

EBA/CP/2020/18

22 July 2020

Consultation Paper

Draft Regulatory Technical Standards on methods to avoid that instruments indirectly subscribed by the resolution entity for the purpose of meeting the minimum requirement for own funds and eligible liabilities applicable to entities that are not themselves resolution entities under Article 45f of Directive 2014/59/EU hamper the smooth implementation of the resolution strategy

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1 Responding to this consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 5.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 23 October 2020. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EU) 1725/2018 of the European Parliament and of the Council of 23 October 2018. Further information on data protection can be found under the Legal notice section of the EBA website.

2 Executive Summary

1. Directive (EU) 2019/878 (so-called “BRRD2”) requires entities which are not a resolution entity to issue own funds to any entity in the resolution group¹, and eligible liabilities directly or indirectly to the resolution entity².
2. The mandate under Article 45f(6) of this Directive calls for methods that avoid that indirectly issued instruments hamper the smooth implementation of the resolution strategy.
3. To comply with this mandate, this consultation paper proposes draft Regulatory Technical Standards where a general deduction framework applies in the general case, and a “fall-back” solution applies where the deduction approach cannot apply.
4. The deduction approach is a ‘full holding-based deduction method’, where the iMREL³-eligible instruments deduction at intermediate subsidiary level amounts to the full amount of the intermediate subsidiaries’ holdings of iMREL eligible instruments of the lower subsidiaries, and a risk weight of 0% is applied to these holdings. The deduction framework complements the one that exists for own funds by including eligible liabilities.
5. Where the general deduction framework is not practicable, the resolution authority assesses whether indirectly issued instruments hamper the smooth implementation of the resolution strategy, and may apply the measures of Art 45k BRRD2 on the breach of MREL, including the removal of a substantive impediment to resolvability.

Next steps

The finalisation of the draft RTS and communication to the European Commission is planned by December 2020.

¹ Own funds may also be issued to other entities, as long as the exercise of write down or conversion powers in accordance with Articles 59 to 62 does not affect the control of the subsidiary by the resolution entity.

² Eligible liabilities may also be issued to an existing shareholder that is not part of the same resolution group, as long as the exercise of write down or conversion powers in accordance with Articles 59 to 62 does not affect the control of the subsidiary by the resolution entity.

³ The minimum requirement for own funds and eligible liabilities to entities that are not themselves resolution entities is commonly named “internal MREL” or “iMREL”.

3 Background and rationale

3.1 Background and objective

1. Directive (EU) 2019/878 (so-called “BRRD2”) has introduced the FSB concept of “internal TLAC” in Union law, designed for subsidiaries of G-SIIs and introduced the same logic into the MREL framework to establish the “internal MREL requirement” applicable to all institutions belonging to a resolution group and to which application of a resolution tool is not planned.
2. Internal MREL, like internal TLAC, aims to take into account group structures in resolution; indeed, in a resolution group, resolution tools should only be applied to the resolution entity. Therefore institutions that are not resolution entities (as well as entities other than institutions, if the resolution authority in consultation with the competent authority, thus decides) will be required under the amended BRRD to maintain a sufficient amount of own funds and eligible liabilities at all times, issued to their resolution entity, which can be written down and converted if the non-resolution entity reaches the point of non-viability. The ultimate goal is to make it possible if needed, through the application of Article 59 BRRD to execute the write down and conversion power on those own funds and eligible liabilities by the resolution authority, to give effect to an upstream of losses from the non-resolution entity to the resolution entity and a downstream of capital from the resolution entity to the non-resolution entity so that the non-resolution entity can be recapitalised without its resolution entity itself necessarily entering resolution as a result.
3. The calibration of internal MREL, laid down in Article 45c(7) BRRD, ensures loss absorption and recapitalisation⁴; and the eligibility conditions of the relevant liabilities, set out in Article 45f(2) BRRD, are almost identical to or cross-referred to some CRR eligibility conditions applying to externally-issued MREL/TLAC. The main difference is the issuance pattern since, unlike external MREL/TLAC which must be issued to external investors, internal MREL needs, in order to fulfil its aims, to be issued to the resolution entity⁵.
4. This resolution entity may be the direct legal parent of the entity subject to an internal MREL requirement. However, this is not always the case. It might be that the relationship between both entities is indirect, or both direct and indirect. The most simple pattern is the situation whereby the resolution entity owns a subsidiary which itself owns another institution also subject to an internal MREL requirement.
5. In case of such indirect relationship, two distinct possibilities exist to ensure the upstream of losses to and downstream of capital from the resolution entity. The first is to have the eligible liabilities issued directly from the entity subject to an internal MREL requirement to the resolution entity, regardless of the legal relationship between both entities (“direct issuance”). The second possibility is to set up a chain of back-to-back issuances and purchases taking place at each level of the chain of ownership linking the resolution entity to all entities subject to an internal MREL requirement. Hereby, the entity subject to the requirement issues capital instruments and eligible liabilities to its

