Report from the Expert Group Meeting of June 30 on contributions under the BRRD/SRM

The Commission's services mentioned that they have received data that are not usable for most part: incomplete, aggregated instead of individual. They will send individual feedbacks. Member States that have not sent data were invited to submit them. The Commission's services cannot estimate intragroup liabilities without the help of Member States. The Commission's services should present a draft of the legal text at the next meeting.

GENERAL COMMENTS

IT would provide data of good quality, at all 3 levels, today or tomorrow.

RO mentioned legal problems related to criminal sanctions if data are transferred. But they are exploring possible solutions.

1) PRINCIPLE OF PROPORTIONALITY

The Commission's services presented their Note on this point.

AT thanked for giving so much thought to the principle of proportionality. Welcomed the approach of lump sum based on several buckets. Asked what the difference is between flat rate and BRRD base. Asked for clarification of the formulas on page 9 and why risk-based contributions were starting at 75k EUR.

The Commission's services explained that the flat rate is the BRRD rate without the risk adjustment. The cliff effect shown here is an approximation because it is without the risk adjustment. This should be a reasonable approximation because the assumption is that the flat rate will be the prominent part (85%).

BG stated that many banks will be right around the threshold – they would prefer equal treatment for everybody, or greater flexibility for local authorities to determine which banks are small.

PL were still consulting internally on the Note. But supported BG. The thresholds should be adjusted to the specificities of the national banking sectors by MS. They will provide more details on that.

DE stated that based on rough estimations only they would contribute approx. 1.5bn € annually. Large Banks that pay a risk adjustment should not be able to reduce their total contributory burden. With the 6-bucket approach, there are 150 banks that would pay more they would have otherwise paid. This contradicts against the principle of proportionality. The best solution would be to have threshold for every bank: 0 € contribution on the first 300Mio of the contributory base.

LU stated that one has to be careful with the remarks of BG and PL. In the Banking Union there should be no national differences. For the Banking Union, one needs to compare to GDP of Banking Union.

FR agreed that we need to find some way of applying the principle of proportionality. The objective should be to minimize administrative burden. We are not in favor of an exemption for small banks. If such exemption is put in place, we need to minimize its redistributive effects. A lump-sum exemption will incentivize banks to create smaller entities. A very large bank which is largely deposit-funded should not benefit from this exemption, so it should be expressed in terms of total assets. Increasing the number of buckets is the right solution to reduce cliff effects.

NL will work with DNB to send entity-level data. Most Member States are in favor that all banks pay at least some contributions, but administrative burden has to be taken into account. The proposal of Commission's services is sensible for small banks. As FR said, this system should focus on small banks, not all banks. Suggest that flat rate is applied to small banks. The administrative burden is for the risk-based adjustment, so why not applying the lowest risk-based adjustment to small banks?

BE All banks should pay something. Attractive solutions: all banks to pay a very small fee below 300 mln , or NL proposal. Certain financial market infrastructures which operate with a banking license have a very different risk profile: they have a limited-purpose banking license, so the principle of proportionality should also be applied to them – we have not identified a solution yet; one way would to work on the interval of the risk adjustment. This issue does not only concern BE.

IT there are a lot of small banks in IT. They will contribute but never benefit from the Fund. They should pay a symbolic amount, which may be represented by the lump-sum. The proposed six-bucket system was not their preferred.

IE We are in favor for the need to universal contributions. There is merit to the Commission's services proposal.

CZ agreed with the NL proposal, use only flat for small banks + lowest (or neutral, i.e. 1) risk factor.

EL their original position is universality, but they can live with special treatment for small banks, but one needs to be careful with thresholds.

DE position was that applying flat fee to small banks is not their view of how one should apply the principle of proportionality.

FI welcomed the proposal of the Commission's services, prefer the second option with 6 buckets. Commission's services should make estimates of what the relative burden for small banks would be under this system.

PT asked why Commission's services did not take a continuous approach instead of buckets.

ES apologized for not having sent the data yet. It was not easy to collect all the data, hope to send it as soon as possible. Share some of the concerns expressed by DE, we need to take into account that small entities might never enter into resolution. We should avoid situations as the ones illustrated by DE: small banks cannot pay more than they would otherwise have to pay under the normal regime. Remember that we will have 1+8, not 8 years in the transition.

