

Amendments to the Capital Requirements Regulation in the area of resolution ('daisy chain' proposal)

OVERVIEW

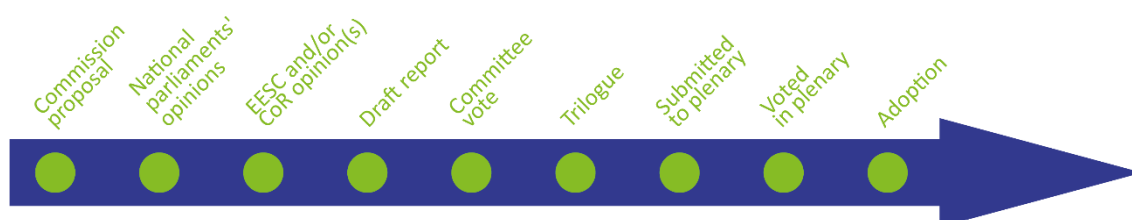
On 27 October 2021, the Commission tabled a regulation amending the Capital Requirements Regulation (CRR) and the Banking Resolution and Recovery Directive (BRRD) with a view to resolving inconsistencies regarding the internal minimum requirements for own funds and eligible liabilities (iMREL). The iMREL are indirectly channelled through a number of intermediate parents up to the resolution entity of the group, in a process also known as a 'daisy chain'.

In its negotiating position adopted in February 2022, Parliament supported the proposal suggesting some changes. The provisional agreement resulting from interinstitutional negotiations adds provisions for a framed review that takes into account the different types of banking group structure. Parliament adopted the agreement on 13 September 2022, and the final act was published in the Official Journal on 25 October 2022.

Regulation amending Regulation (EU) No 575/2013 and Directive 2014/59/EU as regards the prudential treatment of global systemically important institution groups with a multiple point of entry resolution strategy and a methodology for the indirect subscription of instruments eligible for meeting the minimum requirement for own funds and eligible liabilities

<i>Committee responsible:</i>	Economic and Monetary Policy (ECON)	COM(2021)0665
<i>Rapporteur:</i>	Jonás Fernández (S&D, Spain)	27.10.2021
<i>Shadow rapporteurs:</i>	Othmar Karas (EPP, Austria)	2021/0343(COD)
	Linea Søgaaard Lidell (Renew, Denmark)	Ordinary legislative
	Ernest Urtasun (Greens/EFA, Spain)	procedure (COD)
	Marco Zanni (ID, Italy)	(Parliament and Council
	Raffaele Fitto (ECR, Italy)	on equal footing –
	Martin Schirdewan (The Left, Germany)	formerly 'co-decision')

Procedure completed. Regulation (EU) 2022/2036
[OJ L 275/1, 25.10.2022, pp. 1–10](#)

