SRB-FBF academic event

*“Bank resolution in times of COVID-19”*

# REMOVING THE REGULATORY BARRIERS TO CROSS-BORDER BANKING


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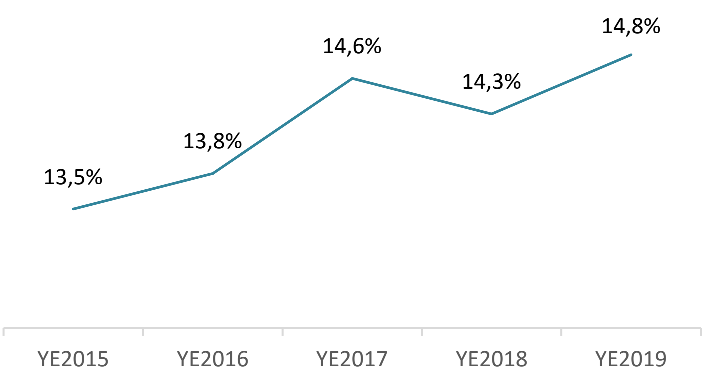
# 1

# The regulatory barriers to cross-border banking

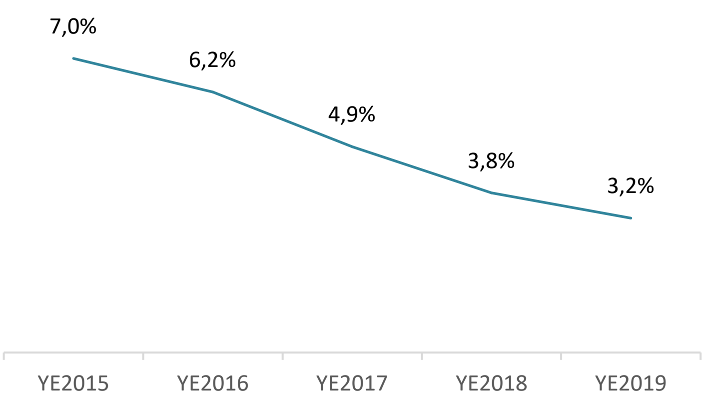
# Euro area banks have made progress, but challenges still lie ahead…

## Banks entered the COVID-19 crisis with higher capital buffers and stronger balance sheets…

**CET1 ratio**
(ECB-supervised banks)



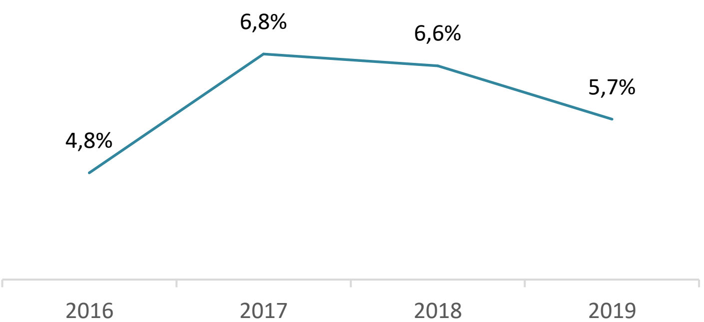

**NPL ratio**
(ECB-supervised banks)



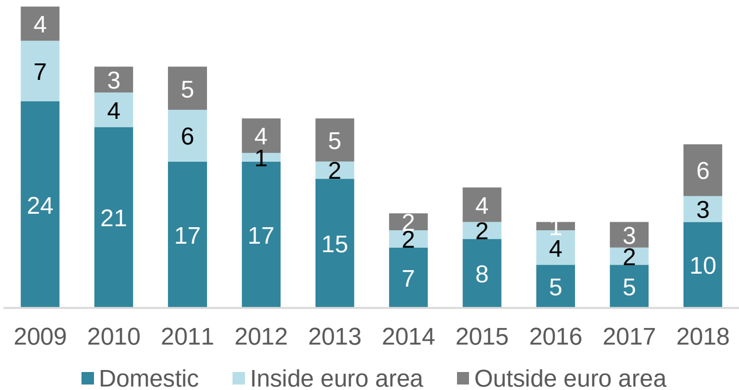

**Source**: Data for ECB-supervised banks are based on the quarterly supervisory banking statistics published by the ECB

## … but low profitability and overcapacity remain significant concerns for the euro area banking sector

**Return on Equity**
(ECB-supervised banks)




**Mergers and acquisitions in the euro area banking sector**




**Source**: European Commission, European financial and integration review 2020

# Ring-fencing measures still in place in the Banking Union

## Application of individual prudential requirements to foreign subsidiaries and restrictions to cross-border intragroup exposures limit banks' profitability and contribute to the fragmentation of the banking market