⁴ Recapitalisation is pursued only if the strategy for this subsidiary is not liquidation

⁵ Internal MREL may also be issued to an existing shareholder that is not part of the same resolution group, as long as the exercise of write down or conversion powers does not affect the control of the subsidiary.

immediate parent which itself issues to its parent until the necessary quantum of capital instruments and eligible liabilities are finally bought by the resolution entity (so-called “daisy chain” structures).

6. Both possibilities have been recognised by the FSB in principle 10 of its 2017 Guiding Principles on the Internal Total Loss-absorbing Capacity of G-SIBs (‘Internal TLAC’)⁶ which specifies that “internal TLAC may be issued directly from the relevant entity within the material sub-group to the resolution entity or indirectly through multiple legal entities within the group.” In the same vein, point (a) (i) of the new Article 45f(2) BRRD, which lists the eligibility conditions for internal MREL eligible liabilities, allows those instruments to be “issued to and bought by the resolution entity, either directly or indirectly through other entities in the same resolution group that bought the liabilities from the entity that is subject to this Article”.
7. International guidance and EU legislation are therefore neutral as regards issuance patterns. However, regulation needs to ensure that the control of the subsidiary is preserved after the write down and conversion process. In daisy chains structures, the passing of the loss-absorbing and recapitalisation capacity through several layers of entities within a resolution group makes it necessary to ensure that sufficient capacity is actually available at the level of each entity.
8. This is why principle 10 of the Guiding Principles on the Internal Total Loss-absorbing Capacity of G-SIBs (‘Internal TLAC’) states that each subsidiary in the daisy chain should issue sufficient internal TLAC to cover any internal TLAC in which it has invested as well as any internal TLAC for the subsidiary’s own balance sheet, in order to prevent double counting of internal TLAC and added that *“To avoid possible double counting, authorities should consider applying an internal TLAC deduction approach or an equivalently robust supervisory approach.”*
9. This principle has been reflected in the new Article 45f (6) BRRD which tasked the EBA with developing “draft regulatory technical standards further specifying methods to avoid that instruments recognised for the purposes of this Article indirectly subscribed, in part or in full, by the resolution entity hamper the smooth implementation of the resolution strategy [...] to ensure, in particular, the proper transfer of losses to the resolution entity and the proper transfer of capital from the resolution entity to entities that are part of the resolution group but not themselves resolution entities, and provide a mechanism to avoid double counting of eligible instruments recognised for the purpose of this Article”. The mandate specifies that those methods “shall consist of a deduction regime or an equivalently robust approach” and “shall ensure to entities that are not themselves the resolution entity an outcome equivalent to that of a full direct subscription by the resolution entity of eligible instruments recognised for the purpose of this Article.”
10. The deduction regime established in this Regulation shall apply only to determine the eligibility of own funds and liabilities applicable under Article 45(1) of Directive 2014/49 to intermediate subsidiaries in case of indirect subscription by the resolution entity. This is without prejudice to Commission Delegated Regulation (EU) No 241/2014, Regulation (EU) 575/2013 and any other provision of the Union legal framework laying down rules on eligibility criteria and deduction of holdings of instruments recognised for the purposes of Article 45f of Directive 2014/59/EU.

