European Bank
for Reconstruction and Development

IEvD
Independent Evaluation Department

THEMATIC EVALUATION

“*Forging Resilience*”

An Evaluation of the Transition Impact and Additionality of the EBRD’s MREL & Bail-in-able Products [2016-2023]

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This report was prepared by IEvD independently and is circulated under the authority of the Chief Evaluator, Véronique Salze-Lozac'h. It was prepared under the guidance of Gabriele Fattorelli, IEvD Director, by IEvD staff: Natalia Kryg, and Theo Sands with the support of Sofia Keenan, Natalia Lakshina, Nikolina Balta, Martin Schunk and the independent consultant, Bostjan Jazbec. The report has been peer-reviewed internally.

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Abbreviations

AIMM	Anticipated Impact Measurement and Monitoring
ATC	Advanced Transition Countries
ATQ	Assessment of Transition Qualities
BRRD	Bank Recovery and Resolution Directive
DCM	The Debt Capital Market
DFI	Development financial institution
D-SIBs	Domestic Systemically Important Banks
DTM	Deal Tracking Module
EBA	The European Banking Authority
EBRD	The European Bank for Reconstruction and Development
ECB	The European Central Bank
ETI	Expected Transition Impact
EU	European Union
EUR	Euro
FIF	Financial Intermediaries Framework
GET	Green Economy Transition
GFC	Global Financial Crisis
ICMA	International Capital Market Association
IEvD	Independent Evaluation Department
IFI	International Financial Institution
IFC	International Finance Corporation
IMF	International Monetary Fund
MREL	The Minimum Requirement for Own Funds and Eligible Liabilities
MSME	Micro, Small and Medium-Sized Enterprises
PLN	Polish zloty
PFI	Partner financial institutions
PTI	Portfolio Transition Impact
RAROC	Risk-Adjusted Return on Capita
RWA	Risk-Weighted Asset
SEE	South-Eastern Europe
SEMED	The Southern and Eastern Mediterranean
SME	Small and Medium-Sized Enterprise
SNP	Senior Non-Preferred
SPE	Single Point of Entry
SRB	Single Resolution Board
TFP	Trade Facilitation Programme
TIMS	Transition Impact Monitoring System
TLAC	Total Loss-Absorbing Capacity
TOC	Theory of Change
TOMS	Transition Objectives Measurement System
TC	Technical Cooperation
TQ	Transition Quality
URP	Unfunded Risk Participation
WiB	Women in Business

Executive Summary: The first evaluation of an MDB's involvement in MREL and bail-in-able products

The introduction of MREL and bail-in-able products has created new opportunities for Multilateral Development Banks (MDBs), but it has also raised questions regarding the role MDBs should play in utilizing MREL and bail-in products to support their countries of operations.

Minimum-Requirement-for-Own-Funds-and-Eligible-Liabilities (MREL) instruments have become a key component in the capital structures of banks within the European Union, as a result of regulations set by the 2014 Bank Recovery and Resolution Directive (BRRD).

For the EBRD, MREL and bail-in products have rapidly become significant business; over the period covered by this evaluation, between 2016 and end-September 2023, the Bank invested in 95 separate MREL and bail-in instruments across 15 countries, with a total investment of EUR 3.1bn.

This evaluation responds to requests from Board Directors to better understand the role of the EBRD in the market for MREL and bail-in instruments, focusing specifically on the additionality and the EBRD's contribution towards transition impact. It is the first evaluation of an MDB's intervention in MREL and bail-in instruments. The evaluation draws upon an extensive portfolio analysis, case studies of the Bank's investments in Romania, Jordan, and Poland, and wider contextual stocktaking of the market for MREL and bail-in instruments.

It is critical to understand how MREL and bail-in instruments may foster transition and drive systemic change.

The EBRD does not have a formal Theory of Change (TOC) for financial resilience, including MREL and bail-in investments. Using project documentation and drawing upon extensive interviews with internal and external stakeholders, this evaluation developed a stylized Theory of Change for bail-in-able products.

This TOC helps distinguish clearly between project-level results and market-level outcomes that may contribute towards greater systemic resilience and transition impact.

Overall, the coherence of supporting regulatory compliance with the EBRD's internal strategies is not clear. In comparison, capital markets development, SME financing and green finance objectives offer a clearer strategic foundation.

