AmCham EU
SPEAKING FOR AMERICAN BUSINESS IN EUROPE

Our position

AmCham EU's position on the Risk Reduction Measures

AmCham EU speaks for American companies committed to Europe on trade, investment and competitiveness issues. It aims to ensure a growth-orientated business and investment climate in Europe. AmCham EU facilitates the resolution of transatlantic issues that impact business and plays a role in creating better understanding of EU and US positions on business matters. Aggregate US investment in Europe totalled more than €2 trillion in 2016, directly supports more than 4.5 million jobs in Europe, and generates billions of euros annually in income, trade and research and development.

American Chamber of Commerce to the European Union
Speaking for American business in Europe

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Introduction

The American Chamber of Commerce to the European Union (AmCham EU) takes a keen interest in ensuring the stability of financial markets as a prerequisite to promoting economic growth and jobs in Europe. AmCham EU is supportive of European rules aimed at improving prudential requirements, recovery and resolution (risk reduction measures, hereinafter 'RRM')[1]. This paper sets out recommendations to further enhance the framework.

Our overarching objective is to ensure consistency with global standards and to avoid undue impediments in our ability to service our clients. Divergences create not only an un-level playing field, but also lead to the misallocation of capital in the financial system, to the detriment of overall growth. It is important that EU policy-makers engage fully in the global rule-making process to ensure that the agreed standards meet their needs on key issues, to enable consistent implementation.

Keeping the important transatlantic and global financial markets in mind while implementing the next iteration of prudential and resolution tools will be key to its success. While we support measures to ensure financial stability and high regulatory standards in the EU, it is crucial that transatlantic financial services activities are not constrained or complicated by divergent or inappropriate legislative developments which could discourage US investment in Europe and damage the EU's economic growth.

Intermediate parent undertaking (IPU)

The proposed EU intermediate parent undertaking (IPU) structure presents many US banks operating in the EU with a potential conflict of law, as they are currently structured. These banks are subject to US structural requirements and limitations which severely restrict the markets activities that can be conducted within the same corporate ownership chain that also includes entities holding federally insured deposits.

If enacted as outlined in Article 21b of the Commission's November 2016 Capital Requirements Directive V (CRD V) text, the single IPU proposal would force common ownership of US banks' capital markets and banking businesses inside the EU, leading to materially negative outcomes wherever the IPU sits within the group structure. US banks would have to either withdraw from parts of their capital markets business, which would hinder Capital Markets Union (CMU) objectives, or from parts of their banking business, significantly limiting their ability to service European customers. Ultimately, the proposal may lead to US banks becoming uncompetitive and potentially withdrawing from the provision of dollar funding to EU corporates.

However, we understand the Commission's willingness to ease the resolution and the supervision of third-country banks, as similar, yet not identical, rules exist in the US. Under the foreign banking organisation rule contained within the Dodd Frank Act, non-US firms are entitled to establish two intermediate holding companies, if one would be incompatible with their home country regulation.

Our aim is to achieve an outcome that meets the EU's supervisory and resolution objectives while enabling third-country groups to continue to provide a full range of banking and non-banking financial services in the EU in a manner that is compatible with home jurisdiction requirements.

We believe that the most effective means of achieving this outcome would be to amend Article 21b to provide third-country groups with the ability to establish a dual IPU structure as a variation on the single IPU requirement, where justified by third-country legal, regulatory or structural constraints.

We welcome the recent Council compromise text proposal from the Estonian Presidency and the ECB opinion signalling a willingness to explore solutions to this issue, both of which provide for the use of two IPUs, where home country restrictions apply.

[1] On 23 November, the Commission proposed the RRM package which included 2016/0360(COD), 2016/0361(COD), 2016/0362(COD), 2016/0363(COD) and 2016/0364(COD)

We support the draft amendment by the US banking association, The Clearing House, which we believe contains wording that meets the objectives of the EU without undermining the viability of US banks' client services in Europe.

Resolution Case for Flexibility for the IPU requirement

We believe that Article 21b creates greater complexity in resolution planning for US firms, potentially undermining the stated objectives of the measure. In resolution investment firms and credit institutions are likely to be treated differently, with investment firms wound down in a solvent scenario, whereas the credit institutions may become objects of sale.

This separability between bank and corporate chains enhances US firms' effective resolution, while maintaining critical functions and preserving financial stability. An IPU structure that reflects the split between bank and corporate chains would preserve these clean lines for resolution purposes, as well as potentially doubling the amount of internal total loss-absorbing capacity (TLAC), that these firms hold within the EU.

In addition, the imposition of a single jurisdictional IPU requirement may be viewed as an attempt to ringfence capital and therefore inadvertently undermine trust amongst regulators. This may hinder rather than help cross border regulatory cooperation, including the establishment of a credible cross border resolution regime.

Timing of IPU requirement implementation

In particular, US banking groups, like other third-country groups, will need an adequate period of time after the implementing national legislation is adopted. This will be necessary for them to carry out any necessary corporate reorganisation, obtain authorisation for any holding companies under the new law and prepare for new supervision requirements arising as a result of inclusion of an entity within a new sub-consolidated group.

