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COVER NOTE

From:	Secretary-General of the European Commission, signed by Ms Martine DEPREZ, Director
date of receipt:	15 December 2021
To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
Subject:	Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 and Directive 2014/59/EU as regards the prudential treatment of global systemically important institution groups with a multiple point of entry resolution strategy and a methodology for the indirect subscription of instruments eligible for meeting the minimum requirement for own funds and eligible liabilities [COM(2021) 665 final - 2021/0343 (COD)] *- Opinion of the European Economic and Social Committee*

Delegations will find attached the above mentioned opinion.

Encl.:

European Economic
and Social Committee

OPINION

European Economic and Social Committee

Amendment to the Capital Requirements Regulation in the area of resolution ("daisy chain" proposal)

Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 and Directive 2014/59/EU as regards the prudential treatment of global systemically important institution groups with a multiple point of entry resolution strategy and a methodology for the indirect subscription of instruments eligible for meeting the minimum requirement for own funds and eligible liabilities
[COM(2021) 665 final - 2021/0343 (COD)]

ECO/570

Rapporteur-general: **Antonio GARCÍA DEL RIEGO**

Referrals	Council of the European Union, 26/11/2021 European Parliament, 22/11/2021
Legal basis	Article 114 of the Treaty on the Functioning of the European Union
Section responsible	Economic and Monetary Union and Economic and Social Cohesion
EESC President decision	09/11/2021
Adopted at plenary	09/12/2021
Plenary session No	565
Outcome of vote (for/against/abstentions)	174/2/3

1. Conclusions and recommendations

1.1 The EESC deems it is necessary to incorporate directly into the Capital Requirements Regulation (CRR) a dedicated prudential treatment related to the indirect subscription of instruments eligible for internal Minimum Requirement for own funds and Eligible Liabilities (MREL). The proposed modifications to the CRR would address the identified inconsistencies between the CRR and the Bank recovery and resolution directive (BRRD).

1.2 The EESC recommends clearer CRR provisions on the comparison between the sum of the actual Total Loss Absorbing Capacity (TLAC) requirements of all the resolution groups within a global systemically important institutions (G-SII) group with a multiple point of entry (MPE) resolution strategy with the theoretical single point of entry (SPE) requirement of that G-SII group. The changes proposed are needed to clarify the extent to which resolution authorities can address the potential inconsistencies between SPE and MPE requirements.

1.3 The EESC stresses that it is necessary to amend the formula for the calculation of the TLAC/MREL surplus of a subsidiary in the context of the general deduction regime applicable to G-SIIs with an MPE resolution strategy, to ensure that that formula takes into account both the risk-based and the non-risk-based TLAC/MREL requirements of the subsidiary, in line with the TLAC standard. This would avoid that the TLAC/MREL surplus of a given subsidiary is overestimated.

1.4 The EESC draws attention to the fact that some CRR provisions applicable to G-SIIs with an MPE resolution strategy should be clarified to allow for the consideration of subsidiaries established outside of the EU. This would align the CRR with the corresponding TLAC principle agreed internationally, which is applicable with respect to subsidiaries established in all Financial Stability Board (FSB) jurisdictions.

1.5 The EESC recommends some targeted clarifications in the context of the requirement for own funds and eligible liabilities for institutions that are material subsidiaries of non-EU G-SIIs ('internal TLAC'), in order to ensure that debt instruments issued by those institutions meet all eligibility criteria for eligible liabilities instruments. The reason for this change is that currently the eligibility criteria for eligible liabilities instruments are based on the assumption that those instruments are issued by a resolution entity, and not by subsidiaries subject to an internal TLAC requirement. The gap would be addressed by clarifying that the same eligibility conditions applicable to resolution entities apply also to non-resolution entities, mutatis mutandis. This, in turn, would enable those institutions to meet their internal TLAC requirement, inter alia with eligible liabilities, as originally intended by the co-legislators.

1.5.1 The EESC stresses that MPE banks should be able to make use of the adjustments agreed to in the TLAC term sheet. These adjustments are designed to ensure equivalent treatment between the SPE and MPE resolution models. These adjustments are included in Articles 12a and 72e(4) of the CRR II but these two articles do not include third countries. In particular, Article 12a, as drafted, indicates that adjustments arising from differences in Risk-Weighted Assets (RWAs) are limited to entities based in the EU, as the concept of resolution entity only refers to subsidiaries with headquarters in the EU. It is important to broaden the scope to include any other subsidiaries that the group may have in any other country.