This limited internal coherence is reflected in weak rationale underpinning the regulatory compliance pathway. The Bank's clients are typically amongst the most financially robust.

Furthermore, aiming to support regulatory compliance at individual clients also raises issues with respect to the fungibility of capital and potential skewed incentives; even if the EBRD's intention is to support regulatory compliance, clients can use financing for other activities, such as Mergers and Acquisitions (M&A). As regulatory capital, the EBRD cannot typically have control over use of proceeds, making it challenging to predict and track how EBRD financing contributed to client resilience.

In comparison, there are clear examples from case studies demonstrating how MREL and bail-in investments have supported capital markets development.

Over the years, the Bank's involvement provided demonstrated effects for new issuances, added credibility to a novel financial instrument, and provided guidance both to clients and wider market stakeholders. This has contributed to the rapid development of MREL markets.

Although capital market development is a key cornerstone of the EBRD's approach to financial resilience, the Bank is not in the position to consistently monitor and measure its contribution towards progress in capital markets.

The Bank's capital market success stories derived from MREL products are rarely supported by a substantiated "transition narrative" or tracked by indicators with baseline and targets.

Instead, the current focus within the monitoring benchmarks of most MREL projects is on capital levels and MREL requirements, rather than changes in how the capital markets operate.

The EBRD's MREL approach has been additional but as markets evolve additionality is declining.

The Bank's MREL and bail-in investments generally find the balance between providing finance where it is not otherwise available and identifying mechanisms to avoid crowding out private sector investors.

This includes supporting transitions from bilateral and private issuances to public issuances, as well as scaling back the Bank's participation in case of additional demand.

The Bank's non-financial additionality, including technical expertise and market credibility, has also been significant. However, the extent to which GET-eligible MREL bonds represent an effective use of conditionalities for non-financial additionality cannot be clearly assessed.

As MREL markets evolve, additionality is declining, particularly in cases of repeat

transactions. However, whilst the general trend is clear, specific assessments of additionality still vary on a case-by-case and country-by-country basis, depending on the level of capital market development.

Growing private sector interest in MREL issuances undermines the case for EBRD involvement to develop capital markets.

MREL / bail-in-able products serve as high-risk mechanism for reaching GET targets; however, the impact of GET-eligible MREL investments on Green Transition appears limited.

MREL projects have become a major driver of GET financing, both through green bonds and GET-eligible bonds.

However, a recent evaluation of the EBRD's green bonds highlighted some issues with the connection between green bonds and green transition.

For GET-eligible MREL bonds, it is not clear that as currently structured they make a strong contribution towards green transition.

There is no evidence to conclude that GET multipliers on MREL bonds are either meaningfully changing the levels of green financing, or behavioural changes within the client.

Based on these findings, the evaluation identified two strategic and two operational recommendations which may enhance the transition impact triggered by MREL / bail-in-able products

Strategic Recommendation 1 – *Strengthening the focus on capital markets*

In order to foster resilience transition at the systemic level, the EBRD should develop a set of clear principles and guidelines, focusing more on targeting sustainable market-level strategic outcomes with bail-in-able instruments.

It is recommended that to enhance the effectiveness of its bail-in-able instruments the Bank develops unified MREL/bail-in-able products strategic guidelines clarifying the principles guiding EBRD's investments in MRELs, the objective of MREL/bail-in transactions and emphasising the focus on systemic change and capital market development.

These guidelines should be initially captured in a position paper that could then become a 'living document' to retain flexibility to respond to changing market circumstances.

Strategic Recommendation 2 – *increasing emphasis on changes in green lending behaviour*

To ensure that GET-eligible MREL / bail-in-bonds deliver a tangible impact on green financing levels, the Bank should encourage and monitor partner financial

institutions to increase the quantity and quality of their green financing.

This should involve setting green finance objectives that gradually increase the requirements for environmental outcomes or tracking how levels of green financing change in PFIs through the EBRD's engagement.

This could integrate but also build on the current GET multiplier approach, providing confidence not just that partner financial institutions (PFIs) are meeting their green finance commitments but also that how clients approach green finance is changing.

The Bank should also consider ways to capture the capacity building/best-practice work carried out with the client, which often is not officially reported on nor captured. This would provide a more holistic picture of how the Bank's engagement has supported the greening of financial institutions at the corporate as well as at the project-level.

