



Review of the Regulatory Framework Risk Reduction Package

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Agenda

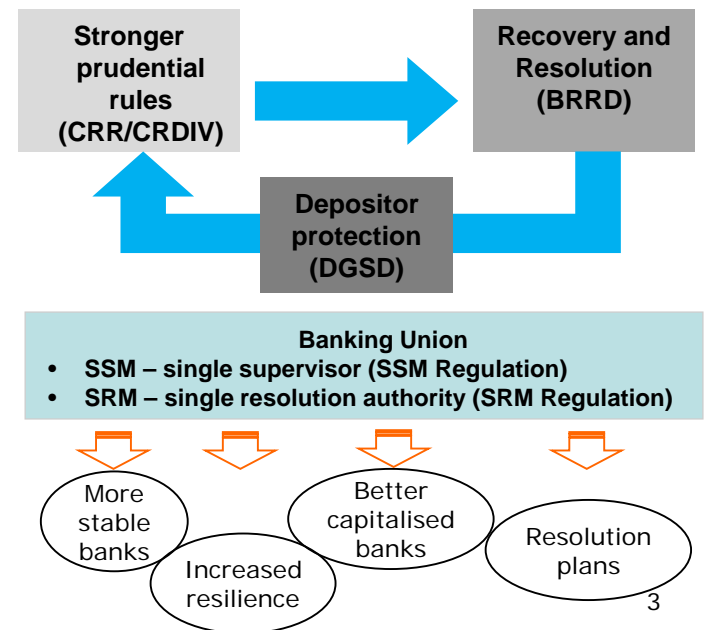
1. Banking sector reform in the EU
2. Background and objectives of the RRM package, state of play
3. Bank creditor hierarchy, adoption of partial EU harmonisation
4. State of play on the Resolution RRM package:
 - TLAC vs MREL
 - MREL calibration for non-GSII
 - MREL quality (subordination principles, eligibility criteria and grandfathering)
 - MREL reporting and disclosure
 - Breach process
 - Internal MREL
 - International/ 3rd country context
 - Moratoria tools
5. Concluding remarks

1.1 Prudential and resolution reforms in the EU

- *Over the last decade, the EU has built a new regulatory architecture for its financial system*
 - EU single market: A single rulebook is now in place for all financial actors across the single market
 - Euro area: the essentials of the Banking Union are in place for the euro area (SSM, SRM)
- *The **current** EU single rulebook includes*
 - stronger prudential requirements for banks (CRR/CRDIV implementing Basel III)
 - improved depositor protection rules (Deposit Guarantee Scheme Directive)
 - rules to manage the recovery/resolution of a failing financial institution (BRRD)
 - in the Banking Union: a single supervisory mechanism (SSM) with a single supervisory authority and a single resolution mechanism (SRM) with a single Board (SRB) managing the resolution planning and execution for 125 groups in the euro-area

- *Implementation of current rules:*
Enhanced prudential rules (CRR/CRDIV). BU status:
 - fully loaded capital ratios increased by EUR 234bn since 2014
 - new standards for liquidity/ funding (LCR at 143% coverage)
 - leverage (decreased by ¼, avg. fully loaded LR increased from 4% to 5.1%)
 - stricter risk management and governance rules.

- BRRD/SRMR: implementation of resolution rules. BU status:
- Binding consolidated MREL set for largest banks, half of which comply and the others will comply within specific deadlines (max 4 years).
 - Operationalisation of resolution plans, more analytical work on critical functions, strategies, impediments.



