

A. Introduction

Deutsche Börse Group (DBG) welcomes the opportunity to comment on EBA's Consultation Paper "Interim Report on MREL – Report on implementation and design of the MREL framework" issued on 19 July 2016.

DBG is operating in the area of financial markets along the complete chain of trading, clearing, settlement and custody for securities, derivatives and other financial instruments and as such mainly active with regulated Financial Market Infrastructure providers.

In addition, Clearstream Banking S.A., Luxembourg, and Clearstream Banking AG, Frankfurt/Main, who act as (I)CSD¹ as well as Eurex Clearing AG as the leading European Central Counterparty (CCP), are also credit institutions in the sense of directive 2013/36/EU (CRD IV) and regulation (EU) No. 575/2013 (CRR). Furthermore, the Clearstream subgroup is supervised on a consolidated level as a financial holding group. Consequently, the Banking Recovery and Resolution Directive (Directive 2014/59/EU, BRRD) also applies to those entities.

In the context of the BRRD, it is important to be noted that both CSDs and CCPs are regulated primarily under the rules for financial market infrastructures such as Regulation (EU) No. 648/2012 (EMIR) as well as (in the future) Regulation (EU) No. 909/2014 (CSD-Regulation; CSD-R) which implement the CPSS-IOSCO principles for financial market infrastructures² in the EU. The banking services both kinds of FMIs are offering (as in the case of our group's entities) are only ancillary to their functions as intermediaries to stabilise the financial markets. Cash positions resulting from its FMI operations dominate the balance sheet and these are mainly driven by short-term cash liabilities. These are received cash collaterals (margins), cash contributions to the default funds, other cash deposits out of the CCP business and (for the

¹ (International) Central Securities Depository

² CPSS-IOSCO No 101 – Principles for financial market infrastructures, published in April 2012;

CSD business) cash deposits for settlement or custody purposes respectively. All cash liabilities towards clients are in principle short-term. The only mid-term liabilities may be commercial papers issued to improve short to medium-term liquidity. There are currently no long-term debt positions and there is no need for long term debt financing.

The balance sheets of our group entities are highly volatile depending on the cash amount placed by clients / clearing members with our group entities whereas the capital requirements due to investments with very low level of credit and market risk are fluctuating – despite the above mentioned volatile balance sheet total – only marginally.

Capital requirements for CCPs and CSDs in question are mainly driven by capital charges for operational risk or additional capital charges for business risk and winding down / restructuring (see Article 16 EMIR and commission delegated regulation (EU) No. 152/2013 as well as Article 47 CSD-R and the final draft regulatory technical standard on certain prudential requirements for central securities depositories³). In line with the EMIR and CSD-R rules based on the CPSS-IOSCO principles for financial market infrastructures the potential credit and market risk is very limited and in general even the ancillary "banking" activities of CSDs (but in general by a matter of fact also CCPs) are restricted to short-term business in combination with their business model and based on the respective regulations (e.g. Article 54 CSD-R). CCPs and CSDs are forced to maintain their liquidity position with short-term maturities.

This paper consists of general comments (part B) and responses to the stated questions (part C).

³ See <https://www.eba.europa.eu/documents/10180/1311085/EBA-RTS-2015-10+Final+draft+RTS+on+CSDs.pdf>

B. General comments

I. Non-Application of MREL on FMI's operating with a banking licence

Although the draft EBA opinion and the respective consultation of certain aspects is only related to the implementation of MREL requirements for credit institutions based on its mandate out of BRRD, we do want to point out that **the application of MREL or any similar concept to FMI's like CCPs or CSDs either on their own in the future or due to the fact of offering banking services ancillary to their main activity seems not to be appropriate.**