⁶ <https://www.fsb.org/wp-content/uploads/P060717-1.pdf>

3.2 Daisy chains rationales considered

11. Since the mandate referred to “a deduction regime or an equivalently robust approach”, the EBA has started with identifying three possible options to ensure double-counting of internal MREL capacity is avoided: requiring direct subscription, deduction of eligible instruments, and increasing the requirement imposed on the immediate parent. Requiring direct subscription by default through the RTS was found incompatible with the level 1 text, which is neutral in regard to the issuance patterns. The EBA therefore weighed the advantages and disadvantages of a deduction of eligible instruments against an increase of the requirement imposed on the immediate parent. Deduction was the preferred option because an increase of the requirement was difficult to set on a legal basis (due to the strict calibration of iMREL in Art. 45c(7) BRRD), and because it was the only option which could ensure that double counting is avoided at all times: while MREL requirements are set periodically in the context of the resolution planning cycle, deductions are applied dynamically by institutions on a continuous basis and would allow the latter to disclose understandable targets to investors.
12. The EBA considered existing chains of ownership and potential cases which would be less straightforward than linear chains of ownership: chains involving minority shareholders and “transversal holdings” where an entity is owned by another entity both directly and indirectly through a subsidiary. The deduction approach is constructed to fit all these patterns.
13. The approach chosen was therefore that of a deduction which generally leads to higher issuances throughout the chain (without changing the MREL requirement), which are necessary to allow each subsidiary to absorb losses of its own subsidiaries and recapitalise them, as well as to absorb its own losses and recapitalise itself.
14. The EBA examined several possible types of deduction⁷:

- i. **‘Partial regulatory-based deduction method’**, where the deduction is limited to the lower subsidiaries’ **LAA**⁸, plus only **its risk-weighted RCA**⁹. However this method was discarded, because even if such an approach would allow to recapitalise the lower subsidiaries up to their RCA, it would not guarantee that the eligible liabilities held by intermediate subsidiaries would be funded by instruments which would still be available at the time of write down and conversion.
- ii. **‘Full regulatory-based deduction method’**, where the deduction is limited to the intermediate subsidiaries’ holdings of **iMREL** eligible instruments of the lower subsidiaries up to the lower subsidiaries’ **LAA and RCA**.
- iii. **‘Full holding-based deduction method’**, where the iMREL eligible instruments deduction at intermediate subsidiary level amounts to the full amount of the intermediate subsidiaries’ holdings of iMREL eligible instruments of the lower subsidiaries, and a risk weight of 0% is applied to these holdings.

⁷ The assessment of the various approaches is summarized in section *Draft cost-benefit analysis / impact assessment*.

⁸ LAA is the Loss Absorption Amount as defined in Art. 45c(2)(a) BRRD

⁹ RCA is the Recapitalisation Amount as defined in Art. 45c(2)(b) BRRD

15. The following considerations were taken into account:

a. **simplicity**: the holding-based deduction is by far the simplest in its application among the methods analysed;

b. **effectiveness of instruments**: if a banking group decides voluntarily that a subsidiary should issue iMREL eligible instruments in excess of its iMREL requirement, **having such surplus capacity upstreamed by the other entities in the chain avoids to leave a bottleneck** of loss absorption and/or recapitalisation at an intermediate level;

c. **neutrality on group structure**: as a preliminary quantitative input, the information gathered from a number of stakeholders suggests a low number of daisy chains, even with BRRD2 waiver conditions which are stricter than in BRRD1. Moreover, large groups – the ones potentially most affected by the present mandate - are already considering issuance schemes that render any debate between the various options void;

d. **legal soundness**: the holding-based approach represents an appropriate implementation of the legal mandate.

16. In order to allow issued own funds and eligible liabilities to play their intended loss absorption and recapitalisation role at each level of the chain of ownership, the chosen method is to require, for each subsidiary along the chain of ownership, a deduction of the **full holding of eligible internal MREL instruments** issued by other entities of the resolution group.

