EACB Comments

EBA draft RTS on Simplified obligations under Article 4(6) of Directive 2014/59/EU

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The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 27 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4.050 locally operating banks and 58.000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 210 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 81 million members and 749.000 employees and have a total average market share of about 20%.

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General comments

The members of the EACB welcome the opportunity to comment on the EBA draft RTS on simplified obligations for recovery and resolution planning under Art. 4(6) BRRD.

- We note that the draft paper only focuses on the methodology of assessment for the eligibility for use of simplified obligations. While it is (half-heartedly) establishing a de minimis threshold, it never raises the question of whether certain simplified obligations might be sufficient for certain banks' sizes. It therefore avoids the fundamental questions: When would simplified obligations be sufficient and when is a full-fledged recovery and resolution planning useful and meaningful?
- The approach of the document appears overly cautious. Many parts of it read as if the key question were a complete exemption of smaller banks from recovery and resolution planning and not simplified obligations.
- We would like to recall that a recovery plan should ideally also be a management tool. As such, it should be aligned to the management structures and management systems of a bank. A disproportionately complex recovery plan could therefore be more counterproductive than useful, especially in the practical implementation phase.
- Overall, we see that the cooperative form of enterprise is not adequately taken into account in the development of the criteria and metrics of the qualitative assessment. Certain qualitative presumptions would result into an undue discrimination of cooperative banks.
- The proportionality thresholds may require other adjustments than those foreseen to better reflect the reality of Member States' markets. Any thresholds should be consistent as much as possible with other acts of regulation (e.g. on FINREP, remuneration etc).
- We see the need for an implementation period in cases where the assessment of the competent authority results in a new requirement for the institution to draw up recovery plans without applying any simplified obligations. In situations where an institution could prepare simplified recovery plans but due to a new decision of the competent authority full obligations are required, the institution will be faced with an additional amount of work and therefore a need for additional resources. The institution should then have a sufficient implementation period to minimise additional costs and maintain the quality of the recovery plans. We consider that a period of at least 1 year before the next recovery plans are drawn up would be necessary.

Answers to specific questions

Q.1 *Do you agree with the list of quantitative indicators for credit institutions provided in Annex I?*

We appreciate that the indicators are consistent with the ones used to identify O-SIIs. An assessment of the institutions on that basis should lead to a high convergence of results

However, we believe that the model in Article 1(1)-(5) is quite complicated and we strongly encourage assessing whether further simplifications are possible. In fact, we observe the following:

- Value of domestic payment transactions: At present, not all LSIs have internal reports that would provide such value, and therefore a new calculation would be

needed. Such a calculation is not straightforward. Currently, payment systems are not domestic (i.e. SEPA and Target are European), and the difference between retail and non-retail transactions is not clear-cut. It would be helpful to provide the most common type of messages that should be considered in the calculation (i.e. Target message MT202).

- Intra-financial system liabilities and cross-jurisdictional items tend to be rare among LSIs (except for those LSIs that use a central entity and consider their transactions as part of the intra-financial system item, in which case they should be excluded) and normally their volumes do not pass the threshold for their reporting.
- LSIs' OTC-positions would normally be linked to structured deposits, retail products (i.e. floors adapted to the French system of amortization of mortgages) or to the distribution of derivatives for hedging among SMEs, and they would quite certainly be covered back-to-back with a major counterparty, with which nowadays there are collateral agreements in place due to EMIR. Therefore, it is quite rare to find LSIs with unhedged OTC positions.

Thus, we would encourage assessing whether these elements could be simplified further.

Q.2 *Do you agree with the calibration of the total quantitative threshold for credit institutions?*

Global Context

We would like to recall that the FSB's "Key Attributes of Effective Resolution Regimes for Financial Institutions" were designed *"[…] for financial institution(s) that could be systemically significant or critical if it fails […]"* Our interpretation of the concepts "systemically significant", "critical" is that the resolution regime has not been presented or endorsed as a regime for the whole financial system, as it is currently being considered in the EU. No such situation is encountered in other jurisdictions. For example, the United States' Office of the Comptroller of the Currency does not enforce the guidelines for recovery Planning on Community Banks and, in general, their Recovery Planning Guidelines apply to banks with average total consolidated assets of $50 billion or more[1].

