latest in the future policy on IPUs would be most welcome.

Internal MREL waivers: We support the use of internal MREL waivers and believe that given the SRB's role as the single resolution authority for cross-border institutions within the Banking Union, that it should seek to utilise such waivers to the fullest extent possible, whilst still maintaining credible resolution plans. The need for alternative mechanisms to distribute losses up to the resolution entity to support the case for an internal MREL waiver is noted, however, it should be clarified in the policy that collateralised guarantees are an alternative to internal MREL subordinated instruments only, not an alternative to waivers.

We strongly believe that the SRB should continue to work with institutions to understand how efficient the possible alternatives are so that waivers can be meaningfully implemented across resolution groups, and not limited to a small number of cases. The SRB should also explore the recognition of alternative actions that are available that may replace internal MREL and allow waivers to be granted, taking into account parental support arrangements or any other recapitalisation mechanisms. The ability for institutions to utilise internal MREL waivers will become ever more important as the scope of entities is expanded to include otherwise immaterial entities, and to avoid this negatively impacting the existing business and funding models of banks, which seek to allocate funds on a commercial basis, to support economic growth, enhance bank profitability while maintaining at group level the flexibility to allocate the financial resources to the entities in need, if any.

Where the SRB are to assess the potential to apply internal MREL waivers, we note that the draft policy makes reference to the subsidiary in question having obtained a supervisory waiver as an important element of this. The level one text does not include this element as a prerequisite for the SRB to grant an internal MREL waiver. Earlier iterations of the draft level one text did consider this as a requirement, but it was excluded from the final legal texts precisely because it was felt by co-legislators that this was disproportionate, and conflated the use of capital and internal MREL waivers unnecessarily.

The absence of a supervisory waiver should not prejudice the SRB's ability to make its own decisions regarding the appropriate application of internal MREL waivers. By assuming that a supervisory waiver would indicate where an internal MREL waiver should apply would ignore the potential preferences of host regulators (who may prioritise going-concern loss absorbing capacity over gone concern recapitalisation capacity) and ignore the alternative arrangements that could otherwise give comfort to host authorities in the event that a

resolution were to occur. This also fails to acknowledge the lower probability of resolution action being taken over loss-absorbing capacity being utilised in times of business-as-usual. We therefore strongly recommend that the SRB reconsiders its stance here.

We encourage the SRB to apply only the criteria as set out in the level one text when considering internal MREL waivers. These are already helpfully noted in the SRB's draft policy in Table 1. Going beyond these criteria will mean effective gold-plating of the agreed level one text. We would not support this.

External issuances of internal MREL: We note that individual entities subject to internal MREL requirements may be permitted to issue instruments externally under certain criteria[11]. However, the SRB draft policy does not comment on this. Can the SRB please confirm in their final policy that such issuances meeting the specified criteria in the level one text will be acknowledged by the SRB? Our understanding is that such instruments should also count simultaneously as external MREL at consolidated level given that it replicates a passing of losses to an external counterparty mimicking the write down or conversion of external MREL at the resolution entity[12].

5. Is the proposed approach to the treatment of guarantees appropriately rigorous and even handed?

Partially collateralised guarantees: Where partially collateralised guarantees are deemed appropriate, we welcome the SRB's confirmation that they would apply the minimum haircuts available under Article 224 CRR. We recognise the level one text requiring appropriately conservative haircuts being applied to collateral backing the guarantee, as explained within the draft SRB policy. We would encourage the SRB to nonetheless consider scenarios whereby the quality of collateral being used is sufficiently high that haircuts need not apply.

With regard to the need to provide legal opinions to support the use of the guarantee, we would encourage the SRB to not seek to impose criteria that are as broad as those currently observed under the SRB's policy on liabilities issued under third country law. We comment on these further below.

<u>MREL for cooperative groups</u>

6. Do you agree with the criteria for recognition of network eligible liabilities? Specifically, do you agree with the condition to disclose to investors subscribing MREL eligible debt instruments information about the potential bail-in of such instruments for the recapitalisation of any of the entities of the network?

