



EUROPEAN CENTRAL BANK
BANKING SUPERVISION

Template for comments

Public consultation on the draft Guide on the supervisory approach to consolidation in the banking sector

Type of respondent

Banking association

Institution/company

European Banking Federation

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General comments



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The EBF welcomes the intention of the ECB to achieve clarification and transparency on its supervisory approach to notifications of proposed acquisitions and applications for permission for a business combination. As the ECB rightfully indicates, decisions for consolidation belong to market participants. Nevertheless, the ensuing supervisory examination is a crucial step in the success of such transactions. The publication of an ECB guide should add clarity to the process

The EBF represents more than 4,500 institutions across Europe, large and small, with diverse business models and from all geographies. Our members have long experience in, and many are the result of, mergers and acquisitions occurred in the past. From that experience we would like to share our views with the ECB about a series of relevant aspects that could facilitate the consolidation of the European banking sector. We split our comments in two blocks: General aspects and specific comments

General aspects

Objective of the ECB Guide on banking sector consolidation

As said, we appreciate the ECB's intention to clarify the supervisory approach on the consolidation in the banking sector. However, the EBF holds the view that the ECB should not just clarify, but facilitate banking mergers. This would help to increase the number of bank mergers and move the consolidation of the banking sector in the EU forward

:Coordination with other authorities

One of the aspects that can put at risk a merger transaction in Europe is the multiplicity of authorities involved. The recognition of the ECB about the coordination with other authorities is welcomed. However, there should be a stronger commitment on the public sector side as to timelines and conditions for their assessments

In particular, the determination by the Single Resolution Board (SRB) of the minimum requirement for own funds and eligible liabilities (MREL) and total loss-absorbing capacity (TLAC) on the combined entity is a key step. We think the ECB should liaise actively with the SRB or issue a public statement in order to obtain public communication from SRB stating that, in the context of the release of this ECB guide, SRB is receptive to the merits of consolidation and is articulating its approach for business combinations, especially on the determination of MREL and TLAC and the transitional arrangements

Another key element is the Combined Buffer which includes decisions under the power of the Member States with significant impact on the rationale of the transaction

Alignment with the ESMA is required in order to overcome obstacles regarding sharing of non disclosed information to the ECB. Guidance is required on the relation between the Market Abuse Regulation and the early communication phase with the ECB for a preliminary assessment

A major commitment by the ECB to minimize execution risks in M&A transactions with faster and more coordinated procedure for a cross border change in control would be very beneficial. In those deals, the ECB must authorize a financial institution for the participation to exercise a significant influence in the transaction. When dealing with cross country transactions, the process will require multiple steps complying with different jurisdictions, authorities and respective participants resulting in a long and cumbersome operation. Therefore we propose that the ECB should be in charge of the authorization process and coordinate also the responses of the national authorities to the request for change of control. For the example, in case the ultimate controlling entity does not change, the authorization process could be simplified



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:Regulatory barriers

European policy makers broadly seek that the European banking sector should consolidate, in order to achieve scale benefits and address problems of profitability. Yet there are many specific terms in the European legislation that significantly hamper consolidation. If we are serious about consolidating our banking system, we should start by reviewing parts of the regulation which go beyond the global standards. For example

The regulatory treatment of any external MREL is a crucial question in any consolidation. If the acquiring entity is a resolution entity, and the acquired entity will cease to be a resolution entity, then the external MREL issued by the acquired entity may cease to be MREL eligible. This alone can block a consolidation exercise, as the acquirer will in many circumstances be incapable of immediately meeting the new 'combined' MREL requirement. It is therefore necessary to provide clear and unequivocal guidance on this issue. Possible ways forward may include temporary grand-fathering of acquired entity external MREL as eligible MREL at the group level, or a temporary switch to a MPE strategy, allowing the acquired entity's external MREL to remain eligible. However, this second alternative also requires that the acquiring entity's MREL requirement (as an absolute number and not a percentage) does not increase by virtue of the acquisition. This is further exacerbated by the unequal treatment afforded to EU and non-EU bank subsidiaries in the Banking Union. EU subsidiaries of EU banks are subject to 100% internal loss absorbency requirements, whereas EU subsidiaries of non-EU banks may be subject to lower requirements. As mentioned before, we think the ECB should liaise with the SRB or issue a public statement in order to obtain public communication from SRB stating that, in the context of the release of this ECB guide, SRB is receptive to the merits of consolidation and is articulating its approach for business combinations, especially on the determination of MREL and TLAC and the transitional arrangements

The Combined Buffer Requirement includes European-specific O-SII buffers and Systemic Risk buffers that can be set at the discretion of Member States and which magnitude can be significant. There is no certainty as to how these requirements might change following a merger transaction, however they may change the rationale of the whole operation

Even though branches may benefit from the Freedom to Provide Services (FPS) within the EU in their day-to-day business, their governance is more difficult to adjust than it is for subsidiaries in the event of a Group's change of strategy due to the coexistence of diverging legal frameworks in Europe

