

# **Treating the E.U. as a Single Jurisdiction for the Implementation of TLAC**

**(EBA Report on MREL, December 2016)**

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*The FSB agreed last year on the TLAC Term Sheet. The Term Sheet specifies certain requirements applicable to the operations of banking groups in foreign jurisdictions in order to make the implementation of bail-in effective in a cross-border situation. The question for the EU is now to determine whether it wants to implement these internal TLAC requirements considering the EU as a single jurisdiction, or rather opt for a fragmentation of the Single Market. In other words: should the subsidiary of a French banking group in Lisbon or Sofia be treated differently from the Miami subsidiary of a NY bank?*

*This presentation will consider:*

How to apply internal TLAC to banking groups

The EU as a single jurisdiction for internal TLAC

No difference between domestic and intra-EU operations

Risk of fragmentation of the Single Market

## Foreword

**Global SIBs  
in the euro area:  
the specific situation  
of France**

**But the points  
developed  
hereafter  
are valid for  
E.U. cross-border  
banking  
groups  
in general**

Bucket <sup>10</sup>	G-SIBs in alphabetical order within each bucket
5 (3.5%)	(Empty)
4 (2.5%)	Citigroup JP Morgan Chase
3 (2.0%)	Bank of America BNP Paribas Deutsche Bank HSBC
2 (1.5%)	Barclays Credit Suisse Goldman Sachs Industrial and Commercial Bank of China Limited Mitsubishi UFJ FG Wells Fargo
1 (1.0%)	Agricultural Bank of China Bank of China Bank of New York Mellon China Construction Bank Groupe BPCE Groupe Crédit Agricole ING Bank Mizuho FG Morgan Stanley Nordea Royal Bank of Scotland Santander Société Générale Standard Chartered State Street Sumitomo Mitsui FG UBS Unicredit Group

# EU Council, June 2016 - Draft Council Conclusions on a roadmap to complete the Banking Union

(...) 7. **UNDERLINES** the importance of the work being carried out by several institutions at Banking Union, EU28 and international level, in particular work by the Commission to:

a) propose amendments to the legislative framework in view of implementing the Total Loss Absorbing Capacity (TLAC) standard and reviewing the minimum requirement for own funds and eligible liabilities (MREL). The Council will seek to ensure consistent rules and adequate amounts for the bail-inable buffers that contribute to an efficient and orderly resolution process in line with BRRD for all credit institutions for which bail-in would be the validated resolution strategy.

b) put forward a proposal on a common approach to the bank creditor hierarchy, to enhance legal certainty in case of resolution.

# TLAC in Context

- ❑ In 2011, G20 Leaders have agreed on the KA as an international standard for resolution regimes.
- ❑ In november 2015, they have agreed on a TLAC requirement (*TLAC Term Sheet*).

## What is TLAC?

- ❑ It is a requirement on the liabilities side of GSIBs, used to absorb losses and recapitalise failed firms in resolution.
- ❑ In the EU, it will be implemented via the MREL.

# Main differences between MREL and TLAC

	MREL	TLAC
1 Scope	<ul style="list-style-type: none"> <li>All EU credit institutions</li> </ul>	<ul style="list-style-type: none"> <li>Global systemically important banks (G-SIBs)</li> </ul>
2 Rule type	<ul style="list-style-type: none"> <li><b>No common Pillar 1 minimum</b></li> <li>Institution specific <b>Pillar 2 Requirement</b> (Parallel approach)</li> </ul>	<ul style="list-style-type: none"> <li><b>Common Pillar 1 minimum</b></li> <li>Institution specific <b>Pillar 2 top up</b> (Integrated approach)</li> </ul>
3 Denominator	<ul style="list-style-type: none"> <li>% of total liabilities and own funds</li> </ul>	<ul style="list-style-type: none"> <li>% RWA (FL P1 min. = 18%)</li> <li>% Leverage ratio (FL P1 min. = 6.75%)</li> </ul>
4 Key eligibility criteria	<ul style="list-style-type: none"> <li>unsecured</li> <li>minimum 1-year residual maturity</li> <li><b>No formal subordination req.</b></li> </ul>	<ul style="list-style-type: none"> <li>unsecured</li> <li>minimum 1-year residual maturity</li> <li><b>subordinated</b> (with exceptions)</li> </ul>
5 Min. Debt Expectation	<ul style="list-style-type: none"> <li><b>No debt expectation</b> (so far banks can freely decide on MREL composition)</li> </ul>	<ul style="list-style-type: none"> <li><b>33% min. debt expectation</b> (Term sheet sets out “expectation” and not a formal requirement)</li> </ul>
6 Buffer treatment	<ul style="list-style-type: none"> <li><b>MREL includes Buffers</b> (Parallel approach)</li> </ul>	<ul style="list-style-type: none"> <li><b>Buffers sit on top of TLAC</b> (Integrated approach)</li> </ul>
7 Contagion safeguards	<ul style="list-style-type: none"> <li>No specific provisions with regard to cross-holding or investments in MREL of other institutions</li> </ul>	<ul style="list-style-type: none"> <li>Deduction of holdings by banks of TLAC issued by other G-SIBs</li> </ul>