Commission's services stated that the principle of proportionality has to be applied in a very refined way. The issue is not very big in terms of numbers, but administrative procedures have to be taken into account. The sensibilities of certain MS have to be taken into account. We all accepted the principle that we should not interfere with the structures of the banking sectors: this implies that we need a special treatment for small banks. Now we need to work on the how.

2) CONSOLIDATED VS. SOLO

The Commission's services presented the Note on this issue and on the exclusion of intragroup liabilities. Some Member States have also raised the point of the treatment of derivatives. As an alternative to netting, risk adjustment could be mitigated on the basis of the netting arrangements. The Commission's service would prefer to touch the base as little as possible.

FR agreed that the base should not be touched very much. They could live with the proposal on the solo basis provided that intragroup liabilities are excluded. The valuation of derivatives is an issue. FMIs could have big discrepancies, depending on whether derivatives are on balance sheet or not. Netting agreements should be recognized. This would also make the basis more stable.

SE asked why the intragroup could be netted only within the Banking Union.

Commission's services replied because SK and FI share the same Fund, while SE and FI do not.

FI stated that the definition of intragroup as proposed would generate double taxation. The argument made by Commission's services is not sufficient. This is detrimental to SPE.

Commission's services replied that SRM has tried to be very neutral w.r.t. SPE/MPE. Maybe we could qualify this definition of intragroup liabilities with characteristics that are compatible with SPE, even if not within Banking Union.

AT welcomed the solo level. The definition of intragroup liabilities is too short. Group-like concepts mentioned in Art. 113 CRR and Art. 10 CRR should also be included.

ES did not agree with the proposal to take out intragroup. This would introduce distortions. Agreed with SE on distortions between participating and non-participating

MS. Entities have the freedom to choose their funding model, so one should not interfere with this decision. Derivatives were behind some of the problems in the financial crisis. In the BRRD we say that derivatives might not always be bailed-in, now we cannot exclude them/treat them preferentially in the contributions to the Fund. They also asked if intragroup with less than 1 year maturity would be also excluded. They also asked whether the 5% use of the resolution fund would be calculated also excluding those liabilities.

The Commission's services replied that the delegated act will need to harmonize this concept. This definition of liabilities could also be taken it into account when using the resolution funds. Of course these instruments would have to be bail-in-able.

EE strongly supported SE and FI views.

DE agreed with ES and AT. On derivatives, we need the Commission's services to provide estimates of the impacts, especially w.r.t. distortions between banking sector structures and across Member States. Banking sectors with very large exposure to systemically relevant banks would benefit to the detriment of banking sectors with high concentration of small banks. High volume of derivatives is a clear factor for the expected use of the resolution funds. Changing the basis is against the mandate of the level 1 text. Intragroup liabilities are a strong proxy for the complexity of a bank: their exemption would reduce the burden to large banks as compared to small banks. Their exemption is also not compatible with the system of national compartments. Appreciate Commission's services proposal to tackle the issue of promotional loans. A clear alignment of the definition of intragroup liabilities with EMIR (also Art. 3 Abs. 2 lit. b) is needed.

BE the intragroup liability should not be deductible only for the mother. Also, we need an estimate of the magnitude.

Commission's services stated that one can never neutralize a liability. The entity with a liability towards the outside world has to pay for it.

BE the conclusion is that we should not exclude intragroup liabilities. We are open to exploring solutions but these have to be fair for the host: BE banks raise deposits and lend to mother companies, so mother companies would enjoy this exemption but BE banks would remain equally exposed to them.

LU stated that a subsidiary would pay twice because it would have a liability when raising liquidity and then for getting some of it back from the mother. Accounting vs prudential reporting also needs to be assessed.

HU In favor of solo approach. Still scrutinizing the issue of intragroup.