The Bank may also explore ways to use MREL / bail-in-able projects as "learning journey" towards the issuance of fully-fledged green bonds.

Whilst it would not be realistic to expect all issuances to make this transition towards green bonds, and that green bonds and general-funding bonds will co-exist going forward, explicitly targeting that objective on a case-by-case basis would provide an additional avenue towards contribution to Green TQ.

Operational Recommendation 3 – *capturing the Bank's contribution towards capital market development*

In order to enhance its additionality and to incentivize the most impactful MREL / bail-in-able projects, the Bank should develop an adequate results-based approach that 1) clearly differentiates between project-level results (focus on client capital adequacy and ability to lend in the real economy) and market-level effects (focus on capital market development); and 2) is able to monitor and measure progress towards both.

This would require an evolution of the transition impact approach for MREL/bail-in-able projects, in both the ex-ante ETI questionnaire and monitoring benchmarks.

More alignment and combined reporting with relevant technical cooperation (TC) work on capital market development should also be considered to strengthen the focus on market-level outcomes.

Finally, building on the guidelines within the position paper incorporated as part of Recommendation 1, the updated "TOMS training manual / guidance" that is currently in preparation should provide MREL/bail-in specific guidance on drafting a transition impact (TI) narrative and on selection of specific transition quality(ies). This latter point may become even more critical if the flexible approach to the number of TQs is implemented.

It is also understood that as part of the redevelopment of the TOMS 2.0 system, the Bank is considering how risk is integrated into TI assessments. As part of that process, it should be considered how bail-in risk is treated in the expected transition impact (ETI) scoring calibration including external (market-related) risks.

Operational Recommendation 4 – *enhancing governance for greater transparency and additionality*

In order to ensure MREL / bail-in-able products are additional and conducive to systemic change, the Bank should enhance transparency and strengthen the ability to assess MREL / bail-in-able products at any point in time, not just at signing, without adding burden to Board members or Management.

Concrete actions should include:

1) Developing a standardised template for issuance notifications, with key metrics including oversubscription ratio, extent of EBRD scale-back, RAROC versus estimate, and investor composition and using them for all projects in a systematic manner.

2) Notifying the Board about each issuance the Bank participates in, rather than only the first, to ensure ongoing oversight. This could be done as part of quarterly performance review (QPR) reporting or provided on quarterly basis as part of Board Online Information.

3) Consider the cost-benefit of reducing the headroom period from 3 years to 1 year, particularly for advanced transition countries in the EU where the MREL/bail-in-able markets are starting to mature and the EBRD's financial additionality shrinks.

This evaluation report benefits from an external viewpoint note prepared by Professor Steven Cecchetti, available in the Annex of this report.

Prof Cecchetti is a distinguished expert in banking regulation and financial sector stability. He is the Barbara and Richard M. Rosenberg Professor of Global Finance at Brandeis International Business School. He has held prestigious positions, including Economic Adviser at the Bank for International Settlements and Executive Vice President at the Federal Reserve Bank of New York. An accomplished author and researcher, he has significantly influenced global regulatory reform and financial policy through his extensive academic and policy publications.

For more details on Professor Cecchetti's extensive expertise and contributions to global financial stability, visit his profile: https://www.kcl.ac.uk/people/stephen-g-cecchetti .

1. Background and Approach: the first MDB evaluation of MREL and bail-in-able instruments

1.1. Rationale for this evaluation

1. The evaluation of the transition impact and additionality of the EBRD's investments in MREL and bail-in instruments was included in the IEvD Work Programme for 2023-2025 and approved by the Board of Directors on 6 December 2022.

Box 1: MREL and bail-in-able products in a nutshell
• **The Minimum Requirement for Own Funds and Eligible Liabilities (MREL) originated from Article 45e(1) of the 2014 Bank Recovery and Resolution Directive (BRRD) implemented within the EU (2014/59/EU).**
• The concept of MREL is rooted in the international efforts to strengthen the resilience of the banking sector following the global financial crisis (GFC) of 2007-08.
• The primary objective of MREL and bail-in-able instruments is to augment the quantity and quality of loss absorption capacity within banks and contribute to recapitalization in case of bank resolution.
• **In the context of the BRRD, the MREL requirements are compulsory for banks in EU countries. Targets for individual entities are set by national regulators in coordination with the European Banking Authority (EBA) and the Single Resolution Board (SRB), and are dependent upon systemic importance, size, risk profile, and business model.**
• As banks started to issue debt to meet their MREL requirements, a new market for eligible liabilities developed. This market covers bail-in-able instruments that are MREL-eligible, such as senior non-preferred (SNP) debt, which was specifically designed to meet MREL criteria. The growth of the market was supported by investor demand for these new instruments, driven by their higher yields compared to traditional senior debt. EBRD first participation in the MREL market was in late 2016.
• **Non-EU countries are exploring similar requirements on their journey towards more robust resolution and alignment with Basel III regulatory standards. EBRD supported its first bail-in-able investment in non-EU countries in 2019.**
Source: IEvD desk research (2024).