For CCPs the concept does not take into account that the default waterfall already is a mechanism to take care of or better even avoid losses from counterparties default and limits (or even avoids) losses for the CCP (and its clearing members and their clients). To supplement the multiple lines of defence with an additional safeguard like MREL will counteract the whole function of a CCP. This nevertheless does not prohibit the setting of adequate levels of capital for CCPs which currently include via Article 16 EMIR and the related level 2 text already charges to allow for orderly winding down or restructuring. MREL in combination with the rules laid down in Article 45 (1) BRRD does not fit to the CCP business at all. Similar arguments are true for CSDs where cash deposits are held in order to fulfil settlement obligations and to secure settlement finality. For CSDs as well dedicated rules to cover cost of winding down or restructuring in the capital requirements (see Article 47 CSD-R as well as the final draft regulatory technical standard on certain prudential requirements for central securities depositories) are by far the better way than the MREL framework in its entirety. Even for settlement institutions under Article 54 (2) lit. b CSD-R, MREL should not be applicable on top of CSD-R requirements.⁴

The EBA should consider this aspect in its report back to the EU Commission.

⁴ This is true for all following arguments on CSDs. For the sake of clarity of this paper, this is not stated below again.

II. Reference base for MREL requirements

We clearly support the proposed move of the reference base from its current set up to RWAs in the sense of total risk exposure (including capital charge for operational, market and other risk categories).

However, EBA should also clarify the reference point from which these RWAs should be taken. In our view, the RWAs should be taken always from the **current risk position as of reporting date** and no assumptions should be made on how RWAs may look like in case a recovery or resolution event may occur. As such, we urge the EBA to clarify this aspect in its final recommendations.

This in our view would align the MREL concept even further towards the TLAC concept of FSB.

By doing so, only the absolute level of required MREL is to be estimated and fixed to reflect the needed coverage for resolution and a two tier estimation process (first: estimate the portion of RWAs to be maintained in resolution and secondly define the MREL level for that portion) could be avoided. Furthermore, in the dynamic set up as implemented with TLAC and proposed by EBA (and supported by us) the first step would have to be done dynamically more or less every day which seems not to be feasible, reasonable and suitable.

III. Leverage ratio as backstop clearly rejected – especially for FMIs

We clearly **reject making the leverage ratio a second alternative** for the calculation of MREL, especially following a "higher of" approach. We already oppose the introduction of a binding minimum Leverage Ratio in the capital regime in general but moreover especially when imposed on FMIs.

The business model of FMIs is in general risk averse which is a natural consequence of their limited activity and their crucial role for the financial markets.

The regulatory framework has taken up this and put harmonised rules around that. This is true both on an EU level (EMIR, CSD-R) as on an International level (CPSS-IOSCO principles). In line with this CCPs and CSDs in the EU (also those with a banking license) are strictly limited in their ability to invest cash (see Article 47 EMIR and Article 46 CSD-R). Investments are only allowed with very low levels of market and credit risk. Resulting capital requirements in the solvency regime are therefore only minor. However, due to the business activities and market conditions it cannot be prevented that cash deposits are placed by clients late in the evening or liquidity is needed on short notice to settle business. For these un-predictable situations already CRD II (Directive 2009/111/EC) introduced a dedicated treatment with regards to the large exposures regime (now Article 390 (6) lit. c CRR). Furthermore, **own funds requirements of FMIs are in particular driven by operational risks which do not correlate with the balance sheet volume**. In combination with the low risk investments and the operational risk being the main driver for capital requirements, **such late fluctuations make it even more inadequate to link MREL requirements for FMIs** to the current amount of total assets or liabilities.

In case, EBA or the EU Commission are not following our proposal to exclude FMIs with or without an additional banking license from the applicability of MREL completely, at least the application of the Leverage Ratio as a basis for MREL should be excluded. Alternatively, at least for the purpose of MREL, adjustments to the exposure measure for that purpose must be made.⁵

We see options in the BRRD itself which could be used in order to reflect better the dedicated business of FMIs in this case. In line with Article 45 (6) lit. d BRRD the refinancing structure and risk profile could be taken into account and liabilities of a securities settlement system or operators of securities settlement systems in the sense of Directive 98/26/EC towards its participants resulting from their participation in that securities settlement system with a remaining maturity of less than 7 days could be deducted from the basis of

⁵ Using a similar approach than that of CRD II as mentioned above for dedicated business

Leverage Ratio at least for the purpose of MREL. This would mirror consequently Article 44 (2) lit. f BRRD and reflect - limited to liabilities resulting from their infrastructure role - the crucial role of FMIs being also credit institutions and therefore in scope of BRRD. It is to be noted that this should include any kind of cash collateral which is placed with a notice period of 6 days or less (including immediate call possibility) in case such collateral can be replaced e.g. by securities any time or be withdrawn as the consequence of over-collateralisation or reduced risk.