1.2 Areas for further strengthening

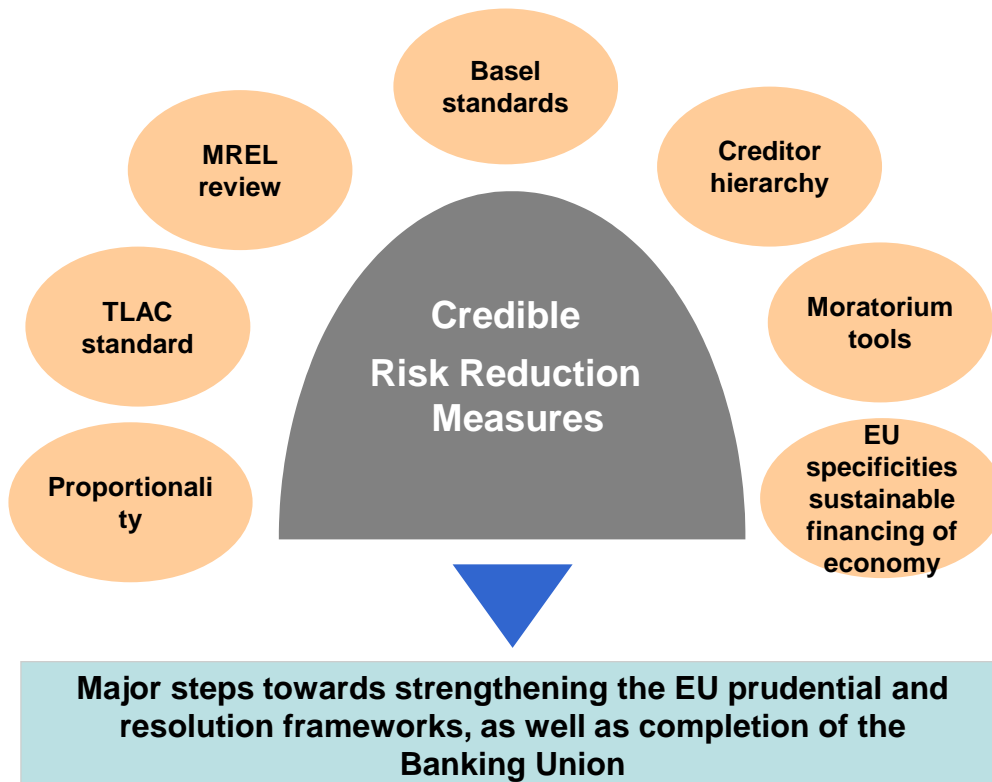
- *In spite of all the progress, there remain areas where our regulatory framework still needs to be strengthened and adjusted. Once the Banking Package will have been agreed, other initiatives are required to complete the Banking Union:*
 - make progress on the EDIS design, as suggested by the Commission in its October Communication.
 - design and implement a common back-stop for the Single Resolution Fund. The Commission contributed to this debate through its EMU proposal from December 2017.
 - clean-up the NPL legacy issues and prevent their build-up in the future
 - non-bank frameworks: CCP recovery and resolution; EMIR2
 - ESAs review (European supervisory authorities)

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2.1 Background and objectives of the RRM package

- The 2016 legislative package paves the way for further **risk reduction** in the banking sector, while balancing out the needs for financial stability and financing of the economy.
- It ensures: *improved resilience of the EU banking sector and a more robust and operationally implementable resolution framework*



- **Capital Requirements Regulation/ Directive (CRR/CRD):**
 - Completion of prudential framework (Leverage ratio, NSFR, Fundamental review of the Trading Book, other Basel standards)
 - Implementation of TLAC standard for G-SIIs
 - More proportionality
 - Warranting EU specificities, including measures to support sustainable financing of the EU economy (Pillar 2, waivers)
 - EU Intermediate holding company rule
- **Bank Recovery and Resolution Directive (BRRD)/ Single Resolution Mechanism Regulation (SRMR)/ Creditor Hierarchy Directive (BRRD):**
 - Revision of existing rules for all banks (MREL stacking order and calibration)
 - Harmonisation of creditor hierarchy
 - Internal MREL and home/host joint decision
 - Harmonisation of moratoria powers
 - Waivers on 3rd country bail-in clauses (Art 55)

2.2 State of play legislative negotiations

- Priority to finalise as soon as possible negotiations on the legislative package published in November 2016, to provide clarity to the market and industry as to the requirements they need to comply with.

- On process,



- **Fast-tracked files** (1/ Bank Creditor Hierarchy proposal 2/ IFRS9 transition and 3/ the exemption to the large exposure treatment of sovereign debt of non-euro countries denominated in euros) have been agreed both in Council and EP, published in the OJ in December 2017.
 - The Bank Creditor Hierarchy Directive creating the new "senior non-preferred" class of liabilities needs to be transposed by MS; certain MS have already done this in anticipation.

