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

Non-SSM bank

Institution/company

Credit Suisse Group

Contact person

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First name

Surname

Email address

Telephone number

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General comments

EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Credit Suisse is pleased to respond to the ECB’s consultation on its Guide on the supervisory approach to consolidation in the EU banking sector. Credit Suisse is an increasingly European Bank, and acts as an advisor to many European headquartered banks through our Financial Institutions Group within the Investment Banking Division. We welcome the ECB’s efforts to improve the transparency and predictability of supervisory actions in credit institutions’ consolidation projects. This has not only sent a positive signal to the .market, but the substance is also timely and critical in changing market perceptions that EU bank M&A transactions would invariably have to .be followed by a recapitalisation

In light of COVID-19 recovery, it is more necessary than ever to have a healthy and strong banking sector to provide low-cost and reliable funding to the European economy, as well as to support the twin transitions (Green and Digital). It is also key to reduce the sovereign-bank nexus at this point in the cycle. As the ECB has widely acknowledged, the current European banking system is characterised by low profitability, over-capacity and siloes along national lines. The Banking Union is a success in terms of the SSM and SRB, but unfortunately not yet functioning as a single jurisdiction for seamless cross-border banking, which is negative for consolidation within the Eurozone. With rates likely to stay lower for longer .and asset quality deteriorating and the volume of NPLs rising, consolidation becomes a key lever to strengthen the system

In parallel to this letter, Credit Suisse has taken the opportunity to provide commentary on the proposed ECB Guide through industry associations including AFME. We will not duplicate the industry responses here, but reiterate our support for the ECB to provide further clarifications in relation to the obstacles to consolidation identified by those forums. In this letter, we focus on a set of broader considerations from the perspective of a financial institutions M&A adviser and practitioner. Although some issues we raise are outside the ECB’s unilateral competence to address, we raise them nevertheless given the ECB’s important influence, and secondly .because we consider it necessary to move forwards across a range of actions in order to galvanise consolidation, and cross-border consolidation in particular

We strongly welcome the ECB’s focus on fragmentation in European banking, and we hope decisive action to accelerate Banking. Union and consolidation will be a positive legacy of this grave crisis

Template for comments

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

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- 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";
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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	32	9	3.3. Badwill	Addition	We would support the ECB to emphasise its stance regarding badwill, i.e. full recognition from a prudential perspective. Even if recent transactions point in that direction, its quantum and relevance within the capital position of the combined entity deserves the highest clarity within ECB communications. For example, in both Intesa-UBI and Caixa-Bankia transactions, the accounting value of the badwill has been fully recognised from a prudential perspective, and there has been a clear communication regarding the expectation that the badwill will be used to underpin the sustainability of the business model of the combined entity, by covering the one-off integration charges and the acceleration of the clean-up of the asset side. Finally, the term “use of badwill” could be defined more precisely, as badwill is nothing else than the difference between accounting value and market valuation, and it is a portion of the capital of the acquired entity on a stand-alone basis.	The ECB should provide the maximum degree of clarity and comfort regarding the full recognition of badwill. Recent merger announcements have already highlighted such full recognition, however, given its quantum and relevance within the capital position of the combined entity, it is paramount that the ECB position minimises ambiguity.		Non-SSM bank	Credit Suisse Group	,	Don't publish
2	27	8	3.2. Pillar 2 capital requirements and Pillar 2 guidance	Clarification	We would welcome further guidance from the ECB on how it proposes to adjust upwards or downwards the P2R/P2G of the combined entity, and ideally, that the direction and quantum of such adjustments could be known ex ante by the merger participants. For example, Caixa has communicated a P2R equivalent to weighted average of Caixa and Bankia P2R (considering benefit of CRR II article 104a). There could be a case to justify a decrease of Caixa capital requirements as - while maintaining a solid solvency position at 250-300bps management buffer over SREP and a 11-11.5% CET1 target - the merger entails a significant increase in provisioning levels for the loan book / real estate and other assets, which together with the revenue and cost synergies envisaged, results in a more sustainable bank.	The ECB should clarify, on an ex ante basis, its approach to adjusting upwards or downwards the P2R/P2G of the combined entity.		Non-SSM bank	Credit Suisse Group	,	Don't publish
3	29	9	3.2. Pillar 2 capital requirements and Pillar 2 guidance	Addition	We view that to encourage further consolidation, the systemic surcharges post-consolidation should be implemented on a transitional basis instead of the current automatic and immediate switch. For instance, Caixa has communicated a 25bps increase in its O-SII buffer to 0.50%, due to an increase in its systemic importance following the merger with Bankia.	Changes to systemic surcharges post-consolidation should be implemented on a transitional basis instead of the current automatic & immediate switch.		Non-SSM bank	Credit Suisse Group	,	Don't publish