| | Capital requirements | | Liquidity requirements | | Internal MREL | |
|---|---|---|---|---|---|---|
| **Prudential requirements at individual level** | Option for supervisory authorities to waive capital and leverage requirements at individual level (under conditions) | Application of capital and leverage requirements at individual level | Option for supervisory authorities to waive liquidity requirements at individual level (under conditions) | Application of liquidity requirements at individual level; option for supervisory authorities to waive these requirements (under strict conditions) | Full or partial waiver of internal MREL (under conditions) | Application of internal MREL at individual level |
| **Restrictions to transfer of liquidity** | Preferential risk-weighting treatment (0% RW for intragroup exposures) | No preferential risk-weighting treatment | Supervisory authorities may allow intragroup exposures to exceed the large exposure limit (25% of Tier1 capital) | Supervisory authorities may allow intragroup exposures to exceed the limit of 25% of Tier 1 capital; Member States may supersede the authorities' decision | | |

Shaded box: Prudential requirements applied to a **subsidiary located in the same Member State** with the parent entity

Dashed box: Prudential requirements applied to a **subsidiary located in a different Member State** from the parent entity

# 2

# The key elements of the proposed framework

# Key elements of the proposed regulatory initiatives

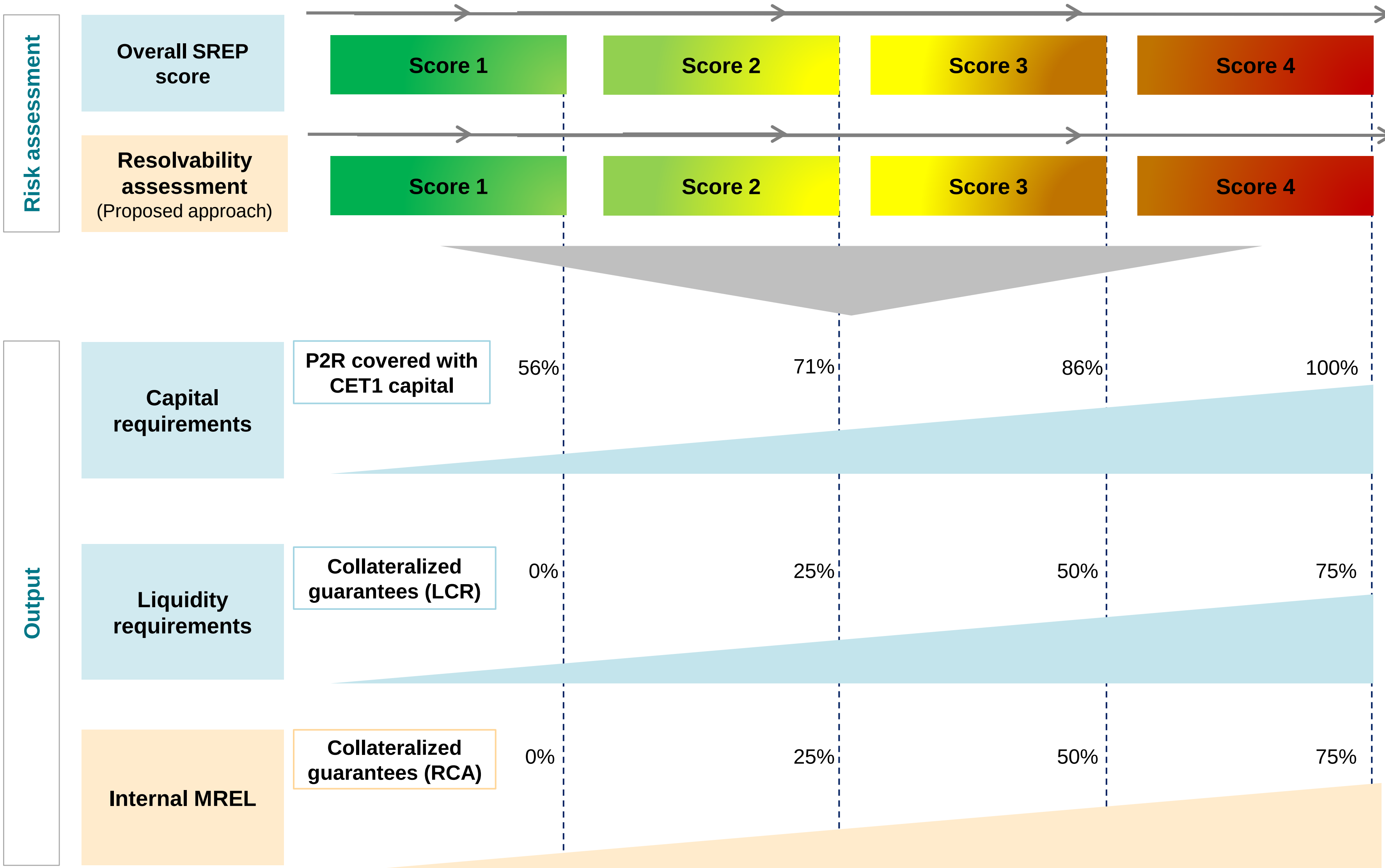
Lifting of restrictions to intragroup exposures and application of reduced individual prudential requirements should go along with the conferral of enhanced powers to the ECB and the SRB to set stricter prudential requirements and take corrective action to prevent failure of subsidiaries