17. As regards potential **cases where even a deduction approach would be difficult to implement** due to the complexity of group structures, a situation which the newness of the internal MREL framework does not allow to rule out, the approach retained is for the resolution authority to inform the entity in order to allow it to demonstrate that the issued instruments fulfil the requirement under Art 45f(6); if the resolution authority is not satisfied with this demonstration, it may apply the measures of Art 45k BRRD2 on the breach of MREL, including the removal of a **substantive impediment to resolvability**¹⁰.

¹⁰ The option of requiring sub-consolidation at some adequate level of the chain of ownership was also considered as a fall-back solution, but abandoned, as not explicitly foreseen by the level 1 text.

Questions to stakeholders

As per BRRD2 Art 45f(1) all institutions are subject to MREL requirements, and resolution authorities may also set iMREL to financial institutions, financial holding companies and parent financial holding companies. BRRD2 Art 45f(3) and (4) provide for possibilities of waivers.

- 1. Do you have any views on the merits of the approach analysed by the EBA to implement the mandate or regarding other options considered under paragraph 14?**
- 2. Could you describe the possible cases of daisy chains¹¹ in the institutions you represent, taking into account the BRRD2 MREL conditions (but without considering waiver possibilities)?**
- 3. In the institutions you represent, how would you deal with daisy chain situations? Do you plan to issue eligible liabilities directly from subsidiaries to the resolution entity, or rather indirectly through the intermediate subsidiaries?**
- 4. The deduction regime increases in general¹² the issuance needs of intermediate entities. What could be the financial impact(s) of such increase of issuances? (allocation of profits/distribution of dividends, capital of subsidiaries, buffers redistribution across the group, tax, etc.). Please answer qualitatively, and if possible, also quantitatively regarding the institution you represent.**
- 5. In the institutions you represent, how many cases are there where an intermediate subsidiary is not regulated, or located in a non-EU jurisdiction (and therefore not subject to banking capital requirements resp. MREL requirements), or where the CA has only set sub-consolidated (and no individual) own funds requirements to an intermediate subsidiary (therefore no individual P2R or CBR applies to it)?**
- 6. Are there any circumstances, including, but not limited to, the complexity of the Group, in which you would foresee significant issues with the implementation of this RTS? If so, please provide further details of the circumstances and the issues that would be faced.**

¹¹ Only daisy chains of institutions are expected in this question; financial institutions and financial holding companies are expected only if they are an intermediate entity in the daisy chain.

¹² An exception is if the institutions already have instruments higher than the sum of their requirements plus the amount to be deducted

4 Draft regulatory technical standards

COMMISSION DELEGATED REGULATION (EU) No .../..

of **XXX**

[...]

supplementing [Directive XXXX/xx/.. / Regulation (..) No xx/XXXX] of the European Parliament and of the Council with regard to regulatory technical standards for [insert text describing the subject matter of the standards required by the basic act] [N.B. when amending another act use/add the following: 'amending with regard to']

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,
 Having regard to Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012¹³, as amended by Directive (EU) 2019/879 of the European Parliament and of the Council of 20 May 2019¹⁴, and in particular Article 45f(6) thereof,

Whereas:

- (1) The Financial Stability Board published in November 2015 its Total Loss-Absorbing Capacity (TLAC) term-sheet. Its principle (vi) states that host authorities must have confidence that there is sufficient loss-absorbing and recapitalisation capacity available to subsidiaries in their jurisdictions with legal certainty at the point of entry into resolution, which results in a need for a credible mechanism by which losses and recapitalisation needs may be passed with legal certainty to the resolution entity or entities. The FSB further elaborated on this principle in its Guiding Principles on the Internal TLAC of G-SIBs in July 2017. Principle 10 on the internal TLAC left resolution authorities to determine the internal TLAC issuance strategy in consultation with the G-SIBs, including whether the issuance of TLAC instruments should occur directly between the relevant entity and the resolution entity or pass through multiple legal entities. It further noted that to avoid possible double counting, authorities should consider applying an internal TLAC deduction approach or an equivalently robust supervisory approach.

¹³ OJ L 173, 12.6.2014, p. 190.