2. **This topic was included in IEvD Work Programme in light of the rapid growth of the Bank's MREL and bail-in portfolio, as well as of significant changes in evolving capital markets for MREL and bail-in instruments.** It was also trigged by ongoing internal discussions regarding the rationale for the Bank's support for MREL transactions.

3. More broadly this exercise aims to provide findings and lessons useful not just to the EBRD, but also to the wider multilateral development bank (MDB) community as different MDBs consider their approach to the capital market for MREL and bail-in instruments.

4. **As the first evaluation looking into an MDB's involvement in the capital market for MREL instruments, this evaluation could provide insights to other IFIs and MDBs exploring potential roles within these markets, drawing upon the EBRD's experience.**

1.2. Evaluation Methodology

Objective and Scope of this evaluation

5. **This report is a thematic evaluation of the EBRD's investments in the Minimum Requirement for Own Funds and Eligible Liabilities (MREL) and bail-in instruments from 2016 to 2023.** The evaluation aims to provide an in-depth understanding of the overall relevance, effectiveness, and efficiency of these investments, which are bail-in-able debt products that enhance the loss absorption and recapitalization capacity of banks in case of resolution.

6. **The objective of this evaluation is to assess to what extent the Bank's activities in the MREL and bail-in-able market have demonstrated additionality and contributed towards transition impact in its Countries of Operation (COOs).** Along with sound banking, additionality and transition impact are fundamental tenets of the Bank's mandate and are necessary pre-conditions for the Bank's investments. Exploring the connection between MREL and bail-in-able products and additionality and transition impact provides a direct mechanism for examining the underlying rationale behind the Bank's MREL and bail-in-able investments.

7. **The scope of this evaluation encompasses the EBRD's involvement in the MREL and bail-in-able instruments market since the initial MREL investment in December 2016 up to end-September 2023.** In total, this covers a portfolio of 95 investments across 15 countries, and a total investment of EUR 3.1bn. Although non-EU bail-in-able investments are not MREL, given their similar bail-in-able characteristics, they are included within the scope of this evaluation.

8. **The Bank defines MREL products in line with EU classifications and applies the same terminology to bail-in-able investments outside of the EU** (Box 2). MREL products encompass Basel III compliant Tier 2 sub-debt, senior non-preferred (SNP) and the senior preferred (SP) that the Bank offers to its eligible financial institution (FI) clients. Although certain forms of equity can count towards meeting MREL requirements, it is excluded from the scope of this assessment.

Box 2: A note on terminology: MREL & Bail-in-able products

- **The evaluation uses the following range of terminology in relation to MREL/bail-in-able instruments in this evaluation report.**

  This choice of wording is influenced by the terminology used within EBRD, which might not necessary be in line with the classifications used outside of the Bank.

  - **Bail-in-able products:** Bail-in-able instruments are financial instruments that can be used to absorb losses during a bank resolution by either writing down their value or converting them into equity.
  - **MREL products:** MREL products are bail-in-able instruments designed to meet the regulatory requirements under the BRRD for FIs operating in the EU jurisdictions. These products, which include senior non-preferred debt, subordinated debt, and other unsecured debt are bail-in-able, meaning they can be converted into equity or written down during a resolution to ensure that the financial institution can absorb losses and continue operations without taxpayer bailouts.