**Proposed amendment of the regulatory framework**

| | | | | |
|---|---|---|---|---|
| **Pillars** | **Lifting of restrictions to transfer of liquidity** | **Reduced prudential requirements** (default approach) | **Option for authorities to set stricter prudential requirements** (based on SREP and resolvability assessment) | **Escalation measures for corrective action** |
| **Measures** | Abolition of option for Member States to supersede the supervisory authority's decision to allow intragroup exposures to exceed large exposure limit | Application of only Pillar 1 and Pillar 2 requirements at individual level | Option for the ECB to increase the portion of P2R covered with CET1 capital (based on SREP) | Mandatory intragroup financial support agreements for banking groups wishing to take advantage of cross-border waivers |
| | Preferential risk-weighting treatment (0% RW) for cross-border intragroup exposures | Waiver for liquidity requirements (under conditions); guarantees from parent entity equal to LCR's denominator | Option for the ECB to require part of the LCR's denominator to be covered with collateralized guarantees (based on SREP) | Recovery arrangements for all subsidiaries enjoying preferential treatment |
| | | Partial waiver for internal MREL; guarantees from parent entity equal to Recapitalization Amount (RCA) | Option for the SRB to require part of the Recapitalization Amount to be covered with collateralized guarantees (based on SREP and resolvability assessment) | Enhanced early intervention powers applied on a group-wide basis |

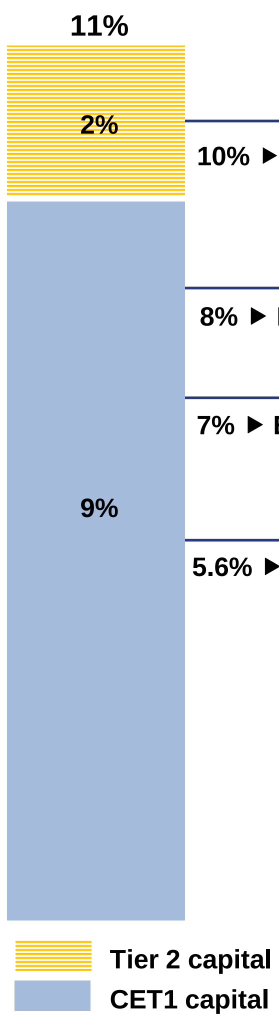
# Enhanced powers for the ECB and the SRB to set stricter requirements