:Lack of harmonization in the regulatory frameworks across jurisdictions

The direct universal succession from one corporate entity to another is not always automatically permitted. For example, a cross border demerger may not be explicitly ruled yet in many jurisdictions and therefore, banks would need to resort to more complex structures, i.e. a local demerger into a dedicated domestic newco, which could need a banking license, and subsequent cross border merger of the newco into another foreign company. More standardization could reduce complexity and uncertainty related to differing local prudential requirements

The difference in tax regimes between Member States in M&A cross-border transactions could create inefficiencies such as the loss of deferred tax assets (DTAs) even without any change in the parent company's head quarter and additional taxes triggered by a change in control



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Also the conduct-related regulatory framework lacks harmonization in Europe. This fragmentation constitutes obstacles to the efficiency of the AML/CFT framework and, indirectly, of cross-border banking activities. This includes

The AML framework in its current directive-format, leaves too much discretion to local regulation, creating an uneven pattern of rules across Europe. This creates both inefficiencies for institutions operating cross border and opens up for vulnerabilities in the joint effort in combatting financial crime. Supervisors support for the EU action plan on AML/CFT, improving harmonization with a focus on the mitigation of risks, is therefore very welcome. Addressing those issues could incentivize banks to further engage in cross-border mergers

As mentioned in the guide, expected efficiency gains is a key driver of consolidation including scale benefits in IT and operations
Operational resilience is key in mitigating risks associated with a cross-border group. However, resilience cannot mean that each local unit should operate in full isolation. The ECB should look into national initiatives, to ensure that cross-border barriers are not being built up within the EU Single Market and Banking Union, resulting in erased scale benefits and de-mergers rather than mergers and the European banking sector continuing to lag behind its global competition

Other characteristics of the global prudential standards need to be taken into account in the assessment of potential consolidation transactions, for instance

There should be some discretion in the application of buffers in consolidation processes, as the combined entity might move to higher size and the increased requirement for the whole new group could change significantly. If there is a business rationale for the merger or takeover, it should somewhat mitigate the increase in capital requirements by other means

Articles 84 to 88 of the CRR set forth certain restrictions to the inclusion of the minority interest in the calculation of the consolidated Common Equity Tier 1, because the excess capital pertaining to minorities is excluded from the calculation of capital at group level. Often the level of capital at subsidiary level exceeds minimum requirements. Due to those restrictions, the calculation of minority interests creates a disincentive to M&A transactions producing minorities' interests (The problem of an inadequate recognition of minority interests is a longstanding issue that has been already prominently raised by the "Vienna Initiative" in a report published in 2012 (European Bank Coordination "Vienna Initiative": Working Group on Basel III Implementation in Emergin Europe, March 2012

The new Basel operational risk framework requires higher capital requirements to larger groups vs. smaller ones; and an additional "extra buffer" to groups with subsidiary-based business models, by requiring the BIC to be calculated at consolidated level (instead of aggregating the BICs at a subsidiary level, like in the current framework

Governance

There should be a fast-track procedure for the Fit and Proper assessment of all Board members and Executive Committee members of the acquired entity. If reducing the time lag is important in a single nomination of an ongoing bank business, it will be all the more important in a case of acquisition of business, as the senior management has to be operational immediately after the takeover because the first months are crucial for the settling of the new banking group. Moreover, in general, it would be very helpful if the ECB clarified the requirements for a merger upfront in the form of objective criteria to pre-empt discussions in relation to a specific transaction

Free flow of capital and liquidity

Existing obstacles to the unfettered movement of capital and liquidity across countries for the same banking group is one of the major impediments to consolidation. In general different national jurisdictions limit the free flow of capital even within the same group, for example when dealing with distribution of excess capital from subsidiaries to the parent company. The EBF would support an initiative of the legislators supported by the ECB in that respect. To that end, we would find it helpful if they could provide a clear view on the application of cross-border liquidity, net stable funding ratio (NSFR), and capital waivers. Furthermore, the ECB could amend its guide on the options and discretions in order to minimize the conditions applicable to those waivers to facilitate the application in practice

Neutralisation of stress test bias

The EBA Stress test exercise should take into account the fact that performance of a recently acquired resolved bank cannot be taken as reference for future projections as the risk profile and management has changed dramatically with the integration on a sounder bank

Additional clarification on issues within the SSM scope should be provided

Prudential authority's on-track inspections on the resolved institution should be "frozen" and remediation plans derived from previous inspections reviewed when there is a plan to integrate the management systems with those of the buyer

Exemption from public responsibility derived from the previous mismanagement in procedures that do not intend to compensate clients/investors but to disincentive bad behaviours should also be contemplated

Template for comments

Public consultation on the draft Guide on the supervisory approach to consolidation in the banking sector

Please enter all your feedback filling in the table below as following :

- Fill in the 5 green columns only: "Paragraph", "Type of comment", "Detailed comment", "Concise statement as to why your comment should be taken on board", "Proposal for adjusted wording";
- Respect drop-down menus. Do not alter the drop-down menus.
- Other columns, blue columns, are filled in automatically; do not alter them;
- Each comment shall deal with a single issue only; you can enter two comments for the same paragraph if you see several issues in the same paragraph; you can enter the same comment several times if it applies to several paragraphs;
- Indicate whether your comment is a proposed amendment, clarification, deletion or addition to the guide;
- Propose an alternative wording when appropriate.