It would be appropriate to adequately adjust the resolution regime to reflect the reality of LSIs. It would be reasonable if competent authorities could indicate when resolution is appropriate for LSIs, e.g. when an LSI is assigned an SREP score of '4' (high risk), and the preparation of a resolution plan is considered relevant. If recovery and resolution planning is enforced on all European LSIs, then simplified obligations should be applied.

Threshold of quantitative score

We have strong reservations regarding Art. 1(3) of the draft, which gives competent authorities the possibility to make a flexible adjustment and to widen the relevant threshold range to between 0 and 105 basis points. Providing this flexibility to competent authorities does in our view not remedy the problem of insufficient level of harmonisation at the EU

[1] https://www.occ.gov/news-issuances/bulletins/2016/bulletin-2016-30.html

level in applying the criteria for assessing the institutions eligibility for simplified obligations. Recital (5) explains that raising the relevant total score should be possible in countries in which there is a highly concentrated banking market, whereas a reduction of the overall score in countries with a large number of small banks could be considered. The possibility of a reduction to 0 would mean that in countries with many small banks practically only those institutions of a magnitude under the 0.015% threshold as per Art. 1 para. 6 would be exempted from the wide-ranging obligations of the recovery and resolution regime.

According to the approach under Recital 5 and Art. 1(3) a high granularity of a (national) banking sector in one county might result in very small banks providing full resolution plans while in a highly concentrated market in another country relatively bigger banks could establish simplified plans. With the use of different scoring scales, distortions of competition between Member States cannot be completely ruled out.

The objective of this RTS is the development of a uniform methodology for the whole European Union. We therefore suggest that a total score of at least 25 basis points as a uniform lower limit for the total score.

<u>Size criterion for small institutions</u>

We expressly support the approach in Art. 1(6) to simplify the procedure by making banks with a rather limited amounts of total assets eligible for simplified obligations in a first step, after a simple quantitative assessment of the assets' size.

However, linking individual institutions' size to the total assets of the banking system in a country generates a wide variety of different thresholds on one side, and on the other side may almost make the threshold irrelevant in smaller economies. However, smaller banks are by definition less complex and dispose of much simpler business models. One should therefore not set the percentage rate too low or the use of a fixed minimum institution size could be helpful.

The stipulated threshold of 0.015% would mean that for instance for Germany, the largest European economy, all institutions with total assets in excess of approx. € 1.2bn would have to undergo a quantitative and qualitative assessment. A similar threshold would result in the case of UK institutions, i.e. € 1.2bn or around £ 1bn.

Another example can make this even more evident. At end-2016 total assets of all Austrian credit institutions amounted to approximately € 1.060 bn. The 0,015% threshold would identify for Austria only institutions with a balance sheet of € 160 million. This seems much too low, as this could well be the case also in other Members States.

Overall, the 0.02% threshold used in the context of the O-SIIs assessment would be a more suitable option.

The wording of para. (6) seems overly cautious insofar as it stipulates *"unless it would not be justified on the basis of Article 2"*. This implies that a full assessment under Article 2 could still have to be made in each and every case. Such an approach seems disproportionate and should therefore be avoided. A bank below the threshold in Article

1(6) should be eligible for simplified criteria. We would suggest a wording such as *"unless **there are specific indications that such judgement** ~~it~~ would not be justified on the basis of Article 2".*

Finally, we strongly recommend to come to a more convergent approach on proportionality in the regulatory framework for banks and not set diverging "de minimis" or "proportionality" thresholds/calculation methods for every simplified application or supervisory requirement. The objective should rather be to reach a modus operandi that is as uniform as possible. In this respect the following could be considered:

- There are thresholds already available: banks may apply a simplified FINREP reporting (data point model) if their total assets do not exceed 3 billion €; the same threshold applies for contribution obligations to the resolution fund. In order to accommodate the specific situation of smaller Member States, this fix threshold could be combined with a relative threshold, for example – as in Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (SSM Regulation), which puts an institution's assets in relation to the Member State's GDP.

Treatment of G-SIIs

We believe that the approach outlined in Art. 1(7) to exclude all institutions of SREP category 1 from the possibility of simplification is consistent.