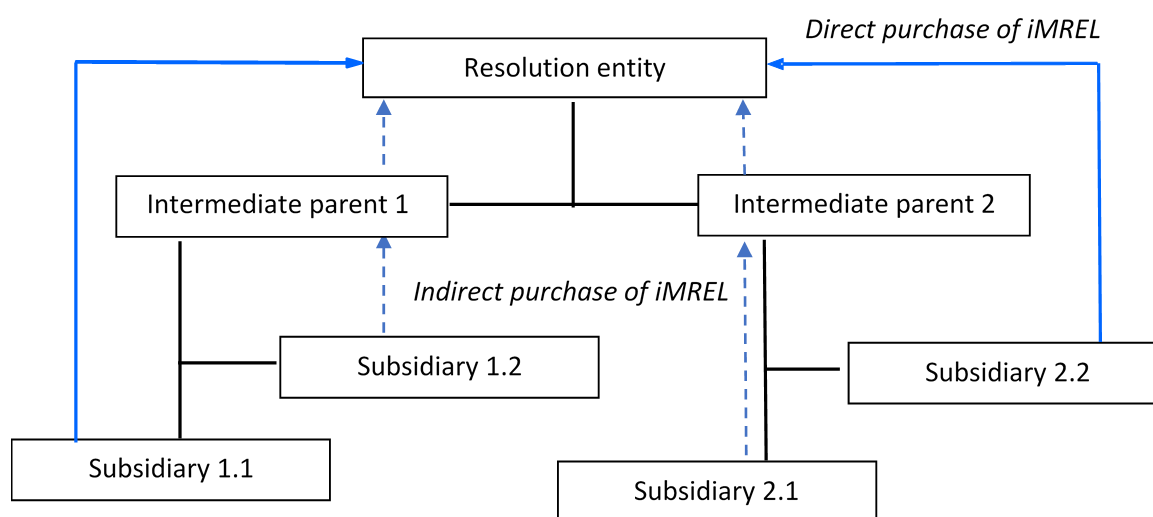


Introduction

The regulatory framework on bank resolution¹ relies on the prudential capital regulation framework set out in the Capital Requirements Directive (**CRD**, [Directive 2013/36/EU](#)) and the Capital Requirements Regulation (**CRR**, [Regulation 575/2013](#)), as well as on the Bank Recovery and Resolution Directive (**BRRD**, [Directive 2014/59/EU](#)) which sets out arrangements to deal with banks in financial distress. The prudential capital requirements follow the international regulatory standards agreed within the [Basel Committee on Banking Supervision \(BCBS\)](#),² in particular the [Basel III](#) agreement, signed in the aftermath of the 2008 financial crisis, and the '[Basel III finalisation](#)' (2017). The EU [amended](#) the legislation in 2019 (in force since 28 December 2020) to implement the principles of total loss-absorbing capacity (**TLAC**) endorsed by the Group of Twenty ([G-20](#)) in 2015. The TLAC standard requires global systemically important institutions (**G-SII**)³ to hold a minimum amount of liabilities that ensure smooth and fast absorption of losses if they are placed in resolution. The amendments also enhanced application of the minimum requirement for own funds and eligible liabilities (**MREL**) for all institutions established in the EU.

On 27 October 2021, the European Commission presented a [proposal](#) – based on [Article 114 of the Treaty on the Functioning of the European Union \(TFEU\)](#) – that would amend the CRR and the BRRD as regards the prudential treatment of G-SIIs. The objective of the proposal was to address the multiple point of entry (**MPE**) resolution strategy of G-SIIs and a methodology for the indirect subscription of instruments eligible for meeting the minimum requirement for own funds and eligible liabilities (**iMREL**) – also known as the 'daisy chain'.

Figure 1 – The resolution group and iMREL



Source: Author.

Existing situation and issues raised

The EU legislative framework on bank resolution relies on the core principle that the banks' shareholders and creditors contribute through a 'bail-in' mechanism. In practice, banks must demonstrate that their assets are adequately financed by 'loss-absorbing and recapitalisation capacity', which are funds made available in the event of resolution. The bank must also validate a resolution plan to guarantee orderly resolution workouts that would minimise the impact of the bank's failure on the rest of the financial system and safeguard its stability, ensure the continuity of the critical activities of the bank, and avoid the use of public financial support.

As outlined in Figure 1, under the MPE resolution strategy, several entities may become a 'resolution entity' and may be resolved separately. The underlying principle of the MPE resolution approach is to enable the resolution of a given resolution group in a feasible and credible way without undermining the resolution plan of other resolution entities and resolution groups in the same banking group.

BRRD [Article 45f\(6\)](#) provides the EBA with the mandate to develop regulatory technical standard (RTS) to establish the methods to ensure that iMREL does not prevent smooth implementation of the resolution strategy. The method consists of 'a deduction regime or an equivalently robust approach'. In July 2020, the EBA launched a [public consultation](#) on the methodology used for the calculation of TLACs. The [outcome](#) highlighted a number of inconsistencies of the requirements. The EBA noted that the CRR did not allow for the deduction of iMREL and similar issues were identified in the area of the CRR leverage ratio requirement. Some issues were also identified in relation to the regulatory treatment of G-SIIs with an MPE resolution strategy. For instance, the CRR currently does not specify whether the various adjustments to TLAC for G-SIIs with an MPE resolution strategy also cover those subsidiaries of a G-SII that are located in a third country. In addition, the formula for the calculation of the TLAC/MREL surplus of a subsidiary in the context of the general deduction regime applicable to G-SIIs with an MPE resolution strategy does not take into account the non-risked-based TLAC/MREL. Moreover, the consultation pointed out at contradictions between texts.

Preparation of the proposal

There was no impact assessment accompanying the proposal as it was a technical proposal aimed at clarifying the CRR and the BRRD. Moreover, preparation relied on the preparatory work conducted by the EBA.

The changes the proposal would bring

The purpose of the proposal was to amend the CRR and BRRD in order to effectively manage the resolution framework, already envisaged by the 2019 banking package:

- incorporation of a dedicated treatment for iMREL, with the harmonisation of the prudential treatment;
- further alignment of the treatment of G-SIIs with an MPE resolution strategy with the treatment outlined in the FSB TLAC standard;
- clarification of the eligibility of instruments in the context of the internal TLAC.

