



**Rabobank**



# A European solution towards statutory loss absorption?

## *Position paper*

### **Introduction**

The position paper published in September 2015 described Rabobank's position towards the German legislative proposal ("German Proposal") to subordinate non-operational debt of banks such as senior unsecured bonds, Schuldschein loans and registered bonds ('specific debt instruments') to equally-ranking operational liabilities. The proposal was adopted in Germany in Q4 2015 and is planned to become effective as from 1 January 2017.

In this second position paper Rabobank responds to other European developments with regards to subordination alternatives to address loss absorbing requirements.

The German approach of subordination of specific debt instruments was designed to help resolvability, enable the bail-in of senior debt instruments before other senior unsecured liabilities without giving rise to the No Creditor Worse Off discussion. It also facilitates German banks in meeting the loss absorbency requirements (MREL, TLAC) of new European bank resolution

frameworks as these require banks to fill in loss absorbency requirements with either structurally, statutory or contractually subordinated instruments. Senior unsecured liabilities are allowed to fulfill MREL, but only in case they do not clash with the No Creditor Worse Off principle.

As expressed in the first position paper, Rabobank is not in favour of the German Proposal to subordinate specific debt instruments. This approach does not fit the Dutch banking sector nor does it fit Rabobank as individual bank. Rabobank is building high capital buffers to protect all senior unsecured liabilities against the (unlikely) event of bail-in. With this strategy, Rabobank aims to ensure access to funding throughout the cycle i.e. also in volatile market conditions which is of high importance to Rabobank and banks in general. Rabobank believes that the German Proposal will increase the cost of funding and that the availability of senior unsecured funding could be at risk as this asset class becomes less attractive. Therefore, Rabobank argues for an alternative approach.

## Working towards a European solution?

Different initiatives have been presented and discussed in European context (German, Italian, Spanish, French[i]) to address loss absorption requirements without giving rise to the No Creditor Worse Off discussion. Recently, the European Central Bank and Single Resolution Board[ii] have expressed their preference for a common framework i.e. a European solution to avoid fragmentation of the market. Rabobank and other Dutch banks support a harmonised European solution and are currently discussing developments and scenarios.

Rabobank strongly supports a harmonised European solution for statutory bail-in debt and believes that a European solution will also be key in establishing a sizeable, liquid and therefore cost efficient market. Rabobank believes that an approach like/ similar to the French proposal - introducing a non-preferred senior unsecured layer - has most potential for a workable European solution for the following reasons;

(1) Even though the French proposal introduces a new asset class specifically designed to meet MREL and TLAC requirements, it enables banks to meet capital and loss absorbing requirements with the flexibility to use their own capital and funding strategy, fitting their own balance sheet structure, investor demand and market characteristics

(2) Contrary to the German solution, the outstanding senior unsecured debt will not retroactively be impacted by the introduction of such a law which prevents the potential risk of claims

(3) Outstanding Tier 2 contracts do not have to be amended for a subordinated layer senior to Tier 2 and in general there will be no impact on existing contractual relations

(4) There will be a clear distinction between capital and loss

absorbing instruments versus funding instruments, thereby protecting banks in ensuring access to and availability of funding

(5) The cost of funding will not be negatively impacted

(6) Introducing the non-preferred senior unsecured layer, non-holding company banks are no longer bound to Tier 2 to meet their requirements which should result in a cost benefit.

The development of a market for non-preferred senior unsecured debt would benefit from a European wide introduction of this proposal. The size of the market could impact liquidity and hence pricing.

## Rabobank's strategy and the French/ European solution

We note that of the various solutions discussed so far, the rationale behind the French solution is most in line with Rabobank's approach towards its capital strategy, i.e. building up high capital buffers to protect its senior unsecured funding base. The proposal is also in line with the Basel 3 reform to increase the quantity and quality of buffers. It allows for several ways to achieve these buffers/ loss absorbing capacity.

Rabobank's capital strategy targets a total Capital ratio with a minimum of 25%, which - subject to loss absorbing requirements - could be revised upwards. With a Total Capital ratio of 23.2% as per YE 2015 and a 'Buffer Ratio' of 27% Rabobank is already well positioned in protecting its senior unsecured debt from being bailed in.

## Conclusion

Rabobank strongly supports a harmonised European solution towards a statutory framework to meet loss absorbing requirements and addresses the No Creditor Worse Off principle.

The European solution should also allow for different capital strategies such as introducing the new non-preferred, holding company senior or buffers in the form of capital instruments (Tier 2).

Rabobank is confident that a majority of European banks can support such an inclusive approach and prefer it over national divergent approaches, which are less inclusive and result in an 'unlevel playing field'. As such, it is not beneficial to EU supervision and effective resolution in case of cross border operating institutions.

## For more information please contact

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