Q.2a *Do you expect any unintended consequences arising from applying that threshold? If yes, please provide details on these consequences.*

The proposal in our view does not provide sufficient room for the principle of proportionality. The regulatory compliance burden for small banks is not alleviated by the requirements when comparing the proposal with the risk profile of these institutions. In our view this is an unintended consequence of the current drafting.
Only exempting 1894 out of 3874 credit institutions means that more than 1800 LSI would need to comply with the full quantitative assessment anyway. We therefore foresee a significant increase in the administrative cost for the authorities as well as in the reporting cost for the small credit institutions. We do not see that all these 1800 institutions would pose a significant threat of negative effects on financial markets, on other institutions or on funding conditions. The threshold applied in Art. 1(6) is too strict and overly cautious. In our view it would be better to align with the criteria for simplified FINREP reporting and the contribution obligations to the resolution fund (€ 3 billion threshold). In order to accommodate the specific situation of smaller Member States, this fix threshold could be combined with a relative threshold, for example – as in Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (SSM Regulation), which puts the an institution's assets in relation to the

Member State's GDP.

A commercial banking LSI of about € 3 to 5bn in Total Assets will typically have a risk management department of 6 to 12 professionals. The size of these departments on average doubled since the crisis as these professionals have comply with, like any other bank, to the increase of regulation that did not take sufficiently into account the proportionality principle. The drafting of a recovery plan would add to this regulatory burden, without changing the risk profile of the institution. In other words, we consider an unintended consequence that for small banks the current regulatory framework is not appropriately adapted to take into account their size and complexities.

As it is difficult for us to distinguish between potentially intended and unintended consequences, we would like to present the consequences we see arising from applying this threshold as regards efficiency and the business model of LSI cooperative banks.

Efficiency

In terms of efficiency or the impact on the bottom line of LSIs, operating expenses and net interest income are affected.

- Operating expenses: Operating expenses of LSIs have greatly increased since 2009 in order to cope with new regulatory and compliance requirements. These requirements are not limited to solvency, liquidity or resolution but include a variety of new or strengthened regulations, such as MIFID, KYC or AML. Most units related to control functions (risk management, compliance, regulatory reporting, etc.) are still barely able to cope with current regulatory workload despite doubling their staff since 2009. Furthermore, important investments in Information Technology have been needed at a time when small banks also had to invest heavily in the digitalization and mobility demanded by their members and clients.

  In some European countries, LSIs produce over 1.500 reports per year[2]. In addition, finance and control areas produce the annual accounts, the Pillar 3 disclosure information, the ICAAP and ILAAP reports, and answer any question that may be raised by Supervisors. In addition, these control units need to implement a proper financial and risk management control system in the bank, with a governance structure for each risk type, which usually leads to a large number of Committees and internal reporting needs. Finally, we should take into account that there are changes in the business environment and new requirements for products and services that need the attention of control units. In contrast with this workload and if we focus on those professionals working on solvency, liquidity and recovery issues, a commercial banking LSI of about € 3 to 5bn in Total Assets will typically have a risk management department of 6 to 12 professionals (half of this before the crisis), having to deal with a large number of risks (credit, market, counterparty, concentration, liquidity, interest rate, etc.). These professionals are still trying to confront the regulatory changes that have happened to date, and further regulatory requirements and an additional supervisory reporting line will increase pressure and affect staff motivation. Small

[2] If it is taken into account that reports are sent monthly, quarterly and annually

banks' risk managers also need to focus their attention on the fundamental technological and economic changes taking place. One of these changes is a low or negative interest rate environment, which requires a strategy to place efficiency and the diversification of income at the forefront. Such diversification of income involves new risks that risk managers need to properly evaluate.

- Net interest income. Those LSIs that have to become issuers in order to comply with MREL will, on average, face much larger financing costs than large banks. If we consider the Asset Swap Spread[3] (ASW) of bank issuances at the beginning of July 2017[4], the medium and small banks′ credit spread was twice that of large banks. The information regarding LSIs is possibly less reliable as the number of issuances is quite small. However we see a clear pattern indicating that on average smaller issuers would have to pay more without necessarily having this premium linked with riskier business profiles, but simply due to the fact that for smaller issuers it is more costly to get on the market.