4	26	8	3.2. Pillar 2 capital requirements and Pillar 2 guidance	Addition	Increased regulatory flexibility allowing a transitional basis for the capital recognition of integration costs or an adjustment downwards of the P2R/P2G to reflect the increased sustainability of the combined entity would facilitate consolidation projects. The capital recognition of integration charges on day one imposes one of the most significant negative impacts on the capital position of the combined entity, as synergies are only recognised at a later stage. As cost synergies are the main driver for consolidation, it should not surprise anyone that sizeable integration charges can be incurred. Traditionally estimated at 1.5x of the run rate cost synergies, recent transactions in Southern Europe have seen this ratio increase to 3.0x and resulting on a capital hit on day one that could range from c.25bps in the Intesa-UBI merger to c.95bps in Caixa-Bankia. Furthermore, integration costs also arise in portfolio rationalization and optimization transactions (such as carve-out and spin-offs), delaying and even preventing the efficient capital allocation of banks' capital. Finally, banks operate with heterogeneous IT systems, and the integration of both platforms into a unique one can be complex, time-consuming and expensive, thereby increasing M&A execution risk.	Transitional (rather than day one) capital recognition of integration costs or an adjustment downwards of the P2R/P2G to reflect the increased sustainability of the combined entity would facilitate consolidation projects and other portfolio rationalisation and optimization transactions.		Non-SSM bank	Credit Suisse Group	,	Don't publish
5	New paragraph	0	0	Addition	In light of new guidelines on the preferential treatment of prudently valued software, a flexible approach from the ECB regarding its definition, and in general, supportive treatment of investments in digital and technology, would allow the combined entity to accelerate the digital transformation and avoid a competitive disadvantage by contrast to certain non-regulated technological players.	A broader definition of software and, in general, support in the treatment of digital and technology investments would allow banks to better compete within the new digital environment.		Non-SSM bank	Credit Suisse Group	,	Don't publish
6	29	9	3.2. Pillar 2 capital requirements and Pillar 2 guidance	Addition	The ECB, together with SRB, could provide clarity on the MREL requirements and timetable post M&A. Because MREL requirements and timetable for the combined entity are unknown prior to the merger, this causes uncertainty arising from the potential incremental cost of funding and the pace at which the merged entity would need to reach its end-state MREL requirements.	Unknown MREL requirements and timetable for the combined entity cause uncertainty arising from the potential incremental cost of funding and the pace at which the entity would need to reach its end-state MREL requirements.		Non-SSM bank	Credit Suisse Group	,	Don't publish
7	New paragraph	0	0	Addition	In a merger between a SPE and MPE firm, the SRB could provide generalised timeframes for the merged entity to complete any asset/liability exercise, development of modelling capabilities, or restructuring actions necessary for resolvability purposes and according to its "expectations for banks" resolution policy.	More clarity is needed on the timeframes for a merged entity between a SPE and MPE firm to meet SRB resolution policy.		Non-SSM bank	Credit Suisse Group	,	Don't publish

8	New paragraph	0	0	Addition	In view of a deterioration in asset quality expected across the Eurozone, banks with a view to offload toxic assets will require clarity on the exact quality of those assets. In this regard, the harmonisation of accounting rules on NPAs, the establishment of provisioning targets to the entire EU banking sector and the ECB calendar provisioning are steps in the right direction. However, ECB support on other initiatives like the development of secondary markets for distressed assets, prudential treatment of NPL securitisation, the facilitation of sales of troubled loans to non-bank investors and the improvement of data quality would provide further visibility on asset quality for acquirers, particularly non-domestic ones, ahead of considering a cross-border consolidation move.	ECB support on in-flight initiatives like the development of secondary markets for distressed assets, prudential treatment of non-performing exposure securitisation, the facilitation of sales of troubled loans to non-bank investors and the improvement of data quality would help enhance visibility on the exact quality of those assets for acquirers ahead of considering a cross-border consolidation move.		Non-SSM bank	Credit Suisse Group	,	Don't publish