Ongoing



- **The rest of the package (BRRD, CRD, CRR, SRMR)**
 - In Council: the Council Presidency is aiming to achieve a General Approach within their mandate. The European Parliament is working with a similar degree of ambition
 - CRR/CRD - mainly technical discussions, closer to convergence. Main open points: Basel implementation and transitional periods, Pillar 2, Leverage ratio surcharge, home/host issues, scope of exemptions from CRR/CRD.
 - Resolution items – more political debate on: MREL calibration and subordination; MREL building blocks and stacking order of instruments; transitional periods; home/host issues; moratorium tool.
 - In Parliament: the Rapporteurs published their reports on BRRD/SRMR and CRR/CRD in October and November 2017, respectively. They are subject to a period of EP amendments which expired on 25 January 2018. The EP vote is expected by May 2018.

2.3. Critical Milestones

Council Working Parties under the BG Presidency:

- ✓ • 15 Jan – CRR/CRD – done. Leverage ratio surcharge and other outstanding technical topics on CRR/CRD were discussed
- ✓ • 1 February – BRRD/SRMR
- ✓ • 6 February - CRR/CRD and BRRD/SRMR
- 20 February –CRR/CRD and BRRD/SRMR
- 28 February - Coreper or possibly Council Working Party meeting
- 7 March - Coreper
- 13 March - ECOFIN

Parliament:

- ✓ • Rapporteurs' reports on CRR/CRD published in November, on BRRD/SRMR in October 2017
- ✓ • Amendments phase – deadline on 25 January
- Analysis of amendments – ongoing
- EP vote – end of May 2018

Trilogues – to be determined

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3.1 Bank Creditor Hierarchy – adoption process

- A swift political agreement has been reached between the EP, Council and Commission on the Bank Creditor Hierarchy Directive in 2017.
- ***Key changes vis-à-vis COM proposal***
 - The most important elements of COM proposal are retained
 - Some additions:
 - a possibility of early transposition by Member States:
 - The new rules have to be applied no later than 12 months from entry into force of the Directive
 - Importantly, the agreed approach also recognises national legislative measures of Member States on the subject matter that might be adopted prior to entry into force of the Directive (ie, "early transposition") to the extent that their content is aligned with the key requirements of this directive.
 - a mandate for the Commission to review the need for a tiered depositor preference in insolvency

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4.1 Zoom-in: state of play Resolution Framework

- **General state of play:** overall the discussions on BRRD are quite political, most debate taking place around calibration of MREL (quantity, quality, consequences in case of breaches and transitional periods), home/host issues and moratoria tools.
- **Way forward:** starting from the Estonian Presidency's Progress Report from December 2017, the Bulgarian Presidency will negotiate the open points in this package and likely oversee the finalisation of a General Approach and the start of Trilogues with the EP.
- **Main elements:**
 - Harmonised minimum requirement for loss absorbing and recapitalisation capacity for GSIIIs (TLAC)
 - Discretion to supplement minimum requirement for G-SIIIs if justified (MREL add-on)
 - Institution-specific MREL continues to apply for other banks – with a new split of MREL building blocks and stacking order
 - Improved rules on intra-group allocation of loss absorbing and recapitalisation capacity (resolution strategies, principles, waivers, safeguards)
 - MREL reporting and disclosure
 - Breach process
 - Increased effectiveness of resolving EU activities of 3rd country banks
 - Harmonised moratoria powers

4.2 State of play TLAC/MREL: Calibration

- **Policy: (GSIIs) TLAC (harmonised minimum level - Pillar 1 MREL):** Phased-in minimum requirement, subject to mandatory subordination (except for 3.5% RWA senior debt or senior debt subject to de minimis 5% of TLAC in the steady state phase)
 - ***State of play:*** *accepted and well anticipated requirement both by industry and regulators. Banks already work towards meeting the TLAC levels by 2019 and 2022. Some debate in Council around the scope of TLAC, for the moment this remains confined to GSIIs*

- **Policy: (all banks) MREL (judgement-based bank specific requirement – Pillar 2 MREL)**
 - **MREL requirement**
 - (i) to absorb losses (Pillar 1 and Pillar 2R capital requirement) and
 - (ii) to recapitalise the bank, to ensure continuing authorisation requirements
 - **MREL Guidance** – additional capacity covering
 - (i) risks of additional losses as estimated by the capital guidance and / or
 - (ii) a market confidence buffer
 - ***State of play:*** *Complex Council discussions on: 1/ MREL quantity and quality (subordination); 2/ the mandatory nature of MREL requirement and MREL Guidance by types of banks; 3/ the stacking order and consequences in case of breaches (MDA restrictions) and 4/ the reference to 8% of total liabilities and own funds.*
Discussions ongoing under BG PCY.