To this end, we welcome the recent Council compromise text proposal from the Estonian Presidency which provides for an implementation period of four years after the date of application and we urge MEPs to support this text.

In addition, after the initial date suggested by the Estonian Presidency text, Articles 21a and 21b should provide that firms must comply with the new IPU requirements within two years of becoming subject to those requirements in the future. By way of comparison, the US rules requiring the formation of an intermediate holding company allowed firms a conformance period of up to three years.

Net stable funding ratio (NSFR)

We urge the co-legislators to carefully consider the full inclusion of the NSFR in the package at this time, given uncertainty with international implementation timelines and ensure there is adequate flexibility in the legislation to adapt to Basel developments. The Capital Requirements Regulation (CRR) proposal recognises the funding value of securities variation margining especially in the form of high quality liquid asset level 1 securities. We strongly support this treatment as it is consistent with the Liquidity Ratio rule.

Short dated secured funding transactions such as repos and reverse repos are important for the functioning of the money markets. The current treatment provides no funding value for less than six months repo with financial counterparties whereas the reverse repos with the same counterparties attract 5% stable funding requirement. This would result in significantly higher costs for market making in government bonds.

Calibration of the elements proposed by the Commission should be assessed. We support the introduction of a mechanism for recognising normal-course hedging practices related to equity transactions.

We also ask the co-legislators to consider the Basel Committee's recent statement[2] that a 20% add-on for future derivatives funding risks is not accurately calibrated to measure true funding risks. We support the Basel

[2] Basel Committee on Banking Supervision (BCBS), Implementation of net stable funding ratio and treatment of derivative liabilities. Available here: https://www.bis.org/press/p171006.htm

Committee proposal of lowering the derivatives add-on to 5% of gross derivatives liabilities without any sunset clause. The standardised approach for measuring exposure for counterparty credit risk (SA-CCR) based measure, in its current form, is very complex and not appropriate for liquidity purposes. There should be no sunset clause which will revert the add-on back to 20%. We believe this will increase uncertainty in the derivatives markets and would increase costs for market participants.

In order to avoid differential adoption amongst the major financial markets, we would encourage coordination amongst EU and other national regulators to introduce similar calibration, subject to a Basel review. The delegated act in the current legislation could be used to reflect any recalibration by the Basel Committee. We support removing the asymmetry between treatment of repo and reverse repos and reductions in stable funding requirement. In addition, the stable funding requirement for equity inventory held as hedge should be reduced.

Fundamental review of the trading book (FRTB)

We continue to have significant concerns regarding the calibration of the FRTB framework but it is important that this is addressed at Basel to avoid fragmentation of capital markets. If a flexible approach to implementing FRTB at EU level is taken, then the ongoing Basel work can be integrated into the EU work more smoothly once it has been finalised. We are encouraged by the EU's proposal to adopt a phased-in calibration to allow for ongoing work at Basel, but ultimately any desired re-calibration should be done at Basel level rather than EU level to avoid fragmentation of capital markets.

The FRTB framework should be implemented in full accordance with the final Basel standard, but should retain enough flexibility on the implementation front to allow for amendments taking into account further work at Basel on key aspects such as profit and loss (P&L) attribution and non-modellable risk factors.

Large exposures

Large exposure rules as proposed by the Commission could impact banks' ability to operate across borders and to allocate resources efficiently. We are concerned that limitations on intragroup exposures may create barriers to the free flow of funds within groups, which would lead to fragmentation. We also believe that this runs counter to the CMU initiative.

We would like for the co-legislators to propose calibration in a manner that is consistent with the aims of CMU, specifically assessing the treatment of intragroup exposures and other intragroup transactions and flows. Retaining the use of internal models for computing counterparty exposures could also mitigate fragmentation. Firms should be allowed to use internal models for derivatives pending a European Banking Authority (EBA) review on the impact of the SA-CCR. Internal models should be allowed for repo transactions pending new Basel 4 changes.

Leverage ratio

The EU's leverage ratio proposal was published prior to the final Basel standard being released. We ask the Commission and the co-legislators to incorporate all the components which have not yet been addressed in the package. For global systemically important banks (G-SIBs), the adoption of Basel's leverage ratio is essential to address level-playing field concerns for international banks. Cross-border intragroup transactions – which global banks use to manage risk – should not contribute to leverage ratio as much as third-party transactions.

Standardised approach for measuring exposure for counterparty credit risk (SA-CCR)

The SA-CCR framework should be implemented in full accordance with the final Basel standard. We support the Commission's current faithful adoption in the RRM. The EU should adopt a cautious approach to the use of SA-CCR until Basel has undertaken its planned review. If SA-CCR were to be implemented without modification, it

could have a negative impact on the derivatives market and impair the ability of end users to manage and hedge their risks. Appropriate calibration is important given SA-CCR's prevalence in the capital rules, eg, standardised RWAs, SLR, G-SIB, large exposures, NSFR, etc.