1.6 The EESC considers that this objective is not achieved with the Commission's recent proposal because the comparison between the hypothetical SPE and the sum of RWA of each resolution entity keeps third country subsidiaries out due to the fact that the comparison refers to Articles 45d and 45h of the BRRD, and the BRRD does not include subsidiaries in third countries nor differences between RWA that arise from different calculation criteria between third countries and Member States. It only includes differences between Member States.

2. General comments

2.1 The Capital Requirements Regulation (CRR) establishes together with the Capital Requirements Directive (CRD) the prudential regulatory framework for credit institutions operating in the Union. The CRR and the CRD were adopted in the aftermath of the 2008-2009 financial crisis to enhance the resilience of institutions operating in the EU financial sector, largely based on global standards agreed with the EU's international partners, in particular the Basel Committee on Banking Supervision (BCBS).

2.2 The CRR has been subsequently amended to tackle remaining weaknesses in the regulatory framework and to implement some outstanding elements of the global financial services reform that are essential to ensure institutions' resilience. A major revision was brought by the Risk Reduction Measures Package, which was adopted by the European Parliament and the Council on 20 May 2019 and published in the Official Journal on 7 June 2019.

2.3 This reform, implemented in the Union the international Total Loss-Absorbing Capacity (TLAC) standard for global systemically important institutions (G-SIIs) adopted by the Financial Stability Board (FSB) in November 2015 and enhanced the application of the minimum requirement for own funds and eligible liabilities (MREL) for all institutions established in the Union.

2.4 The TLAC standard requires G-SIIs to hold a sufficient amount of highly loss-absorbing (bail-inable) liabilities to ensure smooth and fast absorption of losses and recapitalisation in the event of resolution. The implementation of the TLAC standard in Union law, namely through amendments to the CRR, took into account the existing institution-specific minimum requirement for own funds and eligible liabilities (MREL), set out in the BRRD. TLAC and MREL are thus essential to effectively manage bank crises and reduce their negative impact on financial stability and public finances. TLAC and the revised rules on MREL became applicable in the Union on 27 June 2019 and 28 December 2020, respectively.

2.5 In line with international standards, Union law recognises both the Single Point of Entry (SPE) resolution strategy and the Multiple Point of Entry (MPE) resolution strategy. Under the SPE resolution strategy, only one group entity, typically the parent undertaking, is resolved ('resolution entity'), whereas other group entities, usually operating subsidiaries, are not subject to resolution action. Instead, the losses of those subsidiaries are transferred to the resolution entity and capital is downstreamed to the subsidiary. This ensures that the subsidiaries can continue to operate smoothly even after they have reached the point of non-viability.

2.6 Under the MPE resolution strategy, more than one entity of the banking group may be resolved. Consequently, more than one resolution entity and thus more than one resolution group may exist within the banking group. The underlying principle of the MPE resolution approach is to enable the resolution of a given resolution group in a feasible and credible way without undermining the resolvability of other resolution entities and resolution groups in the same consolidated banking group. The revised bank resolution framework provides that MREL for resolution entities should be set at the consolidated level of a resolution group ('external MREL').

2.7 In addition, that framework envisages how the loss absorption and recapitalisation capacity should be allocated within resolution groups ('internal MREL'). According to the BRRD, as a rule, financial instruments that are eligible for internal MREL must be held by the resolution entity, i.e. typically the parent undertaking.

2.8 Since early 2020, the European Banking Authority (EBA) has been working on a draft Regulatory Technical Standard (RTS) on the basis of a deduction regime, in line with the mandate set out in the BRRD and the recommendations in the relevant international standards[1]. The deduction regime developed by the EBA envisages that internal MREL eligible instruments issued by subsidiaries to the resolution entity via an intermediate parent would have to be fully deducted from the amount of the intermediate parent's own internal MREL capacity.

2.9 The EBA concluded that the BRRD requirements could not be fulfilled without additional provisions that needed to rely on the Level 1 text to specify. Apart from the need to operationalise the indirect subscription of instruments eligible for internal MREL, some other resolution-related issues have been identified since the revised TLAC/MREL framework became applicable in 2019. Those issues mainly relate to the regulatory treatment of G-SII groups with an MPE resolution strategy, including those MPE groups that have subsidiaries in third countries. For instance, the CRR currently does not specify whether the various adjustments to TLAC for G-SIIs with an MPE resolution strategy also cover those subsidiaries of a G-SII that are located in a third country.