Transparency vis-à-vis market participants is necessary in order to ensure that investors are well informed. However, the bank resolution process is already part of the risk factors embedded in registration documents and issuance prospectuses.

7. Do you agree that the assessment of any waiver of the internal MREL for affiliated institutions should relate to the bilateral situation between the affiliated institution and the resolution entity, without taking a network-wide perspective?

We do not agree with the SRB's proposal to assess a prompt transfer of own funds or repayment of liability without taking into account the whole network. Given that the support scheme of cooperative banking groups may vary among jurisdictions, and given differences regarding the extent to which solidarity mechanisms

[11] As per Article 45f(2)(a)(i) BRRD2 for internal MREL
[12] As per Article 45b(3) BRRD2 for external MREL

would apply, such an assessment cannot be one-size-fits-all. We therefore encourage the SRB to have a case-by-case approach and take into account potential legal obligations applying to the central body when activating internal solidarity mechanisms among the network. When a central body may activate the financial support from the whole network, it would be inappropriate to restrict the assessment to a bilateral relationship between the central body and each affiliate.

Eligibility of liabilities issued under third country law

We strongly support the goal of effective cross-border resolution including that resolution actions are effective with respect to liabilities governed by the law of a third country. We have consistently supported this goal including through developing model clauses for contractual recognition of bail-in to support implementation of Article 55 BRRD[13].

As highlighted above in our general comments, it is important to clarify the application of contractual recognition of bail-in requirements to existing Additional Tier 1 (AT1) and Tier 2 (T2) instruments and ensure a proportionate approach to requirements for legal opinions to support the eligibility of liabilities governed by the law of a third country.

Impact on own funds instruments: The SRB draft policy makes reference to the application of the amended Article 55 requirements with respect to AT1 and T2 instruments in paragraph 120. Footnote 81 seeks to clarify that the impact on an institution's liabilities would be limited to those issued after the date referred to in Article 55(1)(d) BRRD2, i.e. that those issued prior to this date would remain unaffected. This would also correspond with the grandfathering provisions for own funds instruments as provided for under CRR2 Article 494b. However, we are concerned that this is not sufficiently reflected in paragraph 121 of the draft SRB policy whereby the SRB states that it "*will exclude AT1 and T2 instruments governed by third country law from MREL supply, unless the bank has included an effective and enforceable contractual recognition clause*". We would therefore welcome a firm, clear, and explicit statement from the SRB that this will not impact liabilities issued before the date referenced in Article 55(1)(d) BRRD2, as per the SRB's footnote 81. It is very important that there is clarity for banks and investors on this point. Were this not to be the case we are concerned that there would be significant implications on the eligibility of material amounts of currently issued liabilities, and bring in to question the compliance of SRB policy with Union law. We therefore welcome this reassurance at the earliest possible date.

8. Do you agree with the criteria for the acceptance of legal opinions? Is there any criterion that in your view needs additional detail or clarification?

We remain concerned that the SRB's policy setting out the minimum requirements for legal opinions that accompany the use of Article 55 clauses is overly prescriptive. While we acknowledge the importance that the SRB is satisfied as to the enforceability of contractual recognition of bail-in clauses in MREL governed by the law of a third country, it is important to take a proportionate approach to legal opinions. We therefore consider that it is important that the SRB retains sufficient flexibility in its approach to the content of legal opinions and propose that a less prescriptive approach to the minimum criteria is taken, for example amending the draft policy to provide that the criteria established in Box 2 are guidance as to aspects which the SRB would expect to see addressed in legal opinions rather than a "tick box" list of criteria that must be included. We continue to believe that the emphasis should be on the enforceability of the relevant clause.

[13] See AFME – Model clauses for the contractual recognition of bail-in under Article 55 BRRD - https://www.afme.eu/Portals/0/globalassets/downloads/standard-forms-and-documents/afme-model-clauses-for-contractual-recognition-of-bail-in.pdf?ver=2019-09-24-164450-453

We previously raised a number of areas of uncertainty and practical challenges in our comments on the 2018 MREL Policy – second wave and note that these have not been addressed in the proposed minimum requirements set out in Box 2. We also note that feedback from our members suggests that they have not received confirmation from the SRB that legal opinions delivered with respect to issuances since 16 January 2019 are satisfactory.