Please do not make any changes to the structure of the template. Any feedback provided in a modified template will not be processed.

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Deadline: 1 October 2020

| Id | Paragraph | Page | Section | Type of comment | Detailed comment | Concise statement as to why your comment should be taken on board | Proposal for adjusted wording | Type of respondent | Institution/company | Name of commenter | Personal data |
|----|-----------|------|----------------------------|-----------------|---|---|-------------------------------|---------------------|-----------------------------|-------------------|---------------|
| 1 | 1 | 1 | Introduction | Amendment | lines 8 and 14: Instead of "restructuring" rather "realignment" or "reorganisation", as restructuring may be a too narrowly understood term. | The comment should be taken on board to provide further clarification | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 2 | 5 | 2 | Introduction | Clarification | <p>"Case-by-case approach based on proportionality"</p> <p>We believe the term "proportionality" and its concrete impact in the supervisory approach should be clearly specified by the ECB for the purpose of the Guide in relation to the objectives that the ECB intends to pursue. Broadly speaking, the Principle of Proportionality is that the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties (TEU, Art 5(4)). The Principle of Proportionality requires that an action undertaken must be proportionate to its objective (ECJ), while also taking into account potential prejudice to other EU objectives.</p> <p>Our understanding from July 30 stakeholder engagement call is that the approach will depend on the content of the project. In particular, depending on whether the project only marginally changes the situation of the acquiring entity or is more significant and ambitious (for example by changing the nature and the perspective of the business model), the ECB would act accordingly in its approach.</p> | Given the importance that proportionality should have on ECB approach in the context of banking acquisitions, we believe the concept should be more clearly specified for the purpose of this Guide. | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 3 | 5 | 2 | Introduction | Clarification | We believe that a specific paragraph should be added by the ECB with respect to transactions that occurred during a resolution process. Our understanding from July 30 stakeholder engagement call is that the existing legal framework allows the ECB to waive some requirements on a temporary basis in coordination with the SRB. Some colour should probably be given on the consequences and derogations in the implementation of the guide in this context (for example, regarding §6, §8, §9, §12, §27). | No specific approach to an acquisition in a context of resolution is described in the Guide whereas we think the specificities of such situation would justify the drafting of dedicated developments in the Guide. | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 4 | 8 | 3 | 1.2.1. Early communication | Clarification | We understand that the processes outlined in the guide follow the rules according to Art. 22 CRD as implemented by the national legislators. However, this could be clarified in the guide. | For the avoidance of doubt | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 5 | 11 | 4 | 1.2.2. Application phase | Clarification | We understand that the processes outlined in the guide follow the rules according to Art. 22 CRD as implemented by the national legislators. However, this could be clarified in the guide. | For the avoidance of doubt | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |

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| 6 | 6 | 2 | 1.1. Objectives | Addition | <p>"The entity resulting from the business combination will meet all prudential requirements"</p> <p>On Fit and Proper (FAP) assessment topic, we think that a specific – lighter – FAP assessment process could be put in place for the combined entity, when a FAP assessment of specific individuals has already taken place by the ECB or other EU supervisors in order to limit the administrative burden for banks. Cooperation with supervisors in other jurisdiction should also be envisaged to meet the same objective.</p> <p>On this topic, we also think a specific – lighter – FAP assessment process could be put in place for the combined entity, when ECB assessment of specific individuals has already taken place.</p> | A specific fast-track process could be envisaged for FAP when target Board members have already been through that ECB process. | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 7 | 7 | 2 | 1.2. Process | Clarification | <p>"Assessment Process"</p> <p>ECB mentioned at July 30 stakeholder engagement call that a dedicated team will be established for each consolidation project to run the assessment process and provide the applicant with a holistic view to on the various aspects of that assessment (authorization process, P2R, fit & proper, etc.). We would welcome the addition of clarifying details in the guide on this organisation and especially on the resulting impact for banks in terms of communication with the ECB.</p> | This will clarify for the banks the point of contact for the various topics of the assessment | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 8 | New paragraph | 0 | 0 | Addition | <p>Adding a new section 1.2: "The ECB will make full use of the information collected from its day-to-day supervision in each phase of the supervisory assessment"</p> <p>It could be usefully clarified that ECB should make use of all information already collected as part of its day-to-day supervision in order to avoid any unnecessary administrative burden for banks in the context of this supervisory assessment.</p> | This will limit to the extent possible the administrative burden for the acquirer | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 9 | 8 | 3 | 1.2.1. Early communication | Clarification | <p>"Preliminary feedback"</p> <p>The Guide indicates that ECB Banking Supervision would provide parties involved in a banking consolidation transaction with a 'preliminary feedback on the project'. We request a sample format and guidelines on the content of this preliminary feedback.</p> | It would be useful to the industry to better understand the format and the content of ECB preliminary feedback. | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 10 | 8 | 3 | 1.2.1. Early communication | Clarification | <p>It should be made clear that the ECB should take into account regulatory communication restriction in the context of early communication.</p> | <p>It would be useful if the guide could clarify ECB confidentiality requirements in the context of acquisitions / qualified holdings. However, it is important to stress that early communication to the ECB may be sensitive in some circumstances (e.g. before the issuance of the workers' council's opinion on the project).</p> | <p>"§ 8: Without prejudice to the Market Abuse Regulation or any other EU or national relevant legal provisions, parties involved in a banking consolidation transaction are encouraged to liaise as soon as possible with ECB Banking Supervision (...)"</p> | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 11 | 9 | 3 | 1.2.1. Early communication | Clarification | <p>The timeline regarding the communication of feedback should be sufficiently clear to anticipate when preliminary feedback would be received. For example, a provision could be made for the ECB to give its preliminary feedback without undue delay.</p> | <p>It would be beneficial for the banks involved to better understand the timeline as foreseen by the ECB to better shape the overall process.</p> | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 12 | 9 | 3 | 1.2.1. Early communication | Clarification | <p>With respect to the detail of integration plan, we kindly ask to acknowledge that in M&A projects the level of detail is usually quite limited and not yet very granular in the presumably early transaction stage in which the early communication takes place.</p> | <p>It needs to be ensured that no unrealistic expectations are set. Market participants need confirmation that the ECB will not prolong the transaction process unnecessarily.</p> | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |

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| 13 | 10 | 3 | 1.2.2. Application phase | Clarification | In line with the footnote 12, it should be clearly stated that this application is made only when required by national law. | This comment should be taken on board in order to provide further clarity | “§ 10: In the baseline case, the application phase is triggered following either a notification of a proposed acquisition of a qualifying holding in a credit institution in accordance with national law implementing Article 22 of Directive 2013/36/EU and the European Supervisory Authorities’ Joint Guidelines on the prudential assessment of acquisitions and increases of qualifying holdings in the financial sector, or when provided so in national law, an application to obtain permission (...)” | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 14 | 13 | 4 | 1.2.3. Implementation phase | Clarification | “Supervisory response” Clarifications would be welcome on the form that this supervisory response may take in terms of scope and potential actions in the context of the implementation phase. | It would be useful to the industry to better understand the possible scope the form that the supervisory actions may take. | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 15 | 14 | 5 | 2.1. Sustainability of the business model | Clarification | “Sustainability of the business model” We believe the remark regarding the level of detail expected by ECB in the integration plan should be also stated in the introduction of this section since footnote 8 only refers to the preliminary assessment in the “early communication” phase. | To clarify in the guide that ECB should take into account the specifics of the transaction throughout the different steps of the supervisory assessment process (e.g. hostile takeover) | Thus, we propose to add the following sentence right before paragraph 14 as a caveat: “The level of detail expected on the strategy and the business plan will take into account the national law and the proportionality principle as well as the nature of the transaction, acknowledging in particular that, in hostile takeovers, the acquiring bank has limited information on the target institution.” | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 16 | 15 | 5 | 2.1. Sustainability of the business model | Addition | Bullet point c) - “Short, medium and long-term achievable targets” In line with paragraph 14 where the supervisor should ‘ascertain, to the extent possible, the sustainability of the business model of the combined entity’, ECB Guide should take into account that prudential risk planning is typically based on 3-year horizon forecasts when referring to ‘long-term achievable targets’. | The addition is aimed at reflecting regulatory requirements and actual risk management practices (3-year horizon forecasts) | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 17 | 15 | 5 | 2.1. Sustainability of the business model | Clarification | Bullet point d) - We request more clarification on mergers/acquisitions under stressed conditions, where e.g. one or both companies do not meet the requirements on a standalone basis prior to the transaction. | The scope and framework of the guide needs to be clear to market participants, in particular in relation to special situations. | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 18 | 16 | 5 | 2.1. Sustainability of the business model | Clarification | Bullet point 2 - “The valuation of assets” The Guide indicates that the valuation of assets and liabilities is expected to remain prudent and consistent with the performance of past transactions carried out by the involved parties, adjusted by an appropriate margin of conservatism. We would welcome clarification on the legal basis of this margin of conservatism. | We question the legal basis of the application of ‘an appropriate margin of conservatism’ with the perspective to ensure a consistent application by inspection teams | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 19 | 17 | 6 | 2.2. Governance and risk management framework | Clarification | EBA principles should be followed subject to the comply or explain process carried out by national supervisors | The EBA principles are subject to the comply or explain process carried out by national supervisors | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 20 | 18 | 6 | 2.2. Governance and risk management framework | Clarification | The reference to the competence related to “mergers and acquisitions” in the third bullet point should be removed. | M&A skill does not seem relevant on a long-term perspective as it is not part of the core banking activities. | “a strong leadership team is in place with a proven track record in both the relevant banking business areas, as well as in the management of financial and non-financial risks, such as anti-money laundering” | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 21 | 18 | 6 | 2.2. Governance and risk management framework | Clarification | Last bullet point: Depending on the applicable local laws and governance arrangements, such projects/plans are not systematically submitted to the supervisory functions. | Such projects/plans are not systematically submitted to the supervisory functions | “the consolidation plan includes the timely integration of the risk management and internal control framework, in particular the mitigation of execution risk. The plan should be closely monitored by the management and/or the supervisory functions.” | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 22 | 19 | 7 | 2.2. Governance and risk management framework | Clarification | “Proportionality” In line with our comments on § 5, the proportionality principle could be usefully specified for the purpose of this Guide wherever necessary. | In the case of paragraph § 19, it could be stated that proportionality must also apply considering the size of the activity acquired and the size of the acquirer. | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |

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| 23 | 20 | 7 | 2.2. Governance and risk management framework | Amendment | This point does not state clear if banks should incentivise individuals involved in the business combination or if this incentivisation shall be established following the principles described here. It should be acknowledged that general/ other compensation schemes of the parties involved must be considered. | The allowance of an extraordinary compensation/bonus to the management in the context of a business combination is not systematic. Furthermore, it is important that market participants have clear guidance regarding the ECB's expectations in this respect. Incentive schemes should, generally speaking, be decided upon by market participants, also considering relevant remuneration regulation. | "§ 20: Finally, as the case may be, the execution of the business combination is expected to be governed by adequate remuneration schemes in order to set the right incentives, if any. Variable remunerations should be linked to and conditioned by some risk factors, for example key performance indicators linked to the milestones set out in the integration plan. | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 24 | 21 | 7 | 3. Supervisory approach to key prudential aspects of the consolidation transaction | Addition | "Supervisory approach to key prudential aspects of the consolidation transaction" Potential post-merger additional capital requirement and capital and liquidity local restrictions are key in the context of assessing the feasibility of banking consolidation so that we believe these should be included in the Guide. Therefore we suggest the proposed amendment. | This addition will change supervisory factors from three to four in the determining the feasibility of a business combination in addition to P2R, P2, the prudential treatment of badwill and the transitional arrangements for the use of internal models. | "§ 21: Past experience has shown that four supervisory factors can play a key role in determining the feasibility of a business combination: post-merger Pillar 2 capital requirements (P2R) and P2G, the prudential treatment of badwill, the transitional arrangements for the use of internal models ²² and post-merger additional capital requirement and/or capital and liquidity local restrictions." | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 25 | 23 | 7 | 3.1. Timing for communication | Clarification | Early communication to the ECB may be sensitive in some circumstances (e.g. before the issuance of the workers' council's opinion on the project) | Early communication to the ECB may be sensitive in some circumstances (e.g. before the issuance of the workers' council's opinion on the project) | "§ 23: Without prejudice to the Market Abuse Regulation or any other EU or national relevant legal provisions, the supervisory approach (...)" | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 26 | 26 | 8 | 3.2. Pillar 2 capital requirements and Pillar 2 guidance | Clarification | We would welcome more guidance or clarification on the intention of the paragraph mentioned above. As it is stated in the paragraph, in assessing the appropriate ex post level of capital the impact of the front loading of the costs of the business combination are going to be considered. However, more detail in this regard would be appreciated. To be more specific, could you elaborate how these costs will be considered? would it be possible that these costs do not impact the capital ratio upfront? or would there be a reduction on the combined P2R for the same impact? | The paragraph is not sufficiently clear for us | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 27 | 27 | 8 | 3.2. Pillar 2 capital requirements and Pillar 2 guidance | Clarification | Bullet Point 1: "Pillar 2 capital requirements and Pillar 2 guidance" We kindly ask confirmation on the starting point for P2R and P2G levels of the combined entity. They should be the average percentage weighted by the respective RWAs and the resulting absolute amounts for the combined entity should thus not exceed the sum of the absolute amounts applicable to the two entities prior to the consolidation. | This is to avoid any ambiguity on the formula to calculate the starting point for the P2R/P2G of the combined entity | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |

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| 28 | 27 | 8 | 3.2. Pillar 2 capital requirements and Pillar 2 guidance | Amendment | <p>Bullet point 2: "Complex IT integration"</p> <p>The reference to "complex IT integration" appears too vague. Given that most banks have complex IT infrastructure, the IT integration will be complex in most transactions and, as a result, the analysis should be refined in order to ensure that the principle of having a weighted average P2R/P2G is meaningful. The current wording in the draft Guide creates uncertainty and gives the impression that ECB may treat the industry unfavourably, which would in the end defeat the purpose of having a guide designed to ease banking consolidation.</p> <p>Thus, we think that it would be relevant to be more specific on the assessment of that excessive complexity that would trigger an upward adjustment of the starting point for P2R/P2G. In this context, reference could be at least made to proportionality (cf. relative size of the acquired entity of the acquisition and complexity of the IT integration project for the acquirer) and to the track-record in integrating IT systems and IT systems management in general because these elements allow for a fair mitigation of IT integration risk.</p> | <p>There is a presumption that any IT risk integration project would be deemed complex by the ECB. The actual complexity of the integration project for the acquirer, the quality of its IT integration plan, and its track record on IT systems integration should be taken into account when assessing the complexity of IT integration and this should be explicitly stated in the guide in order to allow a consistent application across inspection teams.</p> | <p>"... (for example, very complex IT integration – after due consideration on risk mitigants coming from e.g. the IT description of the consolidation proposal, the good track record of the acquiring entity or the relative size of the entities"</p> | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 29 | 27 | 8 | 3.2. Pillar 2 capital requirements and Pillar 2 guidance | Clarification | <p>Bullet point 2: "Acquisition in the context of a resolution process"</p> <p>As indicated in a previous comment on the introduction (paragraph 5), acquisitions in the context of a resolution process are specific, therefore we think this should be reflected in a specific approach to be followed by the ECB in order to avoid an automatic P2R/P2G upward adjustment.</p> | <p>We think that this point could be usefully clarified in the Guide to ensure a consistent treatment across inspection teams. It will help for inspection teams to take into account in a homogeneous way the specificities of the acquisitions which are related to a resolution process.</p> | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 30 | 29 | 9 | 3.2. Pillar 2 capital requirements and Pillar 2 guidance | Clarification | <p>Point 1: It could probably make sense that the ECB enriches this paragraph with the information it provided at July 30 stakeholder engagement call about the coordination with resolution authorities, namely stating that:</p> <p>(i) ECB recognizes that resolution requirements are critical issues for consolidation projects. On this point, we would like to highlight that resolution requirements related to an acquisition (external MREL but also internal MREL at the level of the acquired subsidiary) are increasingly considered as a constraint which is more binding than capital ratios for the banks subject to these.</p> <p>(ii) ECB will develop its cooperation with SRB so that the market participants would have as global clarity as possible,</p> <p>(iii) the ambition is that the overall process converges in a more unified way as soon as possible</p> <p>(iv) this section of the Guide has been shared with the SRB.</p> <p>In this paragraph is unclear what is the impact of coordination efforts of ECB with relevant authorities will have on the timeline/ overall process. We would like more clarification regarding the involvement under current policies and procedures of the regulatory bodies mentioned in the paragraph.</p> | <p>Resolution requirements are major impediments to banking consolidation in the EU. Even if the topic is not per se under ECB's remit</p> | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 31 | 32 | 9 | 3.3. Badwill | Clarification | <p>"Badwill": Another aspect that necessitate deeper attention and details is the calculation of badwill (goodwill) of all assets acquired and liabilities assumed in a business combination that are measured at acquisition-date fair value. It should be clarified that this one-time fair value application does not fall under prudential filter regulation with regard to own credit spread.</p> | <p>From an economic point of view it is essential that the fair value effect on balance sheet capital is reflected in the regulatory capital. The prudential filter regulation could be an impediment because no differentiation between the valuation at acquisition-date and the subsequent valuation for regular business is made.</p> | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |

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| 32 | 32 | 9 | 3.3. Badwill | Amendment | <p>From line number 2 of the paragraph starting with the word "expecting" until the end of the paragraph: We believe this sentence should be amended for the following reasons:</p> <p>1. Envisaging non-performing loans impairment or provisions covering integration costs as a "use" of the accounting badwill sounds inconsistent with the relevant accounting standards.</p> <p>2. To determine the accounting value of badwill, the entire balance sheet, and therefore the loan portfolio, is remeasured at fair value, which is an exit price. Under IFRS, this remeasurement does not leave space for « increasing the provisioning on non-performing loans » as suggested in this paragraph.</p> <p>We think that the ECB Guide's wording sounds like wrongly linking the fair value of assets from an accounting perspective to the market value of the acquired entity. The low market valuations of most European banks do not reflect in general the quality of their assets (though it may explain part of it), but more probably low profitability perspectives and uncertain regulation (e.g. dividend ban, Finalisation of Basel III perspective). These cannot and should not be included in the fair value of the assets; hence, the text envisaging the badwill as to be "used" is not appropriate.</p> <p>The paragraph also indicates that the badwill distribution could not occur 'until the sustainability of the business model is firmly established'. This sentence should be rephrased in our opinion to avoid imposing inappropriate distribution restrictions beyond the framework already designed by CRD and CRR.</p> <p>However, the beginning of the sentence "In principle, ECB Banking Supervision recognises duly verified accounting badwill from a prudential perspective" is more than welcome.</p> | <p>Wording to be re-phrased to be consistent with relevant accounting principles and avoid inappropriate distribution restrictions.</p> | <p>In principle, ECB Banking Supervision recognises duly verified accounting badwill from a prudential perspective, expecting it to contribute to the sustainability of the business model of the combined entity, including when applicable its allocation to covering transaction or integration costs, or any other charges, investments or future management actions that would be contemplated by the acquirer as a result of the transaction. In this view, it is generally expected that the potential profits from badwill will not be distributed to the shareholders of the combined entity before any applicable allocation intended to firmly establishing the sustainability of the business model.</p> | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 33 | 33 | 9 | 3.3. Badwill | Amendment | <p>This paragraph should be amended as a "use" of the accounting badwill sounds inconsistent with the relevant accounting standards.</p> <p>We think that the ECB Guide's wording sounds like wrongly linking the fair value of assets from an accounting perspective to the market value of the acquired entity. The low market valuations of most European banks do not reflect in general the quality of their assets (though it may explain part of it), but more probably low profitability perspectives and uncertain regulation (e.g. dividend ban, Finalisation of Basel III perspective). These cannot and should not be included in the fair value of the assets; hence, the text envisaging the bad will as to be "used" is not appropriate.</p> | <p>The text envisaging by default the "use" of the badwill for provisioning sounds like meaning that the market value is relevant for prudential assessment, which, if we follow the logic, means that the CET1 should be the market value of the equity. This is in contradiction with the whole prudential framework.</p> | <p>ECB Banking Supervision will examine both any applicable allocation of badwill and how badwill will contribute to strengthening the post-merger own funds of the combined entity, i.e. to what extent the badwill will contribute to the sustainability of the business model in a forward-looking perspective.</p> | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 34 | New paragraph | 0 | 0 | Addition | <p>Section 3: In the event of a business combination an overrun of large credit exposure limits could occur. For a limited period of time (to be specified) an overrun must not become an obstacle or lead to any deductions from regulatory own funds. It should be temporary accepted to avoid an unnecessary supervisory burden. Therefore a specific guidance should be added to the proposal.</p> | <p>Specific guidance should be added to avoid an unnecessary supervisory burden</p> | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 35 | New paragraph | 0 | 0 | Addition | <p>Section 3: In case of a merger of major banks, additional capital requirements and the use of waivers could be essential for the acquirer. Therefore a passage in particular with respect to systemic identification scoring and waiver rules would be welcome (e.g. using of granted waivers during an appropriate transitional period and SRM recognition).</p> | <p>This will help provide ex-ante visibility on some of the major issues banks are facing with cross-border merger and acquisition and where SSM will/could be involved.</p> | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 36 | 36 | 10 | 3.4. Internal models | Clarification | <p>"Internal Models"</p> <p>We ask additional clarification on internal models risk types, in particular credit, market and operational risk. In addition, additional guidance on "limited period of time" regarding usage of internal models and be more specific regarding the time frame under internal models may be used. A minimum period of time (in absolute terms, i.e. a period of at least two years and, whenever necessary, an extended period beyond that, or depending on conditions on the acquirer and the acquisition) should be defined in order to provide ex-ante visibility on the continued use of internal models that were in place before the merger, for past and new exposures.</p> | <p>This will help provide ex-ante visibility and to ensure consistency across inspection teams in the treatment of the resulting combined entities.</p> | <p>"...ECB Banking Supervision acknowledges that there will be a period of at least two years and, whenever necessary, an extended period beyond that"</p> | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |

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| 37 | 36 | 10 | 3.4. Internal models | Amendment | Footnote 30: The paragraph 36 seems to introduce other conditions such add-ons (footnote 30). We would welcome clarification on the detailed legal scope which is targeted. Therefore, we suggest amending footnote 30 as followed: "Only capital add-ons to cater for additional model risks not originally covered given the new scope of model could be applied". | We deem important to clarify the legal basis and the type of add-ons which are targeted to a ensure consistent understanding across inspection teams. | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 38 | 36 | 10 | 3.4. Internal models | Addition | "More flexibility in the use of internal models" Need to extend the use of buyer's IRB models to all exposures of an acquired bank as soon as these exposures are migrated to buyer's systems. This could imply: (a) Fast track authorization process to apply buyer's internal model to the acquired portfolios (Standardised and IRB). (b) Temporary capital add-ons (until formal authorization is granted) should be avoided (c) Following the previous point this would also avoid any unnecessary complexity in models maintenance and operation, with the need to maintain several "capital engines" running. (d) This would also avoid any unnecessary complexity in models maintenance and operation, with the need to maintain several "capital engines" running. Moreover, we would like to propose the following regarding the section on internal models: • In relation to the availability and quality of the historical data, the correction of the deficiencies in the data should not be a priority. The attention should be given to the current data and the regulator relaxing requirements if it is needed under certain circumstances. • The representativeness analyses regarding the default definition, scope of application, distribution of the relevant risk characteristics and lending standards and recovery policies are required by the regulation. In a banking consolidation scenario, satisfactory results of the representativeness analyses are not assured. Due to the changes of the management criteria and policies in the consolidation process, these analyses should be focused on the current circumstances avoiding the application extra margins of conservatism. • On the other hand, in relation to the AIRB parameters that will be applied to the consolidated portfolio, although a joint parameter calibration could be an option, it is not suitable that the buyer's internal models could be impacted by the historical behaviour of the acquired portfolio. In this regard, a model adjustment to the buyer' internal models could be applied to the purchased portfolio assuring an appropriate performance in the current periods. | Market participants need clarification in order to develop their integration plan and to determine economic effects. | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 39 | 37 | 10 | 4.1. Enhanced monitoring of execution risks | Amendment | We kindly ask to acknowledge that in complex transactions deviations from planned timelines are not unusual. Therefore we request valuation guidelines for such undue deviations. | It needs to be ensured that no unrealistic expectations are set. Market participants need confirmation that the ECB will not interfere unnecessarily. | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 40 | 38 | 10 | 4.1. Enhanced monitoring of execution risks | Clarification | We ask the ECB to provide additional clarification on the specific reporting requirements referred to in paragraph 38 (a). | The paragraph does not give sufficient clarity, w.r.t. the specific reporting requirements. | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 41 | New paragraph | 0 | 0 | Addition | Section 3.5 (page 10): In case of a merger of major banks additional capital requirements and the use of waivers could be essential for the acquirer. Therefore a passage in particular with respect to systemic identification scoring and waiver rules would be welcome (e.g. using of granted waivers during an appropriate transitional period and SRM recognition). We propose to add a new section 3.5 titled "European cross-broder combination benefits" § The ECB recall the need for cross-border consolidation that participates to risk sharing and risk diversification. Therefore, ECB Banking Supervision will support such positive outcomes recognition whenever it is justified. § The SSM supervisory approach also acknowledges that the progress of the Banking Union significantly mitigates cross-border exposures risk between participating Members States. § In the event of a European cross-border combination, as a general rule, ECB Banking Supervision will consider the common framework entities are belonging to and will liaise with competent or designated authority with a view to facilitating the adoption of: • EU G-SII methodology score as per CRD5 Art. 131-2 and 10-c. • Liquidity waiver to support efficient liquidity management by cross-border banks (as those are subject in practice to national supervisors' approval due to intragroup limits) • Capital waiver to support efficient capital allocation within institutions If the above capital requirements adaptations are not applied, they should be offset in Pillar 2. | This will help provide ex-ante visibility on some of the major issues banks are facing with cross-border merger and acquisition and where SSM will/could be involved. | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |

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| 42 | New paragraph | 0 | 0 | Addition | <p>Section 3.6 (page 10): Minority haircuts can be substantial - when the EBA clarified that AT1/Tier 2 issued by bank operating companies would be subject to haircut at the bank holding level in November 2017 (see EBA Q&A 2017_3329), several banks reported a significant impact on their own funds. At year-end 2017, AIB and Bank of Ireland reported decreases of their capital ratios by 95bp and 140bp respectively, while for ABN Amro, the drop was much more pronounced (-5.4%).</p> <p>More generally, given that AT1 and Tier 2 instruments can represent around a quarter of a bank's regulatory capital mix (in the case of 12% CET1, 4% AT1/Tier 2), and that banks often hold at least 2% excess capital, the minority interest haircut (calculated as the proportion of AT1/Tier 2 in the capital structure multiplied by the excess capital) would represent at least 0.5% of RWAs, which is meaningful.</p> <p>The application of this rule therefore directly impacts banking consolidation. For example, when Clydesdale Bank acquired Virgin Money in 2019, the AT1 instrument issued out of the Virgin Money Holding company would have been subject to minority interest haircuts at the Clydesdale Group level, and potentially would have been fully derecognised if Virgin Money Holding UK plc ceased to be an intermediate holding company. As a result, before the acquisition was finalised, Clydesdale had to undertake a consent solicitation on the Virgin Money AT1, to substitute the issuing entity to Clydesdale Bank.</p> | <p>In order to minimise impediments to M&A activity, it would be helpful for the ECB to provide banks with some flexibility to manage the restructuring of their capital structure. The same considerations are also relevant for the MREL requirements, where the resolution strategy of the group could be adapted to facilitate an acquisition.</p> | <p>Therefore, we propose this new section 3.6 titled "Post-combination capital restructuring"</p> <p>"§1 Capital requirements are applied at a consolidated level. As a result, if a bank is bought and becomes a subsidiary of a larger banking group, any capital instrument issued by this bank will become minority interests at the consolidated level, and therefore subject to minority interest haircuts, as per articles 85 and 87 of the CRR.</p> <p>§2 As a general rule, ECB Banking Supervision will provide banks with more flexibility on repurchases: allowing banks to repurchase capital instruments within 5 years of the issuance date, on the basis that M&A activity would constitute exceptional circumstances (and therefore allowed under article 78(4)(d) of the CRR). This will allow banks to conduct open market repurchase of instruments issued out of subsidiaries and replace them with instruments issued from the parent entity. This could be helpful in particular for situations where consent solicitations to substitute the issuer would not be practical or possible.</p> <p>§3 ECB Banking Supervision will also coordinate with the relevant authorities when appropriate. In particular, it will</p> | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 43 | 38 | 10 | 4.1. Enhanced monitoring of execution risks | Amendment | The term "Proportionate": Proportionality to the size, complexity and risk of the acquisition for the acquirer should be taken into account and clearly stated in the guide. | Reporting requirements should be kept proportionate to the actual risk of the acquisition for the acquirer in order to limit the reporting burden. | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 44 | 38 | 10 | 4.1. Enhanced monitoring of execution risks | Clarification | Bullet point c): The bullet point c indicates supervisory measures under the SSM powers to address risks not covered by Pillar 1. We would welcome the provision of more details about the such supervisory measures. | We would welcome the provision of more details about the listing of supervisory measures which can be used for risks not covered by Pillar 1. | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |
| 45 | 43 | 11 | 4.2. Foster the swift convergence of the newly combined entity with standard supervisory activities | Clarification | Paragraph 43 is too vague. Clarifications should be given on the 'specific approach' mentioned. | It is important that ECB provide more details on its intention in order to ensure consistent views within and across inspection teams. | | Banking association | European Banking Federation | Gasos, Gonzalo | Publish |