More broadly in the context of defining MREL requirements when not knowing which portion of the balance sheet may remain after resolution a Leverage Ratio in our view makes even less sense than already under the capital framework. **As such, MREL requirements based on a (dynamic) Leverage Ratio should only be set by the resolution authority in exceptional cases as a pillar II add on but should not be made a mandatory basis.** At least for FMIs such a basis for MREL (if applied at all) should be excluded.

IV. Contingent sources of loss absorbing capacity

The concept of MREL so far only takes into account paid-in resources. Contrary to that, we continue to believe that certain contingent sources of loss absorbing capacity should at least to some extent be considered as MREL fulfilling capacity as they may be used to cover losses or increase capital. Such contingent sources included i.a. a) agreement on loss compensation, b) guarantees, c) partially paid shares with the obligation to pay-in in full, d) comfort letter and e) additional funding obligations.

In our view they should be included in either reducing the MREL requirements for loss absorption (e.g. agreement of loss compensation, guarantees or comfort letter) or increase the MREL holding (e.g. partially paid in shares with the obligation to pay-in in full, additional funding obligation). This should at least be given to the discretion of the resolution authorities. While we clearly see the different quality of already paid-in funds compared to contractually com-

mitted but unpaid obligations, a potential failure to fulfil these obligations should not be taken for granted in advance. In order to cover the potential failure to fulfil the commitment appropriate caps to such commitments may be introduced or only a portion may be taken into account. In combination with the partially unlimited amount of general commitments caps could be:

- a. Guarantees with a percentage of the committed amount;
- b. Percentage of required MREL;
- c. Percentage of total risk exposure amount.

V. Alternative MREL proposal

Beside our strong recommendation to exclude FMIs from the applicability of MREL and not to use the Leverage Ratio for MREL purposes at all and based on our general support to link the MREL requirements dynamically to the current RWAs we have developed a proposal how the individual MREL calculation could be derived prior to possible individual adjustments. We have already shared this proposal with EBA during a prior consultation⁶ but do want to repeat it here as follows taking the FSB TLAC term sheet into account:

As basis for the determination of the minimum MREL requirements we propose 8% of the total risk exposures in accordance with the CRR which will be multiplied with two additional coefficients:

- α (alpha) in a range of 1 to 2 to cover sufficient risks to avoid resolution and make it feasible in case need be and
- β in a range of 1 to x (at least 1.125) as dedicated risk / G-SIB mark up⁷.

⁶ Deutsche Börse Group response to EBA/CP/2014/41 - Draft Regulatory Technical Standards on criteria for determining the minimum requirement for own funds and eligible liabilities under Directive 2014/59/EU:
http://www.eba.europa.eu/documents/ddm/com.liferay.portlet.dynamicdatalists.model.DDLRecord/993682/view_uploadFiles

⁷ The range for α gives the resolution authority the option to have MREL requirements to a maximum twice as much as the capital minimum in order to allow for full recapitalisation and it can be set to 1 in case resolution of any part of the institution is not deemed appropriate. β needs to be set at least to 1.125 to reach (after phase-in in 2022) the minimum of 18 % as set in the FSB TLAC term sheet for G-

Two assumptions have to be fulfilled:

- α will be set to 2 for G-SIBs and
- β will have to be at least 1.125 for G-SIBs.

On top of that capital buffers must be added.

The resulting percentage of minimum MREL is based on total risk exposures (RWAs) and can easily be calculated on every point in time.

In addition agreements like loss-absorption contracts, parental guarantees and reserve liabilities as well as bail-in-able liabilities which are not eligible liabilities⁸ have to be considered in an appropriate manner calibrating the additional capital requirement. Relevant authorities should be in the position to take such agreements into account (even if relevant authorities would determine a haircut for each one of these).