9. With the objective of finding practical solutions that ensure full coverage of liabilities for which a legal opinion is expected, which arrangement would you consider to be the most efficient for your issuance practice?

In addition to the criteria for legal opinions, it is also important to take a proportionate approach to the requirement for legal opinions to be delivered for every individual issuance. For example, consideration could be given to whether issuances under a funding programme could be covered by a single legal opinion to avoid the need for separate opinions for each individual issuance.

Transition arrangements

Whilst we recognise the level one text requiring a linear build-up of MREL up to the 2024 compliance deadline, we note that the SRB's stance with regard to institutions already meeting MREL requirements is somewhat disproportionate. In particular, setting the end-state MREL level as the current required target penalises those institutions that have sought to meet MREL levels sooner. This may hamper these institutions unnecessarily if they were to seek any redemption of MREL, for example to more efficiently manage their liability stack and minimise costs to the group.

This approach does not take into account the need for institutions to seek permission before redeeming MREL and the role the SRB will have in this decision-making process. Where linear build-up targets are set, in line with those institutions that have yet to meet their final end-state levels, the available MREL will not be removed or become ineligible as a result. The setting of the target level on a linear build-up to an end-state requirement does not change the available loss absorbing capacity at the institution and does not damage the resolvability of the institution. It will potentially allow the institution some flexibility should they wish to seek redemptions to better optimise their liability stack, but will nonetheless still require the SRB's approval.

10. Do you envisage any complications or constraints related to the transition arrangements?

We do foresee one particular issue with regard to the transitional arrangements. Due to the nature of this we will seek to raise this with the SRB on a bilateral basis.

Further comments

We believe that to further enhance the understanding of non-expert readers of the SRB policy, in particular the understanding of market analysts and researchers, that a number of clarifications and additions be made.

Under the calibration section, paragraphs 16 and 20 are a little unclear and could be misleading. We propose that for paragraph 16 a timeline could be provided to express this planned use of data sources at different points in simpler terms. Regarding paragraph 20 the use of diagrams to make the usability of CBR capital clear would help. Utilising existing diagrams from the most recent SRB industry dialogue could be considered for this purpose.

Under the subordination section, paragraph 60 introduces the new concepts of Pillar 1 banks (GSIIs, Top-Tier, and Other), alongside their respective unadjusted subordination requirements. This has already caused some confusion amongst readers, and we would propose that the SRB expresses these more simply, giving the definitions of the different types of Pillar 1 institutions to better explain the criteria banks must meet to be deemed a GSII, Top-Tier, or Other Pillar 1 institution. Having the unadjusted requirements set out for these in a diagram would also assist in informing non-expert audiences. In this regard, paragraph 64, which makes note of the 27% TREA cap for Top-Tier banks could be better explained, specifically where the 27% cap would and would not apply. Footnote 62 (stating that the cap may be exceeded but with on explanation) does not provide adequate detail in this regard and has been confused as a contradiction by readers.

Beyond these some smaller additions would be welcomed, including the definition of "level 3 assets" which are referred to on page 16. A glossary definition with the relevant legal references should suffice. Footnote 21 on page 10 should be corrected to read '*See point 133 of Article 4(1) of Regulation (EU) No 575/2013'.* Footnote 60 is referenced on page 21 at the end of paragraph 62, but no footnote is provided at the bottom of the page. Reference to condition (b) of Article 12c(8) SRMR2 should read condition (a) on page 22 paragraph 68. Finally, there is also an issue with the numbering of paragraphs whereby numbers 84 to 88 are skipped.

We hope that you find these comments helpful. Should you have any questions on our response, or wish to discuss related issues, please do not hesitate to get in touch.

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Notes:

1. AFME (Association for Financial Markets in Europe) promotes fair, orderly, and efficient European wholesale capital markets and provides leadership in advancing the interests of all market participants. 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. AFME participates in 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) through the GFMA (Global Financial Markets Association). For more information please visit the AFME website: www.afme.eu.