The legislation requires the development of several regulatory technical standards (RTS) for the SA-CCR. While we support the use of RTS to adapt the international framework to the EU jurisdiction, RTS should not be used to recalibrate lower-risk weightings. This could undermine the global level-playing field.

While SA-CCR does incorporate more risk-sensitive elements, it also introduces certain outdated and conservative calibration choices that must be modernised at the Basel Committee (prior to adoption by the EU), such as:

- The 1.4x alpha multiplier is outdated. The initial calibration in 2006 was overly conservative, empirical data supported a 1.2x multiplier. Since then, Basel 3 and the new mandatory margin requirements have addressed many of the stated reasons for having the 1.4x alpha multiplier.
- The restrictions on netting are not aligned with legal netting agreements or with risk.
- The lack of full collateral recognition does not appropriately reflect the significant improvements and regulatory changes that have been put in place since Basel finalised SA-CCR, in particular the new mandatory margin requirements.

Moratorium powers

The moratorium proposal could have a significant impact on European financial markets. Applying the power to a bank would transfer the risk to other market participants and increase systemic risk. A core objective of resolution is to ensure the continuity of critical services. The moratorium is at odds with this objective and would represent a significant step backwards in achieving the post financial crisis resolution objectives.

The Commission's draft text included the possibility of pre- and post-resolution tools. These tools would automatically trigger a corresponding stay of termination rights under the existing provisions of the Bank recovery and resolution directive (BRRD. This would have the effect of leaving the institution and all of its counterparties at risk of potentially unlimited exposures for a prolonged period of time of up to twelve days. This period is significantly out of step with the international Financial Stability Board (FSB) standards, which suggest a moratorium of no more than two days.

Leaving institutions and counterparties exposed for a prolonged period of time is potentially detrimental to the financial stability of the markets by creating a ripple effect of contagion. A different duration of stay from the international standard could also lead to decreased investment into the EU (i.e. if pensions and asset managers are unable to invest in the EU on account of an extended stay and the uncertainty that arises from it). We have also identified the risk that if the EU and US become misaligned as regards these moratoria powers, this may lead to negative impacts on cross-border cooperation and financial stability and disincentivise EU-US trading in derivatives and securities financing transactions.

The moratoria powers would also apply to the ability of EU custody banks to fulfil payment and delivery obligations to their clients, even where client assets are segregated from the custody banks' balance sheet. This impact on custodian activities will potentially have large impacts on market liquidity and ability of end users, including pension funds and undertakings for the collective investment of transferable securities (UCITS) to offer liquidity to investors unconnected to the underlying assets they invest into. Custodian activities should be out of scope for any moratoria payment and delivery suspensions to avoid market liquidity issues, particularly due to the concentration of custodian providers.

We urge the co-legislators to remain as close as possible to the internationally-recognised stay of two days. In addition, they should consider the impact that this deviation could have on end users such as corporates and pension funds.

Internal minimum requirement for own funds and eligible liabilities (MREL) calibration for non-EU G-SIIs

The proposed calibration of internal Pillar 1 MREL for material subsidiaries of third-country G-SIBs is set at 90% rather than the 75-90% range agreed in the TLAC Term Sheet. This should be amended to allow the host authority the discretion to set the calibration within the FSB term sheet range in consultation with home authority.

Internal total loss-absorbing capacity (TLAC) eligibility

Further clarity is required as to the eligibility criteria for internal MREL (both Pillar 1 and Pillar 2), particularly on whether instruments will need to be directly issued to and held by the resolution entity, or if down-streaming through the organisation structure both through and outside an entity ownership chain is permitted. The CRR should not restrict issuance of internal MREL to any particular strategy, this should be determined on a case-by-case basis between resolution authorities and firms and the Commission's proposal should be amended to provide this flexibility. The interaction of this requirement with the requirement to establish intermediate holding companies also needs to be considered.

We do not favour the fixed 90% requirement, which is at the top of the FSB TLAC term sheet, proposed by the Commission. Instead, we support the 75-90% range, with the exact requirement within the range set by the resolution authority.

Point of non-viability (PONV) trigger for internal MREL

It should be clarified that internal MREL will only be written down or converted with the consent of the home resolution authority in line with the TLAC term sheet. This is important to foster cross-border cooperation and reflect agreements made within Crisis Management Groups (CMGs).

Article 55

Requirement to insert bail in recognition clauses into liability contracts governed by third-country law: the Commission's proposed amendment would allow resolution authorities to grant a waiver from compliance in respect of liabilities that do not count towards MREL where the authority determines that it is legally, contractually or economically impracticable for the bank to include such a bail-in recognition clause and where granting such a waiver would not impede the resolvability of the bank. The current drafting creates too many restrictions on the application of the waiver. We understand that this may have been a drafting error by the EC.

Bank recovery and resolution directive (BRRD) resolution entity definition

The definition of a *resolution entity* is too broad and appears to capture subsidiaries of G-SIBs subject to a single point of entry resolution strategy. This means that subsidiaries of non-EU G-SIBs subject to an SPOE strategy could be brought into the scope of the article 92a (external MREL) requirements rather than 92b (internal MREL) requirements.