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EBF Response to EBA consultation paper on the appropriate target level basis for resolution financing arrangements under BRRD (EBA/CP/2016/08)

Key points:

- All EBF Members agree that the target level for resolution financing arrangements in total and for individual Members States should not increase or decrease.
- The EBF is therefore not in favour of changing the basis of the target level for resolution financing arrangements in the BRRD at this time.[1] Given the early stage of build-up of resolution funds and further reforms in progress to set TLAC and MREL, we believe it is premature to consider a revision of the legal basis for the resolution financing arrangements.
- Individual contributions by banks should remain dynamic and smooth while being practical, simple and transparent. Changing the rules in the course of this build up phase would add complexity and create confusion in a context where the industry is in dire need of stable rules and cost bases.
- The target level basis for the SRF and the BRRD should be the same to ensure a level playing field between banking union and other banks in the wider EU 28.
- The interaction of the resolution financing arrangements framework with the MREL Review and TLAC implementation needs to be taken into account.
- A stable target level is desirable. Total liabilities as a measure may be unsuitable as a target level, because it is more volatile than one based on covered deposits which tends to be more stable over time. Also, total liabilities varies considerably depending on the applicable accounting framework.

General Remarks

The EBF are not in favour of changing the reference basis of the target level at this point in time. Given the early stage of build-up of resolution financing arrangements and the delays in implementing the BRRD in national law in several countries, we believe it is too early to revise the legal basis for these arrangements. Resolution authorities do not have sufficient data on the impact of implementation of ex-ante financed resolution funds – in particular the accelerated SRF – in order to be able to assess the costs and benefits of the existing arrangements, let alone the relative merits of the proposals outlined in the interim report. On this basis alone we urge the EBA to recommend that the EU Commission only consider any legislative proposal to change the target level at a later date when more experience and data has been gained.

Arguments for the status-quo

EBF Members agree with the EBA's conclusion that all banks should in principle be required to contribute to resolution financing arrangement (level playing field). There is also agreement that **the target level for resolution financing arrangements in total and for individual Members States should not increase.** Regarding the draft report the following observations were raised:

[1] The Czech Banking Association does not agree with this view.

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Inappropriate timing

- The building-up phases of the resolution funds have only just started. Changing the rules in the course of this build up phase would add complexity and create confusion in a context where the industry is in dire need of stable rules and cost bases.
- According to Paragraph 8, the current consultation paper (CP) does not aim to set the target level basis for the SRF, but only at the BRRD level. For the Single Resolution Fund (SRF), a separate review of that basis is provided for under the SRM regulation, but only by 31 December 2018. If the target level for the BRRD were changed, it would not be acceptable to change it in isolation from changes to the SRF, as it would mean that different resolution financing arrangements could be subject to different target level bases within the EU. Looking at the two in isolation would potentially impose an additional burden on Banking Union countries and would also increase the framework's complexity, given that the current method in place to calculate the contributions to the SRF over the next 8 years is partly based in the SRM and partly based in the BRRD. As such, we ask the EBA to ensure that changes to BRRD resolution financing arrangements are not considered separately to the SRF, which is to be reviewed only by 31 December 2018. We believe this is the earliest date when BRRD arrangements should be reviewed.

Significant financial impact if the 1% ratio is maintained

Although we fully agree with the EBA's principle that a change on the target level basis needs to be complemented by a change on the appropriate ratio (1%) to reach an overall neutral effect on banks' costs, we have material concerns that if the new target level basis changes the ratio will not change. It would be a fundamental change in regulatory policy to propose a change to the target minimum level of national resolution funds at this point which may be counter-productive in terms of financial stability and further deteriorate the international competitiveness of the European Banking Sector. For illustrative purposes, a rough estimate of the overall amount to be raised under a 1% target level for the SRF based on the three options outlined by the EBA would result in at least a doubling, and up to four times as much. This would impose unacceptable additional fixed annual cost to the balance sheets of banks at a time when the sector is already facing multiple challenges to profitability and capital generation.

Deposits are a more suitable reference

- The interaction of the resolution financing arrangements framework with MREL/TLAC implementation needs to be taken into account. Depending on the outcome of the EBA MREL review and the approach to TLAC implementation taken in the EU, there may be different impacts on the target level and the proposed basis for its calculation. If banks have to step up significantly their issuance of MREL eligible items over the next few years, it means that an overall target level based on liabilities will increase over time whereas in practice the potential exposure of the resolution financing arrangement to losses will decrease as bail-in capacity across the banking sector increases. At a minimum, if the target level basis is changed in future, the measure should deduct own funds, covered deposits and MREL/TLAC eligible liabilities.
- Total liabilities as a measure may also be unsuitable as a target level, because it is more volatile than the one based on covered deposits which tends to be more stable over time. A stable target level is desirable, as when the target level increases then so does the amount to be raised in a given year, putting additional and unpredictable pressure on banks' cost bases which are difficult to manage when total liabilities will fluctuate significantly year on year. It should also be noted that this will have a pro-cyclical effect, as banks will have to make greater contributions in years when their balance sheets have increased and their first priority should be to conserve their earnings as much as possible to cover associated additional regulatory capital requirements.
- As noted by the EBA in its draft MREL interim review and acknowledged by the EU Commission in its delegated regulation on calculation of individual institutions contributions, the definition of total liabilities varies considerably depending on the applicable accounting framework. Whereas the concept of covered deposits has recently been harmonised under the DGSD, there are material differences in calculation of total liabilities that would result in significant variation between Member States' BRRD financing arrangements and, ultimately, contributions to the SRF. This would introduce significant distortions between Member States compared to the current approach.