NL With both approaches you have to make corrections. We have to take the easiest: go for solo, deduct intragroup. You deduct it because you in principle should have the same outcome whether you use one approach or the other. We have to keep in mind that consolidated might be easiest, especially when it comes to risk factors: bail-in-able debt,

LCR. We have to be very careful with the netting of derivatives and in general with adjusting the base. Maybe derivatives netting can be taken into account in the risk adjustment.

UK stated that Member States with levies are not necessarily bound by the delegated act. The proposal as it is now might not be fair. Concerned by banks HQ in UK with SPE approach and operations outside EU: with solo, they might pay less than the level of risk they pose for the UK. We need to do more thinking about how we reflect the SPE/MPE models into the formula.

EL stated that there is a level playing field issue with the proposed definition of intragroup liabilities. Either we do not exclude them, or we do even if they are outside the Banking Union.

CZ welcomed solo approach, but investment firms sometimes are part of the group and sometimes are not, so intragroup deduction could be tricky for them.

BG stated that intragroup should not be deducted in general, but we could accept specific conditions under which the deduction is made.

FR favored a prudential approach.

IE would prefer consolidated, but solo with exclusion of intragroup would be OK.

PL welcome solo approach. Need to further reflect on the issue of intragroup, concerned about distortions b/w participating and non-participating.

The Commission's services stated that this issue has a more important incidence on the distribution of the contributory burden than the first issue. The principle of the solo basis is agreed. We will take into account the issues of level playing field in the formulation of the exclusion of intragroup. We also have agreed that we should touch the contribution base as little as possible. We need to tackle the issue of the different accounting principles. IFRS already allows for netting of derivatives under certain circumstances, especially when they go through CCPs.

3) <u>The additive and multiplicative models</u>

JRC made its presentation.

EI asked for more background on the different models to discuss at home.

SE considered as not correct to state that it is well accepted that the flat part should be prominent.

BE stated that the prominence of the flat contribution is in line with the text and should be common sense. Having a prominent flat part would simplify the discussions since the

impact of the risk-based adjustment would be limited. It would also make it simpler for banks to predict their outcome. We think of a model where the flat represents 80% of the total contributions. The hybrid model only complicates things further. We need something simple.

ES supported what was said by BE. Requested for the JRC presentation to be distributed. The prominence of the flat part minimizes the impact of changes in the relative risk profile.

DE asked to analyze the impacts of the models in greater detail. The risk-adjusted part and the flat part should both incorporate size. A US FED study shows that systemic relevance increases more than proportionately in size.

DK stated that it is not common sense that the flat part is the prominent part.

FR stated we cannot end up with a multiplicative model that multiplies size by size. This discussion should come after the choice of the risk criteria.

IT stated that the risk-based adjustment should always be weighted by size. We agree with a multiplicative approach.

LU DE has a point in saying that larger banks are proportionately more risky. We can make a decision on the relative weight of the risk adjustment only when the risk adjustment is defined.

HU Flat rate should be the prominent part.

EL Large percentage of the flat rate would make the model more predictable. Hybrid looks too complicated.

4) Risk Factors

DK stated that the proposed model does not fit with their banking sector. They mentioned that many of the proposed indicators seem to go in the opposite direction for the DK mortgage credit institutions which are exempted from MREL and therefore cannot be recapitalized. This needs to be reflected in their contributions. Either DK has problems with many of the proposed indicators (covered deposits/loans, asset compared to GDP, bail in able liabilities) or otherwise a special solution needs to be found for these institutions.

SE stated that (1)(a),(b) and (d) give advantage to institutions with low RWA, so maybe Leverage Ratio's weight should be increased. Also, EU GDP should be used instead of MS GDP.

FR stated that (1)(b),(c) and (d) might not be applicable on a solo basis. Number 3 should not include interbank exposures because it would penalize interbank markets, which should not be an objective of the contributions.

ES stated that all of the indicators should have similar weight. Prominence should not be given to RWA in 1. RWA is mainly a going concern factor. RWA does not capture all the risk that is relevant to resolution. All indicators and pillars should weight the same. LTD should not be used in the first year, would prefer not having anything in year 1. LTD penalizes commercial banks and those are not necessarily less stable.

EL Agree with ES on RWA. The definition of State Aid should remain as it was proposed in the last meeting.