4.3 State of play TLAC/MREL: Eligibility criteria

Policy: TLAC/MREL eligible instruments:

- Own funds, except CET1 used to comply with the combined capital buffer requirement
- Eligible liabilities (EL): CRR Articles 72a & b, based on TLAC Termsheet but with new additions.
 - To ensure that the 1 year maturity rule is effective, the instrument should not include clauses which would enable its redemption before maturity.

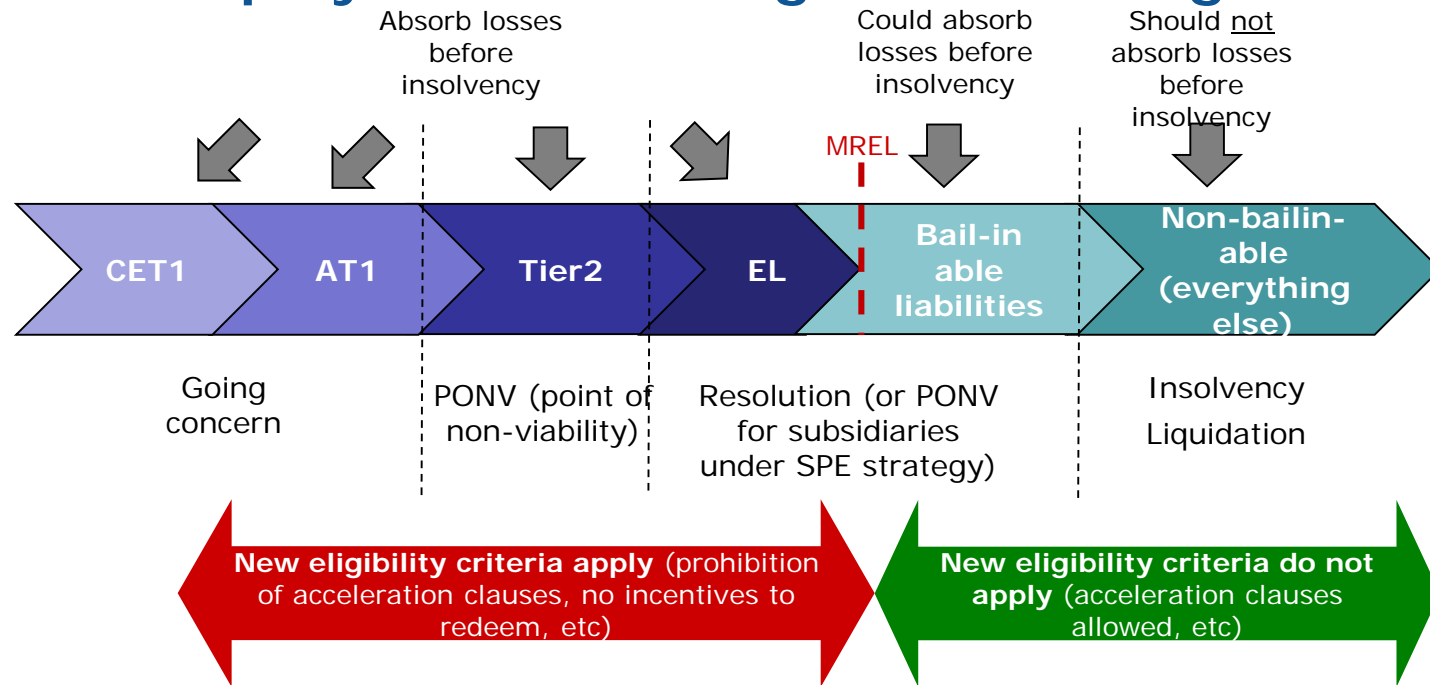
Policy: Specificity for MREL Pillar 2 eligibility:

- Same eligibility criteria as for Pillar 1 (TLAC), except for the subordination criterion which is a discretionary power of the Resolution Authority.
- Certain structured notes can be part of MREL Pillar 2 provided they satisfy additional criteria (e.g. known/fixed protected principal amount non-affected by the derivative component, do not hinder effectiveness of bail-in).