The ECB and the SRB could set more stringent requirements as regards capital, liquidity and internal MREL based on the SREP assessment and resolvability assessment; thus, banking groups would have to place emphasis on the riskiness and resolvability of subsidiaries to avoid increased requirements



# Proposed escalation measures for corrective action

Early intervention measures should be extended to parent entities if the latter are reluctant to support distressed subsidiaries; proposed prudential safeguards ensure that corrective action will be taken either by banking groups themselves or by the ECB/SRB to minimize the possibility for failure of subsidiaries




**10% ▶ Total SREP capital requirements**

**8% ▶ Recovery trigger breach**

**7% ▶ Early intervention trigger**

**5.6% ▶ Breach of PONV**

**Mandatory intragroup financial support agreements**

Banking groups wishing to take advantage of the cross-border waivers must enter into intragroup financial support agreements to provide loans, guarantees and collateral to subsidiaries upon deterioration of their financial situation

**Activation of the Recovery Plan**

Implementation of recovery options (e.g. share capital increase, cancellation of dividend distributions, AT1 coupons and bonuses, issuance of senior bonds, intragroup takings, OpEx reduction)

**Early intervention measures**

- Implementation of recovery options (required by the ECB)
- Activation of intragroup financial support agreements
- Collateralization of internal MREL guarantees or prepositioning of instruments
- Prohibition of distributions (dividends, AT1 coupons, bonuses)
- Prohibition of placements to parent entity
- Replacement of senior management of subsidiary and/or parent entity

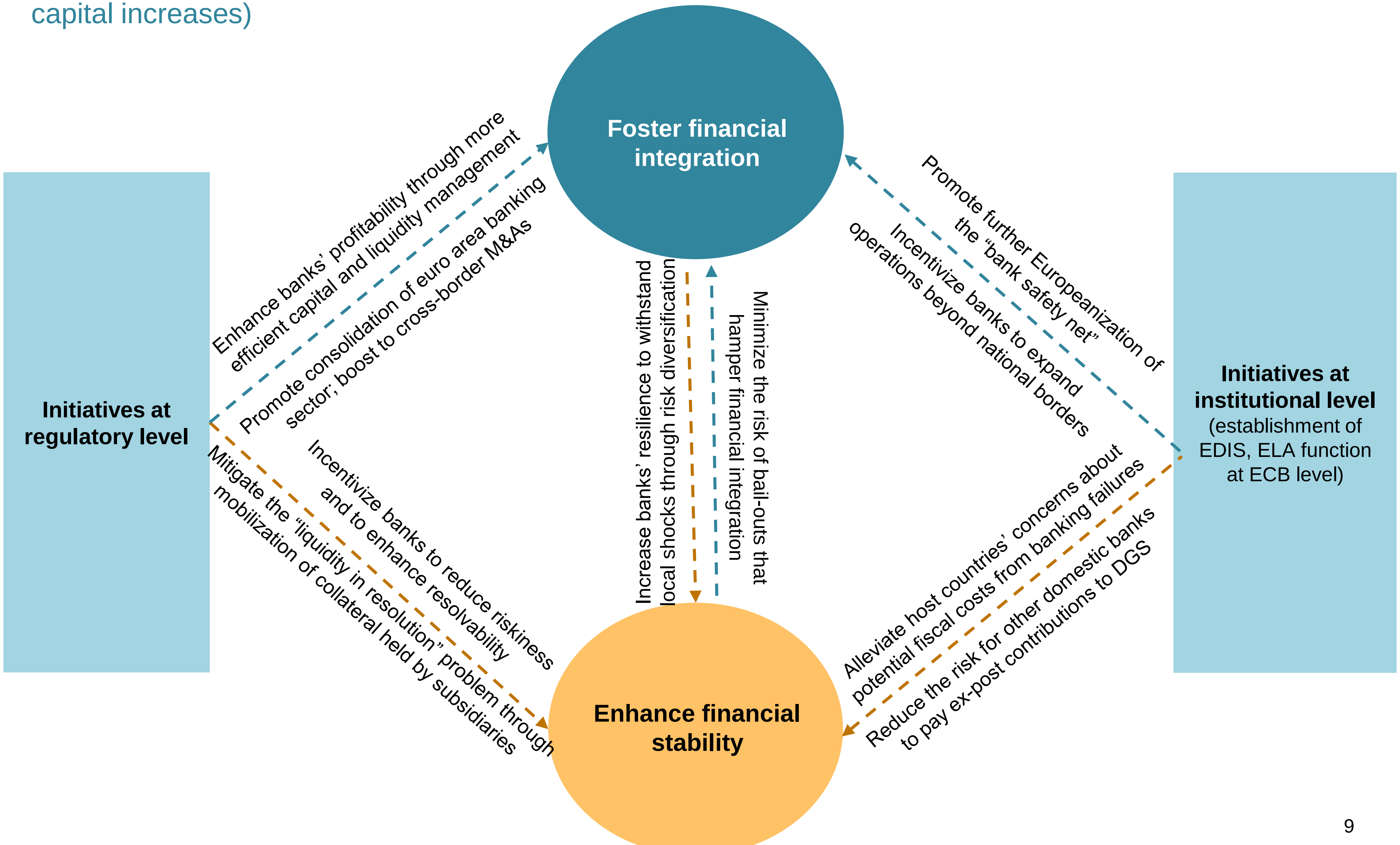
**Write-down/conversion of MREL-eligible instruments / Resolution**