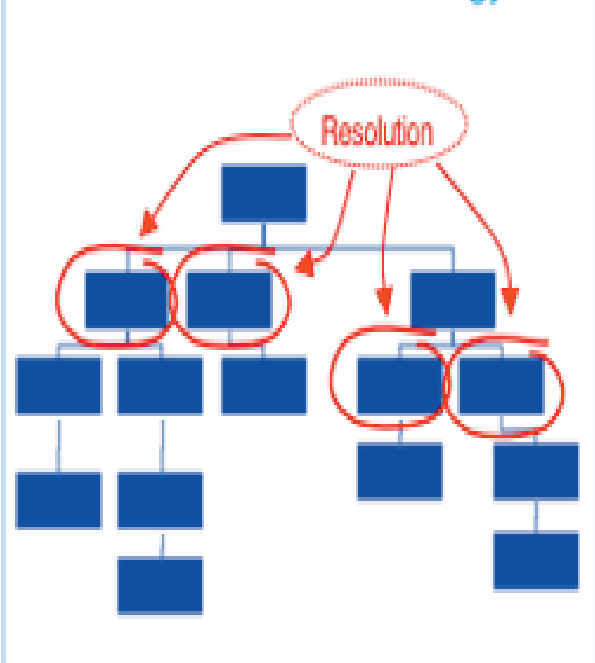
# What is Internal TLAC ?

## Resolution of banking groups and TLAC requirement

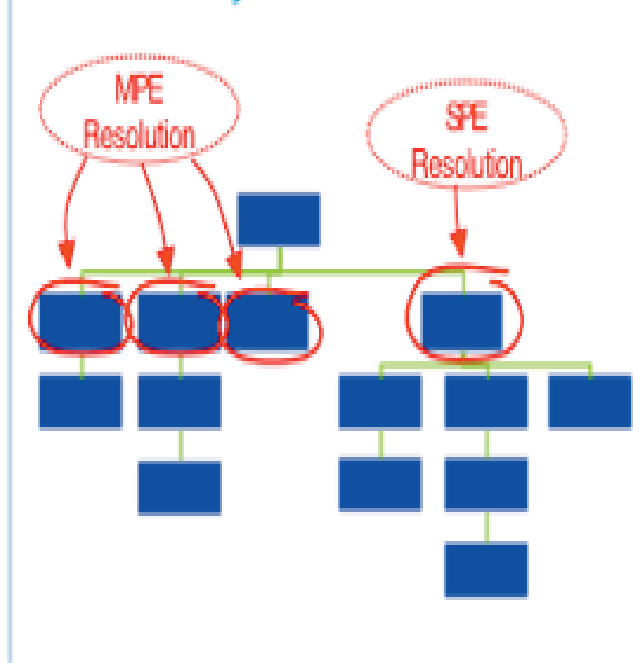
- ❑ A GSIB group may be composed of one or more resolution groups and may have one or more resolution entities.
- ❑ TLAC must be issued externally by resolution entities.
- ❑ When resolution is triggered, these resolution entities are subject to resolution tools in accordance with a preferred resolution strategy.
- ❑ Subsidiaries, including '*material subsidiaries*', stay out of resolution.
- Losses at *material subsidiaries* level need to be up-streamed to the resolution entity.