[3] The difference between the actual bond yield and the fixed rate of the asset swap contract with similar characteristics

[4] Bloomberg Data as of 3rd July 2017

Credit spread of Senior bonds with a maturity of 1 to 3 years (in basis points)[5]			
	Sample of Large Banks[6]	Sample of Non-Large Banks[7]	Sample of LSIs[8]
Group 1: Eurozone countries with lower sovereign risk[9]	23	50	53
Group 2: Eurozone countries with higher sovereign risk[10]	57	128	192

These differences between large and small banks are likely to increase if there were a financial crisis, due to the higher volatility of small issuances and their higher correlation with sovereign risk[11].

With respect to LSIs' business model, the preparation of resolution plans on the basis of which MREL requirements are determined will lead to a fundamental change in LSIs' role in the economy, having to transform themselves into debt issuers in many cases. LSIs will need to change their internal structure so that they can provide investors and authorities with the necessary information required from issuers, which includes biannual audited accounts, the publication of an internal governance report, staff capable of producing issuance documentation, staff prepared to communicate with investors, etc. This new role as an issuer will increase costs and affect efficiency, but it will also transform the way business is conducted. Currently LSIs are generally run in the daily business with annual objectives in mind, so there is no need to provide information about quarterly or biannual results as is typical in listed companies. Such independence from financial markets provides stability and allows business to be conducted with a more strategic long-term view. The needs of investors are different from those of Cooperative members, and while the issuance of bonds could be considered a costly but effective monitoring mechanism, it may also be a destabilizing mechanism

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[5] Sample of 570 Eurozone banks' senior bond issues with maturity of 1-3 years, corresponding to 84 banks. Out of 8,999 issues of Eurozone banks with ultimate parent country of risk in the Eurozone, those issues with amount issued below 50 million euros have been excluded due to their illiquidity. Also excluded are those issues where Bloomberg was not automatically providing data on bond spread, amount issued, banks' Total Assets or country of risk. All issues are senior unsecured bullet bonds denominated in euros, with a fixed coupon, and no easily observable optionality.

[6] Banks with Total Assets above 100 billion euros.

[7] Banks with Total Assets between 10 and 100 billion euros.

[8] Banks with Total Assets between 10 and 30 billion euros

[9] Sovereign countries with a yield on their 10 year bond below 1.2%

[10] Sovereign countries with a yield on their 10 year bond above 1.2%. Greece in not included. Some outliers due to their high spreads are not included.

[11] "Bank bonds: size, systemic relevance and the sovereign" by Andrea Zaghini. Working Paper 966. July 2014. Banca d'Italia.

as it leads to increases in risk-taking in the short run (i.e. in order to post good results in the 1st quarter).

Q.3 *Do you agree with the list of qualitative considerations for credit institutions?*

We see a need for improvements of some of the qualitative criteria or their wording. Moreover, in order to simplify the test and focus on higher risk indicators, it might be advisable to put more emphasis on a list of specific criteria:

- As regards Article 2(1)(a) critical functions, further clarification would be helpful, especially by inserting a reference to both the definition in Art. 2(1) 35 of Directive 2014/59/EU and especially to Article 6 of Commission Delegated Regulation 2016/78. Since a full assessment of whether an institution fulfills critical functions might be rather complex, we would suggest that especially in the context of smaller institutions a "substitutability check" might be sufficient.
- Art 2(1)(b) seems to provide appropriate indications.
- Art. 2(1)(c) would discriminate against cooperative banks. Due to the specificities of the cooperative form of enterprise, cooperative banks usually have a very broad membership base and the voting rights of members in the General Assembly are limited, very often to "one member – one vote". Thus, the shareholding structure is usually highly dispersed by definition. Cooperative Banks' ownership structure is unique as they are owned by their customers. This distinctive form of ownership should not, per se, be used as a reason for applying a more stringent assessment than that applied to other banks. The cooperative/mutual ownership rather prevents for instance situations that could occur under concentrated shareholding, which could be an adverse risk factor if the bank might be unduly influenced by an external owner, or a few powerful shareholders, to take more risk in what should be the recovery phase to maintain their private upside potential (so-called gamble for resurrection). We would therefore highly recommend a rewording. Such rewording should clarify that standard company and group regimes (cooperative form of enterprise, IPS, Art. 113(6) and Art. 10 CRR group structures) would not per se negatively impact the availability or timely implementation of the institution's recovery and resolution actions.
- Art. 2(1)(d) and (e): In our understanding Art. 4(1) as well as Art. 1 BRRD intended to accommodate and reflect the role and function of institutional protection schemes (IPS). For example, institutions that are members of an institutional protection scheme may not have to draw up a recovery plan for their individual institution (Art. 4(9) BRRD). Against this background, the above remarks apply to small institutions accordingly. For IPS member institutions, an assessment based on qualitative criteria should be waived, regardless of the size criteria in Art. 1(6) of the draft RTS, if there are clearly no negative criteria for an institution.