**Option 1**: Write-down and/or conversion of MREL-eligible instruments issued to the parent entity

**Option 2**: Entry into resolution and exercise of write-down and/or conversion powers to MREL-eligible instruments issued to the parent entity and other liabilities to third parties

# Proposed initiatives promote both financial integration and financial stability

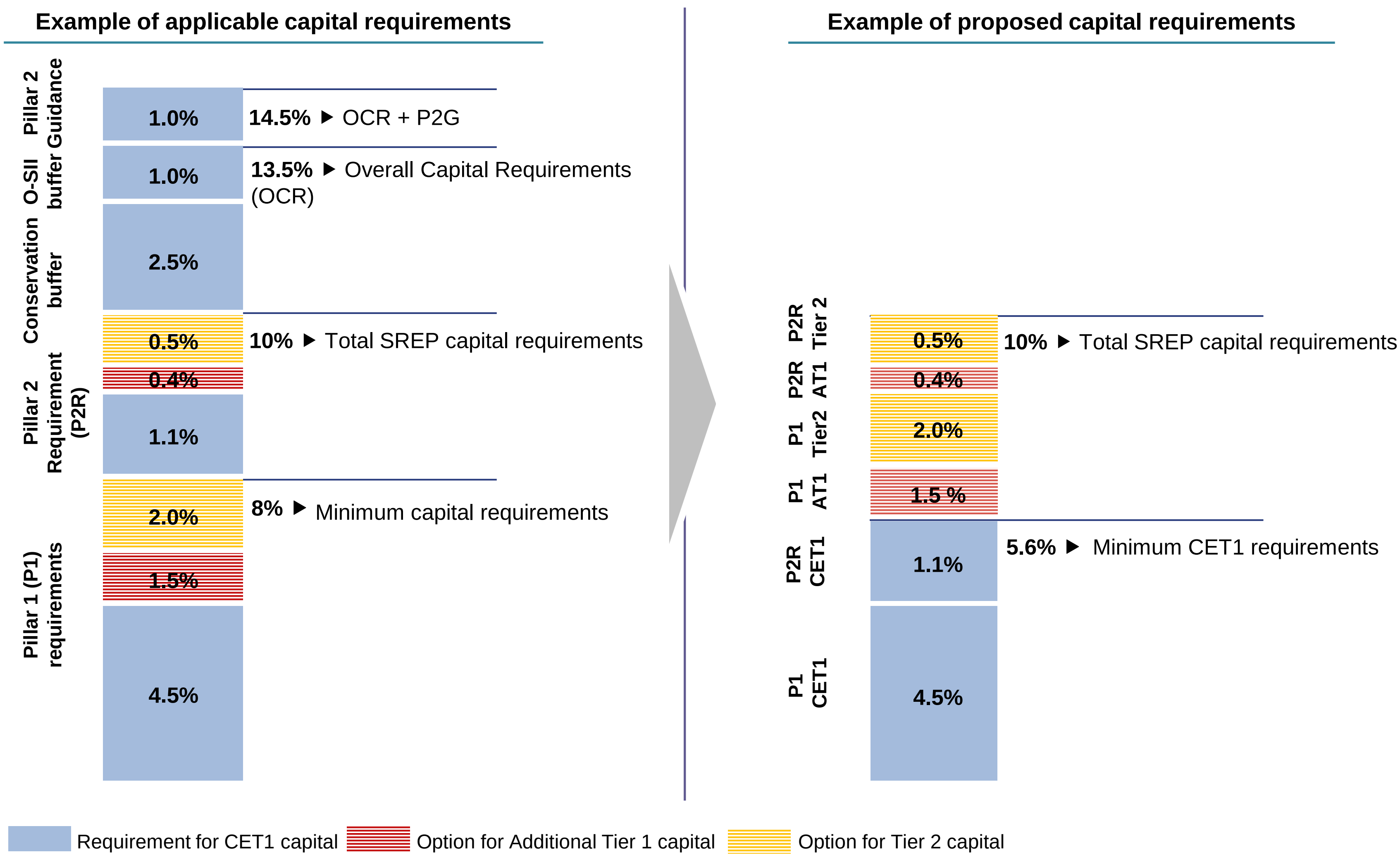
Banks would be incentivized to proceed to more cross-border M&As to achieve economies of scale resulting in increased profitability; proposed measures could contribute to addressing the COVID-19 impact along with system-wide or bank-specific initiatives (e.g. Asset Management Companies, share capital increases)