DE RWA is not an appropriate risk factor since it is subject to internal modelling. Empirical studies have shown that large systems systematically carry less RWA than smaller banks related to their business size. The weight given to number 4 is too low. Furthermore the reasoning for the different weights attached to the risk indicators is not grounded on empirical evidence (e. g. regarding leverage ratio).

The Commission's services stated that for some MSs, pr(failure) is more important, for others pr(using the Fund). The Commission's Note is now tilted towards pr(failure), we need some rebalancing. The DK point is fair.

IT did not like RWA. They can only be taken into account together with capital. Low RWA are often driven by poor internal models. Big banks use internal models, so we would introduce a favor towards them. Did not like LCR because the time horizon is very short (maturity of 30 days): how can we assess the stability of funding if we are only looking at the next 30 days? NSFR would be better. Number 4 should have a minor role.

NL agreed that number 1 is the main factor. Don't buy the argument that internal models are flawed – we'd have to throw Basel and CRD IV away. Agreed with having LCR and NSFR together. For LCR, one should take averages over time instead of one point in time. Right to give low weight to number 4.

AT asked if it is legally feasible to delegate to the Board something that should be in the delegated act. On 3, agree that denominator should be EA GDP. On 4, the risk factors are all mentioned explicitly in the BRRD and strongly supported by Council and EP. To give them together such an extremely low weight is not in the spirit of the BRRD.

The Commission's services replied that provided that it is well framed, it should be possible to leave some of the elements of number 4 to the Board. We would need to give details on how the qualitative assessment should be done by the Board.

FI asked to leave out LTD, b/c deposits are not bail-in-able. Couldn't we use total risk exposure as defined in the CRR? It will also be used for ECB supervisory fees.

PT asked for further clarity on complexity and resolvability.

EI supported concerns on RWA. Strong capitalization protects best against failures. Bail-in-able liabilities over total liabilities would be better than excess over MREL.

EE RWA should get less weight, and more should be given to LR and capital ratio. More weight should be given to point 3.

CZ asked to use ratio of bail-in-able debt covered by MREL definition over total liabilities.

BE supported DK on the point that for some banks it will be hard to measure some of the indicators. It would prefer bail-in-able debt over TA. On 3, they agreed that denominator should be EA GDP".

The Commission's services clarified that RWA over TA is an indicator of how likely default is, it says nothing about costly it will be. Before state aid, RWA/TA for state aid banks is 63% vs. an average of 47%. It is an indicator for banks only, cannot be generalized to countries. It's true that it is a going concern factor, and it should be so. RWA does not take into account all risks, that is why we consider more than one indicator. It's true that there is a link between (1)(a) and (1)(d), but it's a weak link because banks can put in as much tier 1 capital as they want. It's true that big banks use internal models, but it's also true that CRD calls the supervisor to guarantee consistency. The two indicators (RWA and Capital Ratio) serve different purposes. RWA is a forward-looking measure. The sample of banks analyzed is based on public data.

IT asked if the Commission's services checked the amount of capital those banks had. The point is that Capital Ratio should be sufficient. Capital Ratio and Leverage Ratio should be used together.

DE stated that if predictability is the issue, one should look at the leverage ratio.

The Commission's services stated that following this discussion, we will reconsider the weighting of some of the risk factors mentioned in the Note.

LU came back on the LCR at solo level and asked the position of the Commission's services on the waivers included in the BRRD and the CRR. This could be indeed a big problem.

SE warned about the risk of a precedent. The SRM Implementing Act cannot affect the content of the BRRD DA. The logic cannot be focused on the SRM.

The Commission's services clarified that the distinction between the DA and the IA will be dealt at the time of the drafting and both texts will be subject to the LS scrutiny. However, there is the need to ensure a level playing field and harmonization.

5) <u>Task Force</u>

The Head of the TF gave some updates on the establishment of the SRB and on the work of the TF. The priorities are: the DA for the administrative contributions; recruitment;

establish a cooperation work-stream with the NRAs and the future ones (the idea is to have a seminar around September).

DE would be interested in see the draft on administrative contributions and asked some information about the cooperation with the ECB.