  Institutions within a mutual solidarity system would usually see the probability of

a failure of a single entity reduced if not eliminated. Within such a system actions are regularly taken even before any early intervention actions or actions described in the recovery plan would be taken. We do not see these qualitative elements in the draft RTS text.

With regard to Art. 10 CRR, according to Article 4(8)(e) BRRD competent authorities and, where relevant, resolution authorities may waive the application of the requirements of Sections 2 (recovery planning) and 3 (resolution planning) to institutions affiliated to a central body. Only in situations where these entities have not been waived a requirement for affiliated institutions of preparing recovery and resolution plans on single entities level may arise.

Reasoning "*argumentum a maiore ad minus*" we see that if an institution, which is affiliated to a central body is not subject to a waiver according to Art. 4(8)(a) BRRD the content and details of the recovery and resolution plans should be limited to simplified obligations. These institutions should not be subject to an assessment process but either be waived from the requirement on single institutions' level or at a maximum required to submit plans which are subject to simplified obligations. Meanwhile, the central body as the consolidating institution could be required to submit a recovery plan to the full extent.

- Art. 2(1)(f): the objectives of the recovery and resolution plans will usually differ. To avoid any misunderstandings the wording should be amended as follows: "the objectives pursued by the recovery or resolution planning respectively".

Q.4 *Do you agree with the list of quantitative indicators for investment firms provided in Annex II?*

Q.5 *Do you agree with the list of qualitative considerations for investment firms?*

Q.6 *Do you agree with our analysis of costs and benefits of the proposals in this Consultation Paper? If not, can you provide data to justify your position or further inform our analysis of the likely impact of the proposals?*

We do not agree with the proposed analysis. Option 3.3 would exempt 1894 out of 3874 credit institutions. In other words, more than 1800 LSI would need to comply with the full quantitative assessment. We do not consider this a significant reduction of the administrative cost for the authorities as well as reporting cost for the small credit institutions. It is difficult to see that all these 1800 institutions would pose a significant negative effect on financial markets, on other institutions or on funding conditions. In

other words, while we appreciate the principle, we consider the thresholds applied in article 1(6) too strict and overly cautious. In our view it would be better to align with the criteria for simplified FINREP reporting and the contribution obligations to the resolution fund (€ 3 bn threshold). In order to accommodate the specific situation of smaller Member States, this fix threshold could be combined with a relative threshold, for example – as in Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (SSM Regulation), which puts the an institution's assets in relation to the Member State's GDP.

Furthermore, we believe that the cost benefit analysis made is incomplete. It only assessed the impact for the authorities and not the institution. Secondly, EBA states that there is a lack of data to make a correct assessment of the impact for the authorities. We would like to emphasise that a commercial banking LSI of about € 3 to 5bn in Total Assets will typically have a risk management department of 6 to 12 professionals. The size of these departments on average doubled since the crisis as these professionals have comply with a significant increase of regulation that did not take into account the proportionality principle. The drafting of a recovery plan in case the institution would not be exempted from simplified obligations has not been taken into account in the cost benefit analyses. We like to emphasis that the initial drafting of a recovery plan (including all other procedures to make this happen) will cost a LSI compared to a non LSI more time as the amount of expertise cannot be sufficiently shared. In our view EBA did not take into account this add on to this regulatory burden.