# Appendix

# Reduced capital requirements for subsidiaries

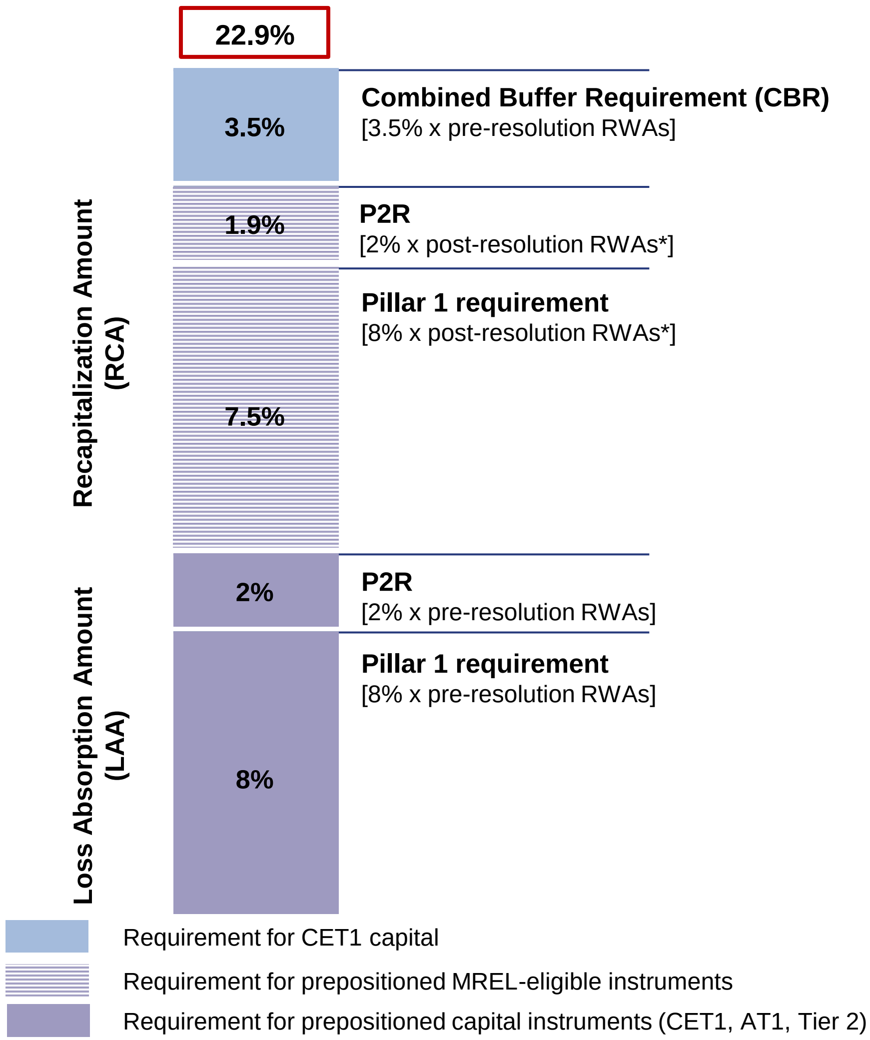
## Under the proposed framework, capital requirements for subsidiaries would consist solely of Pillar 1 and Pillar 2 requirements; capital buffers and P2G should apply only at consolidated level