# Resolution strategies for groups: SPE or MPE ?

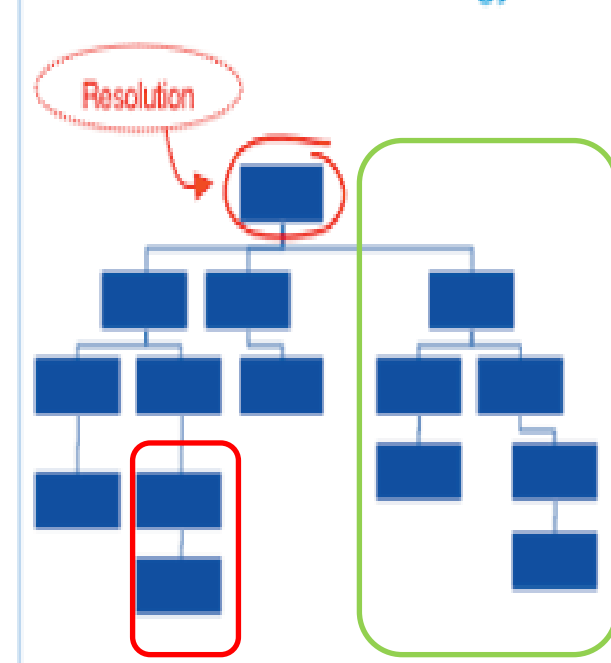
MPE resolution strategy



Hybrid model



SPE resolution strategy



Country B

Country C

Source: BBVA Research + ACPR



# What is Internal TLAC ?

## Objectives of internal TLAC

“It facilitates co-operation between home and host authorities and the implementation of effective cross-border resolution strategies by ensuring the appropriate distribution of loss-absorbing and recapitalisation capacity within resolution groups outside of their resolution entity’s home jurisdiction” (TLAC TS)

- **Inter-jurisdiction tool** : how losses are absorbed and recapitalisation is effected in the resolution of cross-border groups
- “resolution groups outside of their resolution entity’s home jurisdiction” => mainly a concern for host authorities
- **Intra-group arrangement to up-stream losses**
- Ex ante agreement on allocation of losses in a cross-border group; BRRD Currently only refers to the ‘*group financial support agreement*’ (Art. 19), in recovery.

# What is Internal TLAC ?

## How is internal TLAC prepositioned?

- GSIBs have to preposition internal TLAC in *material subsidiaries* in other jurisdictions (ie these *material subsidiaries* need to issue TLAC to the resolution entities).
- The **host resolution authority** determines the distribution of internal TLAC in its jurisdiction, in consultation with the home resolution authority and the Crisis Management Group.
- **The Internal TLAC requirement at a *material subsidiary* level** must be at 75-90% of the size of the external TLAC requirement that would apply to the material sub-group if it were a resolution group.
- **The US authorities may go beyond these figures.**

Home and host authorities may agree to use other instruments instead of full prepositioning: e.g. (collateralized) guarantees.

# Intra-EU LAC: The EU as a single jurisdiction

The EU should be considered as a «single jurisdiction» (*EBA Report on MREL, December 2016*):

- ❑ A common statutory resolution framework (BBRD)
- ❑ A decision body for cross-border groups (Resolution college), deciding both on the adoption of resolution plans and MREL requirements, and on resolution schemes for groups
- ❑ A common mediation mechanism (EBA)
- ❑ A common court for appeals (European Court of Justice)

Such FW can be supplemented by other non compulsory elements:

- ❑ A common State Aid control (DG competition)
- ❑ A harmonised deposit guarantee framework (DGS) or a European Deposit Re-insurance Scheme (EDRIS)

# Intra-EU LAC: The EU as a single jurisdiction

- Resolution measures for a cross-border group are taken by a joint decision of the Resolution college:



- Adoption of group resolution plans: A. 13 BRRD + EBA mediation (A. 19.3 EBA Regulation) + A. 13.9 BRRD “unless any resolution authority concerned assesses that the subject matter under disagreement may in any way impinge on its Member States’ fiscal responsibilities. “ (UK clause)
- Adoption of a group resolution scheme: A. 91.7 and 92.3 BRRD + EBA mediation (A. 31.c EBA Regulation).
- These long and very detailed procedures create **binding obligations on EU resolution authorities whatever their Member State.**

# Intra-EU LAC: The EU as a single jurisdiction

- ❑ **Binding obligations on EU resolution authorities, whatever their Member State, regarding decision-making on cross border groups:**
  - A. 87 BRRD (“General principles regarding decision-making involving more than one Member State”): “when making decisions or taking action pursuant to this Directive which **may have an impact in one or more other Member States (...)**”
  - “due consideration is given to the **interests of each individual Member State where a subsidiary is established**, in particular the impact of any decision or action **or inaction** on the financial stability, fiscal resources, resolution fund, deposit guarantee scheme or investor compensation scheme of those Member States;”
  - “due consideration is given to the objectives of balancing the interests of the various Member States involved and of avoiding unfairly prejudicing or unfairly protecting the interests of particular Member States, including **avoiding unfair burden allocation across Member States;**”

# Intra-EU LAC: The EU as a single jurisdiction

## □ EBA legally binding mediation:

“(…) the Authority may, in accordance with the procedure set out in the third and fourth subparagraph of Article 44(1) take a decision requiring them to take specific action or to refrain from action in order to settle the matter, with binding effects for the competent authorities concerned” (Art. 19.3 EBA Regulation)