¹⁴ OJ L 150, 7.6.2019, p. 296–344

- (2) Accordingly, the amendments to Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms, introducing among others the TLAC standard into Union law provide, in Article 45f of that Directive, a requirement for institutions that are subsidiaries of resolution entities or of third country entities, but are not themselves resolution entities, to meet a minimum requirement of own funds and eligible liabilities (MREL) issued to their resolution entity, in order to ensure upstream of losses and downstream of capital. Instruments eligible to meet this requirement may be issued to and bought by the resolution entity either directly or indirectly through other entities in the same resolution group that bought the liabilities from the entity that is subject to an internal MREL.
- (3) Where issuances of MREL eligible liabilities done by entities which are not themselves resolution entities are indirectly bought by the resolution entity, as per Article 45f, paragraph 2, point (i), subparagraph (a) of Directive 2014/59/EU, there might be a risk that the amount of own funds and eligible liabilities to be issued by an entity that is itself not a resolution entity to comply with the requirement of own funds and eligible liabilities determined under Article 45c, paragraph 7, of Directive 2014/59/EU is insufficient to absorb the losses of both the issuing entity and its subsidiaries, as well as to recapitalise them in accordance with the preferred resolution strategy. This might put at risk the feasibility of a resolution strategy based on the write-down and conversion of those instruments. Therefore, adequate rules, suited to the specificities of each type of chain of ownership, should be laid down in order to avert this risk and allow for a smooth upstream of losses and downstream of capital within resolution groups.
- (4) Reciprocal issuances of instruments among entities that are not resolution entities constitute MREL instruments to the extent, inter alia, that they do not constitute direct funding pursuant to Article 45f(2)(a)(v) of Directive 2014/59/EU. To the extent that such issuances meet the eligibility criterion in Article 45f(2)(a)(v) of Directive 2014/59/EU, this Delegated Regulation should ensure that their reciprocal issuances do not lead to double counting.
- (5) In case of indirect issuance a deduction regime should be applied to own funds and eligible liabilities issued by institutions or entities subject to Article 45f of Directive 2014/59/EU in order to ensure the proper transfer of losses to the resolution entity and the proper transfer of capital from the resolution entity to entities that are part of the resolution group but not themselves resolution entities and provide a mechanism to avoid double counting of eligible instruments. The deduction should apply to own funds and eligible liabilities issued by entities that are part of a resolution group and are not resolution entities themselves, when they hold own funds and eligible liabilities instruments issued by other entities that are part of the resolution group and are not themselves resolution entities. Therefore, the amount to be deducted by any of such entity should be equal to the MREL eligible instruments that the entity has subscribed from its direct or indirect subsidiaries which are part of the same resolution group and are also subject to Article 45f of Directive 2014/59/EU.
- (6) There should be consistency in the deduction of own funds between the supervisory framework and the resolution framework. Therefore, the Resolution Authority should inform the Competent Authority about the need for deduction of own funds for resolution planning, in consistency with Article 49(2) of Regulation (EU) No 575/2013; in this case the deducted own funds would not be risk weighted, in consistency with Article 49(4) of Regulation (EU) No 575/2013. Besides, the Resolution Authority should request from the Competent Authority the application of a risk weight of 0 to deducted eligible liabilities.

- (7) Deduction of eligible liabilities should apply progressively, starting from the most senior layer of MREL instruments issued to comply with the requirement of own funds and eligible liabilities by entities that are not themselves resolution entities. Accordingly, in line with Recital 21 of Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013, eligible liabilities should be reduced first. To the extent this is insufficient, Tier 2 capital, then Additional Tier 1 capital, and finally Common Equity Tier 1 capital should be reduced, so that the necessary amount is deducted.
- (8) This Regulation is based on the draft regulatory technical standards submitted by the European Supervisory Authority (European Banking Authority) (EBA) to the European Commission.
- (9) The EBA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010.¹⁶

HAS ADOPTED THIS REGULATION:

Article 1 - Definitions

For the purpose of this Regulation, “intermediate entity” shall mean an entity subject to Article 45f of Directive 2014/49 that is part to a resolution group and is not a resolution entity itself, which holds own funds and eligible liabilities instruments issued by other entities that are part of the resolution group and are not themselves resolution entities.

