



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

Lord Boswell of Aynho
Chair
European Union Committee
Committee Office
House of Lords
London
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Dear Tim,

28th June 2018

EM 14777/16, 14775/16 and 14776/16: On amendments to the Banking Recovery and Resolution Directive (BRRD) and the Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR).

I would like to express my gratitude to the Committee for granting a scrutiny waiver ahead of the May ECOFIN meeting to enable us to support the compromise tabled by the Bulgarian Presidency. A General Approach was reached with the support of 26 Member States and two abstentions, from Italy and Greece. I'd like to take this opportunity to outline the outcome reached with regards to the outstanding issues tabled by the Presidency at ECOFIN.

The first issue is the framework for setting the EU's Minimum Requirement for Own Funds and Eligible Liabilities (MREL). The Presidency successfully brokered a compromise between Member States on MREL calibration requirements, specifically the politically divisive issue on MREL subordination. The UK government supported the compromise on MREL calibration as it broadly achieves UK negotiating priorities on flexibility for the resolution authority to set the appropriate quantity and quality of MREL for firms.

The overall quantity of MREL was settled earlier in negotiations where the UK, alongside other likeminded Member States successfully removed the uncertain concept of MREL 'guidance' and lifted the proposed cap on the amount of MREL that institutions would be required to hold. We are satisfied with this outcome which means that resolution authorities have the ability to increase the amount of MREL to ensure a bank can command sufficient market confidence to continue to meet the conditions for authorisation following a resolution.

Regarding the quality of MREL, you may recall that the issue of subordination divided Member States. As noted in previous correspondence, MREL subordination enables MREL resources to rank below (and therefore absorbs losses before) liabilities related to day to day operations and critical economic functions of a bank. This way, MREL subordinated

instruments can easily absorb losses without jeopardising the critical functions of the firm when it is in resolution.

In summary, the final compromise on MREL subordination includes a notion of 'top-tier' banks to determine the subset of financial institutions that are systemically important and to whom higher subordination requirements should apply. Top tier banks are defined as institutions with a consolidated balance sheet of higher than €100 billion and, alongside Globally Systemic Important Institutions (GSIs), will be subject to a subordination requirement equal to 8% of total liabilities and own funds (TLOF). The UK was successful in achieving flexibility around the subordination TOLF level to ensure an appropriate approach which reflects the level of subordination required to deliver the preferred resolution strategy. Resolution authorities will be able to set MREL subordination requirements below and above 8% TLOF subject to specific criteria and conditions. For firms that have a consolidated balance sheet of below €100 billion, there will be a lower subordination requirement based on the amount needed to overcome compensation risks in resolution.

I can confirm that the compromise includes and maintains language favoured by the UK on MREL eligibility criteria. This addressed significant industry concerns about new MREL eligibility criteria which would have invalidated most of the existing stocks of MREL.

On MREL timings, firms will need to comply with full MREL requirements by 1 January 2024, with resolution authority discretion to extend on a case by case basis. The UK was successful in securing agreement that GSIs and top-tier firms shall be required to meet minimum MREL requirements by 1 January 2022, in line with the TLAC standard.

There is also the issue of the implementation of the Fundamental Review of the Trading Book (FRTB) following the Basel Committee's announcement of a delay in implementing FRTB as outlined previously. The compromise put forward by the Presidency introduces FRTB as a reporting requirement in this package, with the commencement as soon as possible of the necessary technical standards and the expectation of full implementation in the near future. At ECOFIN, several Member States reiterated the importance of sending a strong message that the EU remains committed to full and timely FRTB implementation when the standards are finalised in Basel. Therefore, a stronger commitment was introduced in the legal text and Vice President Dombrovskis reaffirmed the Commission's readiness to follow up the work on FRTB when the work of the Basel Committee is completed.

On the exemptions from the scope of the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD), Member States agreed on the compromise text which included the further exemptions of promotional banks.

Lastly, there was a discussion on a change in the way G-SIs are designated. Currently a bank is determined as systemic based on the scale of its cross-border activity. If a bank is determined to be a GSI it must hold additional regulatory capital. In addition, there are different categories of GSIs, and different capital buffers are assigned based on the scale

of cross border activity of the firm. Basel rules currently dictate that cross-border activities within the Banking Union are considered like any other cross border activities.

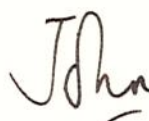
A change in this methodology was proposed for this calculation which would discount cross border activities conducted within the Banking Union. The justification for this is a recognition of the progress made in establishing the Banking Union. If an EU bank's G-SII designation is changed, and buffers for that firm are subsequently reduced, a consequence is that other EU Member States who supervise subsidiaries of that firm will have fewer tools to manage domestic risk. This was a concern for smaller Member States whose banking sector (and banking risk) is made up of banks which are subsidiaries of major banks from other Member States. Given the opposition to such changes, the Presidency compromise text introduced safeguards such as ensuring current G-SIIs will not lose their designation and enforces the limit on the ability of the respective competent authority to lower a G-SII's buffer.

Many Member States noted concerns with the proposed G-SII score methodology, but were prepared to accept the proposal in the spirit of compromise. The Chancellor expressed our concern that this proposal represents a deviation from Basel, but as it does not create risks for the UK, we were content to accept the proposal to achieve a balanced overall deal across the package.

The European Parliament's Committee on Economic and Monetary Affairs voted on amendments to BRRD, CRD and CRR on 19th June and now have a mandate for trilogues. I understand the Austrian Presidency will commence trilogues in July in order to meet the timeline I outlined in my previous letter. On MREL subordination, a majority of the European Parliament ECON committee supported the Rapporteur's position on MREL subordination which effectively caps the level of subordination at 18% of risk weighted assets, which reflects the minimum TLAC standard but does not give not resolution authorities the flexibility to require a higher level of subordination to deliver the preferred resolution strategy. The Council has a strong mandate to defend its position on MREL subordination in trilogues and we will be engaging with our EU counterparts on this issue.

I am copying this letter to Sir William Cash, Chair of the House of Commons European Scrutiny Committee; and copying this letter to Lynn Gardner, Clerk to the Committee; Chris Johnson, Clerk to the Lords EU Committee; Matthew Manning, Clerk to the Lords EU Financial Affairs Subcommittee; Les Saunders, Department for Exiting the EU; Frances Milsom and Barbara Armstrong, HM Treasury.

with very best regards



JOHN GLEN
ECONOMIC SECRETARY TO THE TREASURY