□ **This mechanism, together with the BRRD, implies that resolution measures concerning a banking group taken in one EU jurisdiction will be fully recognized and enforced throughout the EU, whatever the preferred resolution strategy for this group.**

□ **In a single jurisdiction such as the European Union, no need for either internal TLAC or “internal MREL”. “Intra-EU MREL” should ensure loss absorption by the parent entity in a SPE strategy.**

# No difference between domestic and intra-EU operations

## What would this « intra EU MREL » look like?

- ❑ Requested from material subsidiaries within the EU in view of impediments to resolvability or specific risks that could not be covered by alternative options
- ❑ Set by the group's Resolution College
- ❑ Quantum: requirement between 50% to 80% of the size of the external TLAC requirement?

# Comparison of (i) intra-EU LAC and (ii) internal TLAC with a third country

	Resolution involving the EU and a 3rd country (US, JAP, ... UK)	Intra-EU resolution
1 Jurisdictions	<ul style="list-style-type: none"> <li>• Two jurisdictions</li> </ul>	<ul style="list-style-type: none"> <li>• One single jurisdiction sui generis</li> </ul>
2 Decision	<ul style="list-style-type: none"> <li>• CMG consultation</li> <li>• Host authority's decision</li> </ul>	<ul style="list-style-type: none"> <li>• Resolution college</li> <li>• <u>Joint</u> decisions (resolution plan and resolution scheme)</li> </ul>
3 Tool	<ul style="list-style-type: none"> <li>• Internal TLAC</li> </ul>	<ul style="list-style-type: none"> <li>• MREL Solo« for institutions submitted to that requirement »</li> <li>• Intra EU MREL</li> </ul>
4 Criteria	<ul style="list-style-type: none"> <li>• Subordinated instruments</li> <li>• collateralized guarantees</li> </ul>	<ul style="list-style-type: none"> <li>• Subordinated instruments</li> <li>• Collateralized guarantees</li> <li>• <b>Within the EU single jurisdiction: simpler forms of guarantees or commitments</b></li> <li>• Adjusting internal TLAC Framework for building internal MREL (requirement between 50% to 80% of the size of the external TLAC requirement?)</li> </ul>



# Risk of Fragmentation of the Single Market

- ❑ **The TLAC implementation must strengthen the Single banking Market or there will be a strong risk of « ringfencing »**
- One could draw an analogy with a regime for fighting fires in a town.
- The town could either fund a central fire department that would move and intervene at any house experiencing trouble (SPE), or it could instead forsake the fire department and require each house to have a sprinkler system (MPE).
- The MREL should be required at the appropriate level in the group in order to reflect the multiple-point-of-entry approach or single-point-of-entry-approach contained in the resolution plan. **Otherwise, it would be akin to the State allowing a town to build a fire department, and then requiring a sprinkler system for each house anyway.** This is unnecessarily costly and contradictory with the idea of the Single banking market.

# How to Strengthen the EU Single Jurisdiction?

## □ Cooperation challenges

- Home – host: smooth and effective functioning of Resolution colleges, including EBA mediation whenever needed (« post Brexit »?)
- Consistency between the distribution of the LAC internally and the resolution strategy
- Process for triggering intra-EU MREL

## □ Legal challenges

- Insolvency law fragmentation => complexifies (comp. U.S. where all banks are subject to the same Federal insolvency regime)
- June 2016 Council Conclusions: « put forward a proposal on a common approach to the bank creditor hierarchy, to enhance legal certainty in case of resolution »

# The Commission's legislative proposal to implement TLAC in the EU (« BRRD 2 »)

## □ A revision of BRRD, CRR, CRD IV, SRMR

### □ On MREL / transposition of (i)TLAC:

- MREL remains in principle required for each individual institution.
- Can be fully waived but under strict conditions, including that both the resolution entity and the subsidiary be subject to « supervision by the same Member State » (?). No Single Market perspective as in the EBA Report? Not even a reference to the Banking Union?
- The resolution authority may impose more stringent requirements.
- Internal MREL would be required and could be constituted of 50% of collateralized guarantees.

## □ A fast-track revision of article 108 BRRD on creditor hierarchy, in order to harmonise creditor hierarchy accross Europe.

# Conclusions

- ❑ **If we are not able to achieve in the EU what has been achieved by the US - and which was the situation at domestic level prior to the Banking Union - , then people may legitimately wonder:**
  - ❑ **What has happened to the Single Market?**
  - ❑ **Where is the Banking Union?**
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