2.10 Some targeted changes to specific resolution related aspects of the CRR are necessary to address the above issues. In particular, the regulatory treatment of G-SII groups with an MPE resolution strategy, including of those MPE groups that have subsidiaries in third countries, needs to be better aligned with the treatment outlined in the TLAC standard. This would help to ensure that, in case of resolution, each resolution entity and group belonging to those GSIIs can continue to perform critical functions without the risk of contagion.

2.11 The amendments proposed would not alter the overall architecture of the framework but would ensure the proper application of TLAC and MREL.

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1 Financial Stability Board, Guiding Principles on the Internal Total Loss-absorbing Capacity of G-SIBs ('Internal TLAC'), 6.7.2017. Under that regime, instruments eligible for internal MREL issued by the subsidiary and subscribed by the intermediate parent would be fully deducted from the eligible instruments issued by the intermediate parent to comply with its own internal MREL.

2.12 These proposed amendments to the CRR can play an essential role in improving an institution's resolvability. Given that the corresponding provisions are already applicable in the Union, the proposed modifications would need to be made in a timely manner. The need for an expedited adoption is further amplified by the fact that banking groups need clarity on the mechanism to decide how best to preposition their internal MREL capacity in view of the general MREL compliance deadline that is set to 1 January 2024, with binding intermediate targets needing to be complied with by 1 January 2022.

2.13 This proposal is not accompanied by a separate impact assessment, as this proposal does not alter the fundamental aspects of the CRR but mainly aims at clarifying the legal relationship between two existing EU law instruments, namely the CRR and the BRRD, by incorporating directly into the CRR a dedicated treatment for the indirect subscription of instruments eligible for internal MREL. Such clarifications would ensure that the two highly interlinked frameworks remain largely aligned.

2.14 This, in turn, would enable institutions to continue to calculate, report and disclose one set of total risk exposure amount and total exposure measure for the purpose of both the CRR and the BRRD, thereby avoiding an undue increase in complexity. This includes the possible need to issue additional MREL eligible instruments to comply with internal MREL, as introduced by the co-legislators through the revised BRRD.

3. Specific comments

3.1 The resolution strategies that are being developed by Crisis Management Groups (CMGs) are broadly based on two stylised approaches: "single point of entry resolution" (SPE), in which resolution powers are applied to the top of a group by a single national resolution authority and "multiple point of entry resolution" (MPE), in which resolution tools are applied to different parts of the group by two or more resolution authorities acting in a coordinated way.

3.1.1 Single point of entry (SPE) involves the application of resolution powers, for example, bail-in and/or transfer tools, at the top parent or holding company level by a single resolution authority – probably in the jurisdiction responsible for the global consolidated supervision of a group. An SPE strategy operates through the absorption of losses incurred within the group by the top parent or holding company through, for example, the write-down and/or mandatory conversion of unsecured debt issued.

3.1.2 Multiple point of entry (MPE) involves the application of resolution powers by two or more resolution authorities to different parts of the group, and is likely to result in a break-up of the group into two or more separate parts. The group could be split on a national or regional basis, along business lines, or a combination of each. The resolution powers applied to the separate parts need not be the same and could include resolution options, such as bail-in within resolution, use of a bridge entity, transfer of business or wind-down. MPE strategies nevertheless require actions to be coordinated across jurisdictions so as to avoid conflicts or inconsistencies that undermine the effectiveness of the separate resolution actions, a disorderly run on assets and contagion across the firm.

3.1.3 There is no binary choice between the two approaches. In practice, a combination might be necessary to accommodate the structure of a firm and the local regimes in the key jurisdictions where it operates. For example, some MPE strategies may involve applying multiple SPE resolutions to different parts of the firm such as regional blocs that are separable from one another.

3.2 The proposal is broadly based on preparatory work carried out by the EBA, notably with regard to the development of the regulatory technical standards on the indirect subscription of internal MREL eligible instruments within resolution groups. The proposal primarily aims at addressing unintended consequences related to the existing TLAC/MREL framework, resulting from the rules currently contained in the CRR. The proposed amendments would have a limited impact on the administrative burden for institutions and the costs for them to adapt their internal operations, with most of the costs expected to be offset by allowing the approach of indirect subscription of internal MREL eligible instruments within resolution groups, to function properly and, for the institutions concerned, by the benefits derived in terms of an improved recognition of third-country subsidiaries and by further specifying the eligibility of instruments issued in the context of the internal TLAC requirement.

3.3 Specifically, the proposal provides for:

3.3.1 Dedicated treatment for the indirect subscription of instruments eligible for internal MREL. The proposed Regulation thus introduces, in the CRR, a requirement that intermediate parents along the chain of ownership would have to deduct from their own internal MREL capacity the amount of their holdings of internal MREL eligible instruments, including own funds, issued by their subsidiaries belonging to the same resolution group.