State of play: Overall, the enhanced, more conservative eligibility criteria were well received by most MS and authorities to ensure sufficient loss absorption capacity at the right time.

(On substance, some MS supported the deletion of the disclosure criteria from the contractual documentation. Also, certain MS preferred more accommodative features for the prohibition of acceleration right (e.g. allowing them after 30-days from an event of default), however without a wider support).

4.4 State of play TLAC/MREL: grandfathering



State of play - Grandfathering rule:

- The Commission's legislative proposal does not contain transitional provisions for existing instruments that do not meet the new eligibility criteria.
- Potential transitional provisions might be envisaged along various options:
 - "CRR-style" grandfathering: phasing out over several years (more complex)
 - "US-style" grandfathering: full and unlimited recognition of all outstanding instruments issued before the cut-off date, no recognition of instruments issued after the cut-off date.
- So far, preference for US style grandfathering as this is less complex.

4.5 Transitional compliance period, reporting, disclosure

- **Transitional compliance period:** *COM proposal did not include a harmonised transitional period in Level 1 text because the current BRRD foresees a bank-specific transition period to be decided by the Resolution Authority. This is kept in the COM proposal.*
- **Supervisory reporting** (to competent and resolution authorities)
 - Frequency:
 - TLAC: semi-annual basis
 - MREL: in COM proposal at least yearly, Council discusses to align with TLAC (at least semi-annually)
 - Object of reporting: MREL amount (both external or internal MREL, depending on reporting entity), composition of items including their maturity profile and ranking in normal insolvency proceedings.
- **Public disclosures:**
 - Frequency:
 - TLAC: at least yearly
 - MREL: at least yearly
 - Object of disclosure: MREL amount (external and internal MREL, depending on reporting entity), composition of items including their maturity profile and ranking in normal insolvency proceedings; only the MREL requirement and add-on for GSII is disclosable to the public. MREL guidance is not publicly disclosed.

State of play: *discussion ongoing on maximum timeline for the compliance period for all EU banks (e.g. 2024) versus a minimum timeline from when compliance should start (e.g. compliance starts only from 202x with case by case deadlines by bank)*

4.6 Consequences of MREL breach

Policy:

- Powers available to resolution and competent authorities when MREL is breached :
 - Powers to address impediments to resolvability (Articles 17 and 18 of BRRD)
 - Administrative penalties and administrative measures (Articles 110 and 111 of BRRD)
 - Early intervention measures (Article 27 of BRRD and Articles 104 of CRD)
- Consultation requirement between competent and resolution authorities when they exercise their respective powers, to avoid any conflicting or overlapping measures
- Enhanced powers to address impediments to resolvability and the related decision making procedure:
 - New powers: e.g. requiring the bank to submit MREL and capital buffer **Restoration Plan** or to change the maturity profile of eligible liabilities
 - Shorter decision period: actions in case of MREL breaches can be taken in an expedited manner: simpler notification process and shortened periods for each procedural step (2 weeks)
- Restrictions to MDAs (distributable amounts) kick in:
 - In case the bank breaches its combined capital buffer requirement (CCBR) due to an inability to replace MREL instruments for more than 6 months, while simultaneously continuing to comply with its capital requirements (Articles 141 and 141a of CRD)
 - If MREL and capital requirements are both breached, MDA restrictions kick-in immediately

State of play: *different views regarding the importance of MDA triggers, whether it should be automatic or discretionary and at what level they should kick in.*

4.7 Internal MREL and home/host joint decisions

Policy:

- Decisions on external and internal MREL to be taken in resolution colleges
 - Joint decision on external and internal MREL, with possibility of EBA binding mediation
 - No more "top down" approach, parallel approach, i.e. a single decision on external and internal MREL
- Internal MREL mechanism:
 - Subsidiaries issue internal MREL eligible instruments to their parent/resolution entity
 - Internal MREL liabilities to be subordinated to non-regulatory capital liabilities issued externally
 - Allows up streaming of losses and recapitalisation of subsidiary to resolution entity at PONV of subsidiary without a need to place it in resolution (SPE strategy)
- Internal MREL eligibility: same criteria as in CRR Art 72a and b, except that internal MREL is subordinated to all liabilities other than own funds
- Waivers: 1/ within the same MS (existing); 2/ cross-border within BU: *possibility to replace prepositioned internal MREL with a guarantee issued by the parent (very controversial with host MS)*

State of play: *Most MS do not support the cross-border possibility to replace internal MREL with collateralised guarantees. There is preference to keep this option only within the same MS.*

Host MS support the inclusion of certain features such as: the "safe harbour", possibility of mixed issuances for subsidiaries (internal MREL issued to parent and external MREL); intra-group liabilities mandatorily excluded from bail-in at the parent).

Discussions ongoing.

4.8 Third country context (IPU, iTLAC, EU colleges)

- Policy Objective: enhance the resolvability of 3rd country groups operating in the EU
- EU IPU proposed rule: to establish intermediate EU parent undertaking
 - IPU form: may be a CRD authorised institution/ financial holding company/ mixed financial holding company
 - Applies only where a third country group has two or more subsidiaries in the EU
 - Applies only where combined assets of EU branches and subsidiaries > EUR 30 billion or third country group is identified as a GSIB
- Internal TLAC: Where the third country group is a GSII, the parent must preposition at least 90% of internal TLAC with its subsidiary in the EU if:
 - The global group resolution strategy is SPE and the EU entity is not a resolution entity itself
 - Materiality thresholds referred to in the TLAC term sheet are reached
- Amendments to improve the governance of European resolution colleges (Art 89 BRRD)
 - Covers all situations where there are multiple subsidiaries in the EU, regardless of whether a requirement to establish intermediate EU parent undertaking applies
 - Where global strategy is SPE, MREL instruments to be issued to foreign resolution entities
 - More explicit rules on chairing of the European resolution colleges
- Bail-in contractual recognition clause (Art 55 BRRD): waiver mechanism with safeguards (no MREL eligibility, subordination).
- **State of play:** The internal TLAC prepositioning at 90% for 3rd country GSII broadly accepted, the EU IPU rule discussed, as well as amendments to Art 55. Negotiations ongoing.

4.9 Moratoria Tools

- 2016 EGBPI discussions and mandate for Commission consultation process
- Objective of harmonisation: achieve consistency in scope, duration, triggering conditions of moratorium powers
- Two separate tools introduced
 - **Pre-resolution moratorium**
 - Where necessary for decision on early intervention measures and conducting valuation to determine the condition for "failing or likely to fail"
 - **Resolution moratorium**
 - Where necessary for the purpose of valuation/effective application of resolution tools
- Scope limitations: covered deposits and CCP exposures excluded
- Duration
 - Period strictly necessary for purpose
 - No longer than 5 working days
- **State of play:** Interdependencies with internationally agreed stay period for derivatives and securities contracts (max 2 days – as per ISDA protocol).

Difference in views among MS regarding the pre-resolution moratorium tool, the inclusion of covered deposits and the duration.

Certain MS prefer to merge the two tools into one, to be used only once the "failing or likely to fail" decision was triggered.

Negotiations ongoing.

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- **The 2016 banking package is risk reducing because:** it introduces a minimum harmonised standard into EU law (TLAC); adapts the MREL requirement; strengthens the eligibility criteria to ensure loss absorbing capacity is ensured at all times; harmonises (partially) the hierarchy of creditors for more legal clarity and certainty on how to achieve subordination for TLAC/MREL. It also improves the resolvability and supervision of third country banks in the EU; allows for more proportionality for the recognition of EU bail-in powers in third countries and harmonises the moratoria powers.
- **The COM proposed rules provide for a flexible approach allowing a proportionate application of provisions to the entire population of EU heterogeneous institutions:**
 - systemic/complex banks as well as small/simpler regional or national banks
 - wholesale-funded as well as deposit-funded institutions
 - banks with good economic and financial fundamentals as well as with bad fundamentals
 - banks in going concern as well as banks emerging from resolution