Any limited commitment should be included in the basis of available eligible liabilities and any unlimited commitments (e.g. loss absorption agreements) should be included as reducing the required MREL (e.g. to calibrate the α - and β -coefficients).

SIBs. The maximum value need to be determined by EBA in order to allow for other adjustments.

⁸ Bail-in-able liabilities with a short remaining maturity continue to be bail-in-able although they will not count as eligible liabilities for MREL purposes. This in our view falls short the real refunding capacities.

C. Responses to the questions for consultation and remarks on the provisional recommendations

In the following we comment the provisional recommendations and answer raised questions:

1. Reference base for MREL requirement (denominator):

We indeed agree to the EBA's provisional view that the MREL reference base should be changed to **current** RWAs. By this change the concept of risk sensitivity is strengthened. Nevertheless we disagree to the accompanied leverage ratio requirement as backstops as the leverage ratio is not a meaningful ratio in general and more precisely in the MREL context (see above). This is true in particular for FMIs operating with a banking licence.

2. Relationship with regulatory requirements:

We clearly agree to the EBA proposal to add the regulatory capital buffers on top of MREL.

We further support the intended careful consideration of the interaction of MREL with income distribution and the SREP.

3. Breach of MREL:

No comment.

4. Adequacy and calibration:

We support the intention to incorporate the business model into the calibration of MREL requirements. As stated in section B, FMIs should not be subject to MREL and if so, no leverage ratio should be applied as a basis (for further details see above). As we oppose a fixed generic pillar 1 minimum but rather ask for an individual one for all non G-SIBs (see our alternative proposal above), there should only be one unique MREL requirement based on a well calibrated α and β . As such, no "higher of" would apply.

5. Eligibility:

We in general support the need to have a clear disclosure of the liabilities hierarchy.

The EBA invites stakeholders to comment on the appropriate scope of any subordination requirements. More precisely stakeholders are invited to comment on what the highest priority information and disclosure needs are, in the three areas of i) disclosure of bank balance sheet structures; ii) disclosure of banks' MREL requirements and iii) availability of standardised information on statutory creditor hierarchies.

As we feel that MREL should not be imposed on FMIs, we do not comment in detail on the information to be disclosed. General information on the rank should be available and clear information should be given in case of issued debt instruments (prospectus). Furthermore, liabilities being eligible for MREL should be shown per balance sheet line as a thereof category. The MREL requirements and its fulfilment should be stated in the notes to the financial statements (in line with IAS 1) or the pillar III disclosure report (either or, no double disclosure, we prefer statutory accounts).

The use of the terminology “subordination” and the concrete implementation of subordination need to be carefully aligned with the criteria for central bank eligibility. It needs to be secured that debt instruments issued by banks are in general still eligible as collateral at the central banks (without interfering into the autonomy of Central Banks) and that ruling out central bank eligibility is not further increasing the cost of funding.

6. Third country recognition:

The EBA invites stakeholders' to comment on the practical difficulties faced in implementing the recognition clauses, specifically in the field of MREL, and on alternative approaches to improve the regime without creating incentives to evade the scope of bail-in.

Credit institutions with dedicated deposit driven business like many retail banks but also FMIs are in general not in a position to issue bail-in able liabilities and are not issuing MREL eligible debt instruments. While this needs to be taken into account when deciding on the applicability of MREL to FMIs as well as when calibrating the MREL requirements, this leads to the fact that such institutions are not faced with the problems concerned under the third country recognition requirements.

We nevertheless agree that there is need to address practical difficulties and reduce the burden in this field. We support the proposal to introduce additional exemptions from the requirement for certain classes of liabilities, which should include, inter alia, liabilities to financial market infrastructures. In particular, the application of Article 55 of the BRRD to liabilities vis-à-vis third county CCPs contradicts the function of a CCP to assure the safety and integrity of markets.

We hope our comments are seen as a useful contribution to the discussion and final issuance on the respective guideline is reflecting our comments made.

Eschborn

29 August 2016

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