Article 2 – General deduction framework for indirect subscriptions of eligible instruments

1. Intermediate entities shall deduct from the amount of instruments recognised for the purpose of Article 45f of Directive 2014/59/EU the amount of their holdings of own funds instruments and eligible liabilities instruments compliant with Article 45f, paragraph 2, of Directive 2014/59/EU in entities that are not themselves resolution entities and which belong to the same resolution group as the relevant intermediate entity.
2. The Resolution Authority shall inform the Competent Authority about the need for deduction of own funds for resolution planning.
3. The Resolution Authority shall request from the Competent Authority the application of a risk weight of 0 to deducted eligible liabilities.

¹⁵ Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

¹⁶ OJ L 331, 15.12.2010, p. 12.

Article 3 – Sequence of deduction

The amount of holdings of own funds instruments and eligible liabilities instruments mentioned in Article 2 shall be deducted from instruments recognised for the purpose of Article 45f of Directive 2014/59/EU in the following sequential way:

- (a) From eligible liabilities first;
- (b) If eligible liabilities are insufficient, the remaining deductible amount after eligible liabilities have been reduced to zero shall be deducted from own funds.

Article 4 – Cases where the general deduction framework is not practicable

By way of derogation from Article 2, where the Group Level Resolution Authority concludes that, due to the complexity of the group structure, it is legally or otherwise impracticable to apply the deduction method set out in that Article, the following provisions shall apply:

- a) the Group Level Resolution Authority may require the issuing entity to provide a demonstration that the instruments issued indirectly from an entity subject to a requirement under Article 45f(1) of Directive 2014/59/EU to its resolution entity ensure the proper transfer of losses to the resolution entity and the proper transfer of capital from the resolution entity to the issuing entity, and that there is no double counting of instruments.
- b) Where the Group Level Resolution Authority is not satisfied that the instruments recognised for the purposes of Article 45f of Directive 2014/59/EU comply with the conditions set out in Article 45f(6) of Directive 2014/59/EU, it shall determine whether some or all of those instruments cannot be recognised for the purposes of applying the minimum requirement of own funds and eligible liabilities pursuant to Article 45f of Directive 2014/59/EU.

Article 5

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*. It shall apply from [insert date].

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the Commission
The President*

*[For the Commission
On behalf of the President*

[Position]

5 Accompanying documents

5.1 Draft cost-benefit analysis / impact assessment

18. Article 45f(6) of the BRRD2 requires the EBA to develop draft RTS specifying methods to avoid that instruments indirectly subscribed for the purpose of meeting internal minimum requirement for own funds and eligible liabilities (iMREL) hamper the smooth implementation of the resolution strategy.
19. As per Article 10(1) of Regulation (EU) No 1093/2010 (EBA Regulation), any regulatory technical standards developed by the EBA shall be accompanied by an Impact Assessment (IA), which analyses ‘the potential related costs and benefits’. This analysis should provide an overview of the findings regarding the problem to be dealt with, the solutions proposed and the potential impact of these options.
20. This section presents the cost-benefit analysis of the main policy options included in the RTS described in this CP. The analysis is high level and of a qualitative nature.
21. In parallel with the consultation, the EBA is launching a data collection from RAs to support the impact assessment of the provisions proposed in these draft RTS.

A. Problem identification

22. iMREL is the loss-absorbing and recapitalization capacity that resolution entities have committed to subsidiaries. This requirement recognises that feasible and credible resolution strategy may involve the placement of loss-absorbing capacity and recapitalization in all parts of the resolution group.
23. It provides for a mechanism whereby losses and recapitalization needs of subsidiaries may be passed with legal certainty to the resolution entity of a resolution group, while the subsidiaries themselves do not enter into resolution. iMREL should be set at a level that is sufficient to support the resolution strategy for the resolution group.
24. Under point (a)(i) of Article 45f(2) BRRD2, iMREL may be issued directly from a subsidiary to the resolution entity or indirectly through multiple legal entities within the group. The latter can include cases where the subsidiary issues iMREL through another entity within the resolution group to the resolution entity, which itself is subject to iMREL (“daisy chain”).
25. As the intermediate subsidiary of a daisy chain invests own funds and potentially eligible liabilities into its subsidiaries, the same eligible instruments might be counted twice – toward



the iMREL of the intermediate subsidiary itself and toward the iMREL of the subsidiaries of the intermediate subsidiary.