The proposed changes [included](#):

- introduction in the CRR of a dedicated prudential treatment relating to the iMREL;
- clarification of the CRR provisions relating to the sum of the effective TLAC requirements of all resolution groups within a G-SII group with an MPE resolution strategy, and its comparison with the theoretical SPE requirement of that G-SII group;
- modification of the formula for the calculation of the TLAC/MREL surplus of a subsidiary in the context of the general deduction regime applicable to G-SIIs with an MPE resolution strategy in line with the TLAC standard;
- clarification of some CRR provisions applicable to G-SIIs with an MPE resolution strategy to control for third-country subsidiaries;
- targeted clarifications in the context of the requirement for own funds and eligible liabilities for institutions that are material subsidiaries of non-EU G-SIIs ('internal TLAC') are needed to ensure that debt instruments issued by those institutions meet all eligibility criteria for eligible liabilities instruments.

Advisory committees

In its [opinion](#) of 8 December 2021, the European Economic and Social Committee ([EESC](#)) supported the initiative to incorporate directly within the CRR a dedicated prudential treatment relating to the indirect subscription of instruments eligible for internal MREL, that would address the identified inconsistencies between the CRR and the BRRD. It also recommended clearer CRR provisions on the comparison between the sum of the actual TLAC requirements of all the resolution groups within a G-SII group with an MPE resolution strategy with the theoretical SPE requirement of that G-SII group. It was also necessary to amend the formula for the calculation of the TLAC/MREL surplus of a subsidiary in the context of the general deduction regime applicable to G-SIIs with an MPE resolution strategy, to ensure that the TLAC/MREL surplus of a given subsidiary is not over-estimated. It also drew attention to the fact that some CRR provisions applicable to G-SIIs with an MPE resolution strategy should be clarified to allow for consideration of subsidiaries established outside the EU and/or where TLAC is applicable at a later stage.

According to the EESC, this would align the CRR with the corresponding TLAC principle agreed internationally, which is applicable with respect to subsidiaries established in all Financial Stability Board (FSB) jurisdictions. Finally, it recommended some targeted clarifications in the context of the requirement for own funds and eligible liabilities for institutions that are material subsidiaries of non-EU G-SIIs ('internal TLAC'), in order to ensure that debt instruments issued by those institutions meet all eligibility criteria for eligible liabilities instruments.

National parliaments

The deadline for the [submission of reasoned opinions](#) on the grounds of subsidiarity was 7 February 2022. No subsidiarity concerns were raised.

Parliament's starting position

During the previous legislative term (2014-2019), in 2016, the Commission [tabled](#) a proposal to revise the MREL and implement TLAC principles with a view to implementing the international TLAC standards and integrating the TLAC requirement into the general MREL rules, avoiding duplication by applying two parallel requirements published by the FSB. Parliament's [amending](#) text [underlined](#) that the objective of the TLAC standard was to ensure that G-SIIs in the EU framework, have sufficient loss-absorbing and recapitalisation capacity so that in cases of resolution, those institutions can continue to perform critical functions without using taxpayers' funds, or jeopardising financial stability.

Legislative process and final text

On 28 October 2021, the Commission tabled its proposal, based on [Article 114 TFEU](#).

In its [opinion](#) of 13 January 2022 on the amending regulation, delivered on request of the Council and the European Parliament, the European Central Bank ([ECB](#)) acknowledged that the proposed regulation consisted of technical adjustments aimed at making legislative decisions implemented by the latest amendments to Directive 2014/59/EU (BRRD) operational, and supported the proposed regulation, which would ensure better alignment between the provisions of the CRR and those of the BRRD, following the entry into force of the revised framework on TLAC and the MREL. In addition, the proposed regulation would ensure better alignment of the regulatory treatment of G-SIIs with an MPE resolution strategy, including groups with subsidiaries registered in third countries, with the treatment outlined in the TLAC standard.

The ECB recommended to specifying that the local resolution regime of a third country to which a subsidiarity is subject should be aligned with the standards set out in the Financial Stability Board's 'Key attributes of effective resolution regimes for financial institutions' and that the TLAC standard approach is applicable to the third-country subsidiaries of an G-SII, when those subsidiaries are

subject to a local resolution regime equivalent to internationally agreed standards 'more specifically'.

The ECB also recommended monitoring and assessing the interplay between the BRRD and the CRR, to avoid G-SIIs engaging in regulatory arbitrage between SPE and MPE resolution strategies based on the minimum requirement for own funds and eligible liabilities or TLAC target levels.