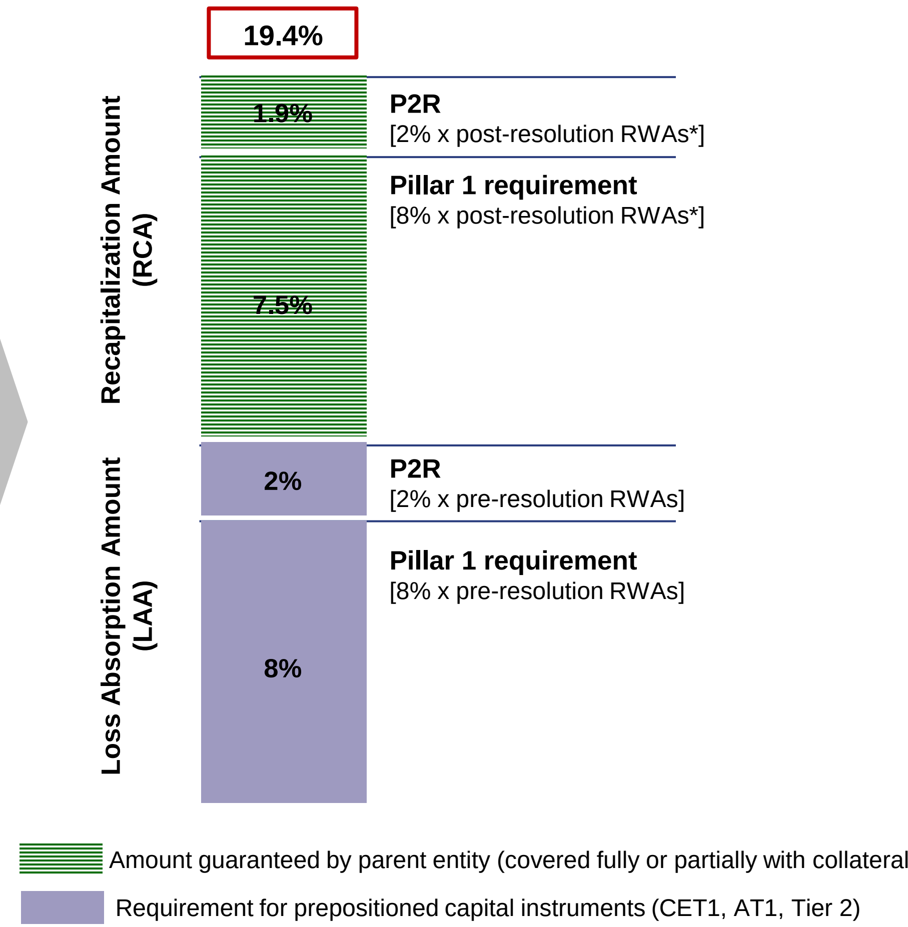
# Reduced internal MREL for subsidiaries

## Subsidiaries should meet a reduced portion of internal MREL with prepositioned MREL-eligible instruments; Recapitalization Amount should be covered (partially) with collateralized guarantees

**Example of applicable internal MREL target (incl. CBR)**




**Example of proposed internal MREL target**




***** The Loss Absorption Amount is calculated based on the pre-resolution RWAs, while the Recapitalization Amount is calculated based on the (reduced) post-resolution RWAs due to balance sheet depletion. Assuming a RW density of 60%, the post-resolution RWAs stand at the level of 94% of the pre-resolution RWAs