- The current reference point of covered deposits is most suitable operationally as it ensures that the contributions are dynamic and smooth while being practical, simple and transparent. Moreover, the EBA report shows that the correlation between state aid levels and deposits is positive and there is no significant improvement when the total balance sheet is used, as such, this indicator can be seen as a valid measure for financial means to be kept in the resolution fund. In addition, as said in the report, having the same reference for DGS and Resolution funds enables authorities to have a predictable and global view on available financial means to address bank crises. This point should therefore receive a higher weighting in the scoring methodology on page 23.
- Any measure based on balance sheet (even excluding own funds and covered deposits) will result in imposing a higher burden on certain diversified business models funded both by deposits and wholesale funding, whereas diversification of activities is a major source of resilience against crisis (because not all activities will incur difficulties at the same time).
- If the calculation of the target level should be changed to total liabilities, the level of contributions would increase significantly in countries with many/large mortgage credit institutions as they do not have deposits but do have liabilities. As mortgage credit institutions will be wound-up under national insolvency procedures[2], the resolution funds will not contribute to these institutions and it will accordingly be inexpedient if mortgage credit institutions should cause an increase of the level of contributions. If this is not taken fully into account, the level of contributions would be increased significantly in countries with large mortgage credit institutions compared to countries which do not have any (or only a few/small) of such institutions creating an uneven level playing field. Accordingly, the target level (the percentage) would need to be differentiated between the different countries that in itself may easily lead to an uneven playing field.

In conclusion, changing the reference point would achieve very marginal differences of limited value and relevance. However, it would risk large scale confusion and further operational burden for resolution authorities and banks. As the building-up phase of the resolution funds has already started, it is now preferable to stabilise the rules instead of adding more complexity.

Answers to Questions

Question 1: Do you think the report is missing any crucial criteria or arguments in favour or against a particular option?

Yes, the report should include a quantitative impact analysis by Member State. Although the ratio is still unknown and will be subject to calibration by the European Commission, it will be the same for all Member States, so each Member State may be impacted differently by this proposed change to the target level basis. The current calculation methodology of the contributions is the result of negotiations between the parties concerned. The impact of any change to this methodology should be duly assessed. We also consider that a quantitative impact analysis on different bank types is missing, which could be done through a segmentation based on (i) an average type of bank, (ii) a higher risk type bank and (iii) a lower risk type bank, as per the calculation of the contributions of banks to resolution financing arrangements. This analysis could be done based on historical data (2014-2015) but should also incorporate a dynamic element using the estimates for future MREL issuance over time to validate over a medium term period the implications of the proposed change.

Also, in our view the report does not take sufficiently into account the burden of changing the target level methodology for the resolution authorities and the institutions. This drawback is mentioned by the EBA but is not assessed. As the build-up phase of the resolution funds has already started, this point is an essential criterion that should be taken into account in the analysis.

Finally we suggest that:

- In option 1 (page 23), the link between RF and DGS should have a better score (at least "++") and the correlation should receive a "+" weighting;

[2] Cf., the Bank Recovery and Resolution Directive (2014/59/EU), art. 45 (3).

- In option 2, the last criteria on page 25 should receive "---" because estimating funding needs on the basis of both bail-inable and not bail-inable liabilities lacks a clear rationale.

Question 2: Do you have a preference for one of the following recommended options?: (a) total liabilities (including own funds), (b) total liabilities excluding own funds, (c) total liabilities excluding own funds less covered deposits.

We consider it important to carry out the analysis proposed above, as the corresponding results could better support any decision on this matter.

The EBF strongly recommends not to change the reference point at this time. Indeed, the current reference point (covered deposits) is presently the most suitable operationally (as the report suggests it is the best option regarding "dynamic and smoothness of contribution", "practical consideration" and "simplicity and transparency"). "Covered deposits" as the reference point also allows to have a common basis for the target levels of the resolution financing arrangement and the DGS funds, which makes it easier to raise the optimal level of those funds.

Moreover, regarding the Single Resolution Fund (SRF), a separate review of that basis is provided for under the SRM regulation, but only by 31 December 2018. Having different rules between BRRD and SRM does not seem appropriate.

From an accountancy perspective there are several differences between local GAAPs in the EU, that could lead to major discrepancies on the way to calculate total liabilities and institutions at solo level will be particularly impacted due to taking account of intragroup exposures.

As a consequence, the EBF does not support any of the three recommended options.

Question 3: Is there any other option which would be preferable to those in the recommendation? Please provide the rationale supporting your view.

The EBF believes that the best option is to keep the current reference point (covered deposits) at this stage. As stated in the report, the overall level of the resolution financing arrangements is expected to remain constant even if any change to the basis would occur. The consequences and possible benefits arising from changing the reference point would thus be limited. However, the resulting burden to resolution authorities and banks and relevance and risk of confusion would be disproportionally high.

About EBF

The European Banking Federation is the voice of the European banking sector, uniting 32 national banking associations in Europe that together represent some 4,500 banks - large and small, wholesale and retail, local and international - employing about 2.5 million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that securely handle more than 300 million payment transactions per day. Launched in 1960, the EBF is committed to creating a single market for financial services in the European Union and to supporting policies that foster economic growth.

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