26. In addition, in a resolution scenario, which may affect all entities in the resolution group simultaneously, the calibration formula under Article 45c(7) BRRD2 might lead to insufficient internal loss-absorbing and recapitalization capacity.

27. This might further put at risk the feasibility of the overall resolution strategy based on the write-down and conversion of those instruments.

28. Thus, daisy chains create the risks that resolution authorities cannot resolve a resolution group in an orderly manner, including to place certain of its subsidiaries under resolution, thus creating potentially disruptive effects on the market.

B. Policy objectives

29. At high level, the RTS is expected to contribute to the general objectives of a high, effective and consistent level of banking regulation across the EU and to achieve legal clarity.

30. More specifically, the RTS should ensure that iMREL at the level of material subsidiaries ensures that the preferred resolution strategy of the resolution group can be implemented independently from the group's issuance pattern of eligible instruments. This ensures that resolution authorities can credibly and feasibly resolve the resolution entity and thereby retains market confidence and avoids market disruptions.

31. At the technical level, the RTS provides resolution authorities with adequate methods to avoid that eligible instruments indirectly subscribed for the purpose to meet iMREL hamper the smooth implementation of the resolution strategy of the resolution group.

C. Baseline scenario

32. The baseline scenario is the scenario against which the impact is assessed. The baseline scenario is the current situation, where resolution authorities determine the level of eligible instruments for the purpose of iMREL without any guidance for situation where indirect subscription of eligible instruments creates disruptive effects on the resolution strategy.

33. Under the baseline scenario, the risk that daisy chains can hinder a smooth and orderly resolvability of the resolution group remains, which create risks to the real economy and public finances of the Banking Union.



D. Options considered

34. Resolution authorities are required to determine iMREL for each subsidiary of the resolution group with inter alia the objectives to ensure the smooth implementation of the resolution strategy and to avoid double counting of eligible instruments, independent from the group structure and group's issuance pattern.
35. The RTS prescribes methods to determine iMREL for material subsidiaries, which ensures the compliance with the targeted objectives. It thereby distinguishes between simple versus complex group structures and allows resolution authorities to provide guidance on iMREL in cases of complex resolution group structures in which the methods outlined in the RTS are not sufficient.
36. To achieve the targeted objectives, the RTS prescribes that eligibility to iMREL of an intermediate subsidiary is determined by considering its holding in other subsidiaries and thereby needs to address these holdings in form of a deduction in its own funds and eligible liabilities holdings.
37. A deduction method results in the ineligibility of a part of the eligible instruments of the intermediate subsidiary for the purpose to comply with its iMREL. Consequently, the entity may be required to issue a higher amount of eligible instruments in order to be compliant with its own iMREL target.
38. The EBA has considered the following options for the deduction of own funds and eligible liabilities of subsidiaries from the iMREL of the intermediate subsidiary:
- Option 1.1: Partial regulatory-based deduction method
 - Option 1.2: Full regulatory-based deduction method
 - Option 1.3: Full holding-based deduction method
39. Under Article 45c(7) BRRD2, iMREL is defined as the sum of a loss absorption amount (LAA) and a recapitalisation amount (RCA).
40. In cases of an indirect subscription of iMREL from the resolution entity via an intermediate (material) subsidiary, the intermediate subsidiary should deduct from its eligible instruments holdings of eligible instruments of any of its own subsidiaries.
41. Under a regulatory-based deduction method, the deduction from the intermediate subsidiary's iMREL instruments is limited by the LAA and RCA of its subsidiaries. Under the full regulatory-based deduction, the total amount of iMREL of its subsidiaries is deducted, i.e. the sum of their LAA and RCA. Under the partial regulatory-based deduction, the deduction is limited to the subsidiaries' LAA plus only a portion of the subsidiaries' RCA.