In October 2021, Parliament's Committee on Economic and Monetary Affairs (ECON) appointed Jonás Fernández (S&D, Spain) as rapporteur,⁴ and his draft report was presented on 16 December 2021. ECON adopted the [final report](#) on 2 February 2022, and the Committee decision to enter into interinstitutional negotiations was confirmed by plenary on 16 February. The [Council](#) negotiating mandate was endorsed on 21 December 2021. Interinstitutional negotiations between Parliament and the Council started on 31 March 2022 and ended on 28 April 2022. The text was [adopted at first reading](#) in plenary on 13 September 2022, and then subsequently by the Council. [Published](#) in the Official Journal on 19 October 2022, it took effect on 14 November 2022.

The agreement resulting from the interinstitutional negotiations

The [final text](#) resulting from the interinstitutional negotiations further ensures that the loss absorption and recapitalisation of financial institutions occurs through private means when they are placed in resolution. It incorporates a dedicated treatment for iMREL and further aligns the treatment of G-SIIs with an MPE resolution strategy with the treatment outlined in the FSB 'TLAC standard'. It also clarifies the eligibility of instruments in the context of internal TLAC.

An agreement was reached on divergences, namely the deduction regime for iMREL and the treatment of G-SIIs with an MPE resolution strategy. The deduction regime is expected to avoid double-counting of iMREL and maintain effective TLAC in line with disclosed MREL.

In addition, a review clause is added to take into account the impact on different types of banking group structures. This will be assessed by the Commission. The treatment of G-SIIs with an MPE resolution strategy is better aligned with the regime defined by TLAC international standards and takes into account third-country entities within such groups.

EUROPEAN PARLIAMENT SUPPORTING ANALYSIS

Christie R. and Grzegorzczuk, M., [Don't let up: The EU needs to maintain high standards for its banking sector as the European economy emerges from the Covid-19 pandemic](#), in-depth analysis for the ECON committee, Economic Governance Support Unit, DG IPOL, European Parliament, October 2021.

Mesnard B., [Loss absorbing capacity in the Banking Union: TLAC implementation and MREL review](#), Economic Governance Support Unit, DG IPOL, European Parliament, July 2016.

Stamegna C., [Amending the bank resolution framework – BRRD and SRMR](#), EPRS, European Parliament, June 2019.

OTHER SOURCES

European Parliament, [Amendments to the Capital Ratio Regulation in the area of resolution \('Daisy chain' proposal\)](#), Legislative Observatory (OEIL).

European Parliament, [Amendments to the Capital Ration Regulation in the area of resolution \('Daisy chain' proposal\)](#), Legislative Train Schedule.

ENDNOTES

- ¹ ['Bank resolution'](#) is the restructuring of a bank by a resolution authority through the use of tools aimed to safeguard the continuity of the bank's critical functions and financial stability for the public's interest, at minimal cost to taxpayers. A bank resolution occurs when authorities determine that a failing bank cannot go through normal insolvency proceedings without harming public interest and causing financial instability.
- ² The Basel Committee on Banking Supervision [sets standards](#) for the 'prudential regulation of banks' globally and provides a forum for regular cooperation on banking supervision. Its 45 members comprise central banks and bank supervisors from 28 jurisdictions. [Prudential regulation](#) of banks is a set of rules aimed to make banks, which collect savers' deposits, resilient and stable while securing their financial support for the real economy. One of the category of rules consists of ensuring that banks have sufficient capital to face financial distress.
- ³ [Systemic risk](#) can be defined as 'a risk of disruption to financial services that is caused by an impairment of all or parts of the financial system and has the potential to have serious negative consequences for the real economy'.
- ⁴ Parliament appointed Fernandez rapporteur for the three legislative proposals that were part of the legislative package, namely the proposal for a directive amending the CRD (Directive 2013/36/EU) ([COM\(2021\)0663](#)), the proposal for a regulation amending the CRR (Regulation 2013/575/EU) ([COM\(2021\)0664](#)), and the present proposal for a regulation to amend the CRR in the area of resolution (the 'daisy chain' proposal).

DISCLAIMER AND COPYRIGHT

This document is prepared for, and addressed to, the Members and staff of the European Parliament as background material to assist them in their parliamentary work. The content of the document is the sole responsibility of its author(s) and any opinions expressed herein should not be taken to represent an official position of the Parliament.

Reproduction and translation for non-commercial purposes are authorised, provided the source is acknowledged and the European Parliament is given prior notice and sent a copy.

© European Union, 2022.

eprs@ep.europa.eu (contact)

www.eprs.ep.parl.union.eu (intranet)

www.europarl.europa.eu/thinktank (internet)

<http://epthinktank.eu> (blog)

First edition. The 'EU Legislation in Progress' briefings are updated at key stages throughout the legislative procedure.