3.3.2 Comparison between the theoretical SPE requirement and the sum of the actual MPE requirements. The CRR provides that G-SII groups with an MPE resolution strategy must calculate their TLAC requirement under the theoretical assumption that the group would be resolved under an SPE resolution strategy (theoretical SPE requirement). That theoretical SPE requirement is then to be compared by resolution authorities to the sum of the actual TLAC requirements of each resolution entity of that group under an MPE resolution strategy (MPE requirements). However, the CRR provisions as regards the consequences of that comparison are inconsistent.

3.3.3 Deductions from eligible liabilities items. The rationale of this provision is to minimise the risk of contagion within a G-SII group and to ensure that resolution entities have sufficient available loss-absorbing capacity in case of failure, which should not be diminished by losses arising from intragroup holdings of TLAC instruments. Without those deductions, the failure of one resolution entity in the G-SII group would lead to losses in other resolution entities of that group and consequently to a reduction in the loss-absorbing and recapitalisation capacity of those resolution entities.

3.3.4 Consideration of subsidiaries established outside of the Union. Articles 12a and 72e(4) of the CRR do not explicitly cover subsidiaries that are located in a third country. It may thus not be possible for EU banking groups with a global MPE resolution strategy to take subsidiaries that are established outside of the Union into account.

3.3.5 Clarifications on the eligibility of debt instruments issued in the context of the internal TLAC requirement. Article 92b of the CRR lays down the internal TLAC requirement for material subsidiaries of non-EU G-SIIs that are not resolution entities. That requirement may be met with own funds and with eligible liabilities instruments, as specified in Article 92b(2).

3.4 Detailed Amendments to the proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 and Directive 2014/59/EU as regards the prudential treatment of G-SIIs groups with a MPE resolution strategy.

3.4.1 **Consolidated calculation for G-SIIs with multiple resolution entities (Article 12a)**

3.4.1.1 The EESC stresses that MPE banks should be able to make use of the adjustments agreed to in the TLAC term sheet. These adjustments are designed to ensure equivalent treatment between the SPE and MPE resolution models. These adjustments are included in Articles 12a and 72e(4) of the CRR II but these two articles do not include third countries. In particular, Article 12a, as drafted, indicates that adjustments arising from differences in RWAs are limited to entities based in the EU, as the concept of resolution entity only refers to subsidiaries with headquarters in the EU. It is important to broaden the scope to include any other subsidiaries that the group may have in any other country.

3.4.1.2 The EESC considers that this objective is not achieved with the Commission's recent proposal because the comparison between the hypothetical SPE and the sum of RWA of each resolution entity keeps third country subsidiaries out due to the fact that the comparison refers to Articles 45d and 45h of the BRRD, and the BRRD does not include subsidiaries in third countries nor differences between RWA that arise from different calculation criteria between third countries and Member States. It only includes differences between Member States.

3.4.1.3 Regarding the need for an agreement to make this adjustment, the EESC is of the opinion that although there is a specific procedure for an agreement about the requirement of own funds and eligible liabilities in Article 45h, points 4 to 6 of BRRD II, this is a procedure that would only be applicable in the case of different resolution authorities within the EU and under a common regulation. One example to explain why the procedure is not valid for third counties is that it involves the EBA in cases where no agreement is reached between the resolution authorities.

3.4.1.4 The EESC proposes that in cases where the adjustments arise in a subsidiary of a third country, the European resolution authority of the parent institution is that which, taking into account the non-binding opinion of the resolution authority of said third country, has the ability to apply the adjustment without the need to reach an agreement with the third country authority.

3.4.2 **Deductions from eligible liabilities items (Article 72e)**

3.4.2.1 The EESC underlines that Article 72e shall include a grandfathering period until 31 December 2024 (deadline for TLAC implementation in third countries). During this transition period MPE banks shall be able to adjust the deduction on the holdings on third country subsidiaries without an equivalent resolution requirement, calculating the surplus based on the total capital requirement applicable in the third country. Otherwise there would be an unintended consequence, because the need to issue eligible liabilities will increase as a result of not being able to adjust this holding on a third country subsidiary, and from 2025 onwards, with a resolution regime in place, the Parent Institution requirement will decrease due to a lower adjusted deduction for these third country holdings and the need for these issuances of eligible liabilities will no longer be needed.

Brussels, 9 December 2021

Christa SCHWENG
The president of the European Economic and Social Committee

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