42. The assumption of the regulatory-based deduction is that the loss to be considered for each entity in a group does not exceed its own funds requirements.
43. Under the full holding-based deduction, the intermediate subsidiary deducts from the amount of its iMREL instruments the full amount it holds in own funds and eligible liabilities issued by its material subsidiaries. A risk-weight of 0% is applied to these holdings to ensure that risks of those holdings are not accounted twice in the intermediate subsidiary.

E. Cost-Benefit Analysis and preferred option

44. Under Option 1.1, the regulatory deduction approach would allow to recapitalise the subsidiaries up to their RCA, however, it would not guarantee that the eligible liabilities held by the intermediate subsidiary would be funded by instruments which would still be available at the time of write down and conversion.
45. Under Option 1.2, the method to determine iMREL eligibility for the intermediate subsidiary would exactly allow the implementation of the resolution strategy calibrated by the iMREL. Resolution groups can ensure the smooth implementation of its resolution strategy calibrated by the MREL, as losses are absorbed up to the LAA and recapitalisation of material subsidiaries up to the RCA is ensured.
46. Under Option 1.2, any amount of the eligible own funds issued by a subsidiary beyond its requirements can be used to absorb its own losses, however, will not be transferred via the intermediary subsidiary to the resolution entity. Transfers to the resolution entity are only made up to the level of the iMREL, not up to the amount of all eligible instruments.
47. The holding-based approach, Option 1.3, ensures that all the existing eligible iMREL instruments can be used to allow loss absorption and recapitalization. The approach equals a direct subscription of all eligible instruments of subsidiaries by the resolution entity.
48. It further provides a conceptually simple approach, however, requires the intermediate subsidiary to hold a higher amount of iMREL instruments than under the regulatory-based approach, which increases the instruments issued to the resolution entity.
49. Under Option 1.3, higher eligible instruments are locked into the subsidiaries, which decreases flexibility in term of capital and liabilities allocation of the banking group and thereby may adversely affect its business strategy.
50. During a preliminary assessment of EU resolution groups few daisy chains could be identified, which leads to the assumption that the potential higher economic costs of Option 1.3 are limited. The assessment of daisy chains in the EU will be carried out during a high level data collection, which is launched in parallel to the consultation. Further assessment of the economic impact of the proposed options will be carried out based on the results of this data collection.

51. Option 1.3 is retained.



5.2 Overview of questions for consultation

Questions to stakeholders

As per BRRD2 Art 45f(1) all institutions are subject to MREL requirements, and resolution authorities may also set iMREL to financial institutions, financial holding companies and parent financial holding companies. BRRD2 Art 45f(3) and (4) provide for possibilities of waivers.

- 1. Do you have any views on the merits of the approach analysed by the EBA to implement the mandate or regarding other options considered under paragraph 14?**
- 2. Could you describe the possible cases of daisy chains¹⁷ in the institutions you represent, taking into account the BRRD2 MREL conditions (but without considering waiver possibilities)?**
- 3. In the institutions you represent, how would you deal with daisy chain situations? Do you plan to issue eligible liabilities directly from subsidiaries to the resolution entity, or rather indirectly through the intermediate subsidiaries?**
- 4. The deduction regime increases in general¹⁸ the issuance needs of intermediate entities. What could be the financial impact(s) of such increase of issuances? (allocation of profits/distribution of dividends, capital of subsidiaries, buffers redistribution across the group, tax, etc.). Please answer qualitatively, and if possible, also quantitatively regarding the institution you represent.**
- 5. In the institutions you represent, how many cases are there where an intermediate subsidiary is not regulated, or located in a non-EU jurisdiction (and therefore not subject to banking capital requirements resp. MREL requirements), or where the CA has only set sub-consolidated (and no individual) own funds requirements to an intermediate subsidiary (therefore no individual P2R or CBR applies to it)?**
- 6. Are there any circumstances, including, but not limited to, the complexity of the Group, in which you would foresee significant issues with the implementation of this RTS? If so, please provide further details of the circumstances and the issues that would be faced.**

¹⁷ Only daisy chains of institutions are expected in this question; financial institutions and financial holding companies are expected only if they are an intermediate entity in the daisy chain.

¹⁸ An exception is if the institutions already have instruments higher than the sum of their requirements plus the amount to be deducted