  The evaluation considers the following instruments to fall under this category (*Box 4): i) Basel III compliant Tier-2 subordinated debt (sub-debt); ii) Senior Non-preferred debt (SNP); and iii) Other senior unsecured instruments that are MREL-eligible, in the context of CRR II (Senior preferred debt - SP).*

- **Outside of the EU, some regulatory environments are exploring similar requirements to the EU's MREL regime, building on existing Basel III regulation.** Investments in bail-in instruments outside of the EU are not MREL investments but share the same characteristic risk of bail-in.
- **An important disclaimer is that in the context of EU countries, all three instruments above are MREL-eligible instruments as recognised by Bank Recovery and Resolution Directive (BRRD).**
- **Capital market for MREL instruments**: the capital market has developed around instruments eligible to meet the MREL regulatory requirements. IEvD refers to it as "*MREL market*" which refers to a capital market for MREL instruments.

The scope of this evaluation is the EBRD's investments in MREL and bail-in transactions that fall under the EBRD's internal risk guidelines for MREL and bail-in transactions.

Source: IEvD (2024).

Evaluation Questions

9. **This evaluation takes a thematic approach, drawing upon a wide range of different sources to address the evaluation questions.** A thematic approach to evaluation is typically employed when addressing larger strategic questions, compared to the more operational and granular perspective provided by project or cluster evaluations.

10. The evaluation is structured around an overarching evaluation question and four evaluation questions, with an in-depth evaluation framework. The overarching question is:

To what extent has the EBRD's support for MREL and bail-in instruments been additional and contributed to fostering transition in the Bank's region?

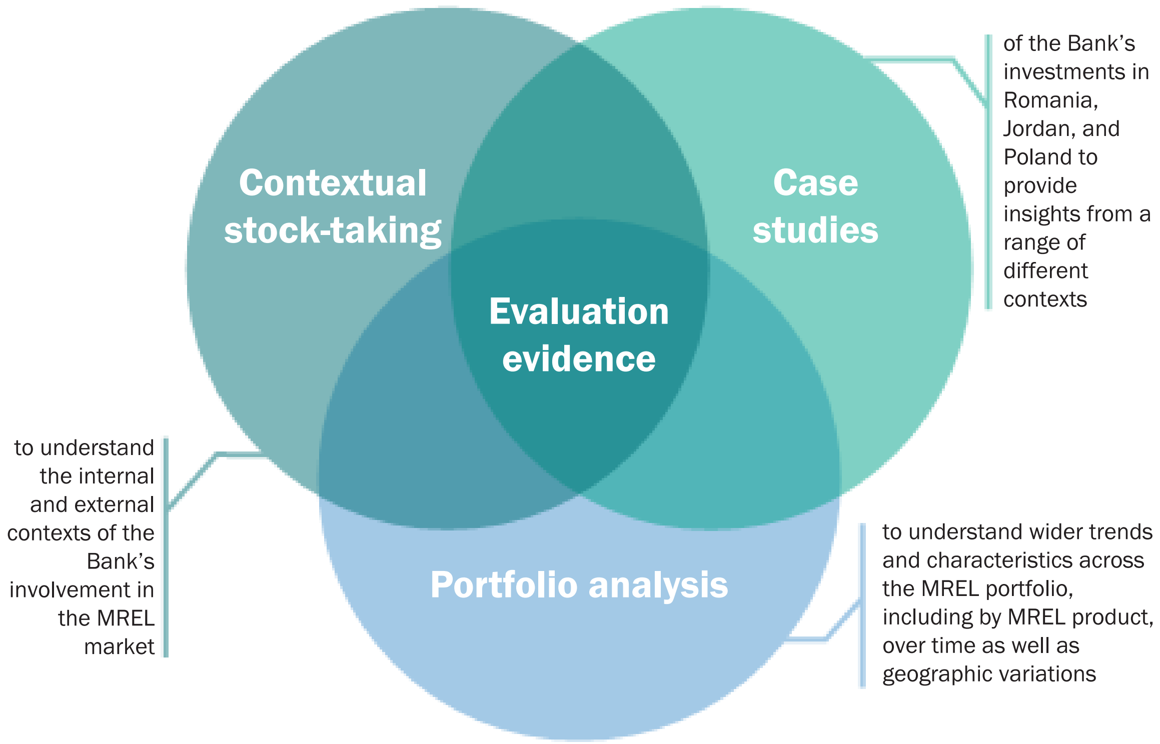
11. **The four evaluation questions are:**

- EQ1. How has the EBRD's involvement in MREL and bail-in instruments been relevant to the client's needs and the Bank's strategic priorities [Relevance; Internal Coherence]
- EQ2. To what extent has the EBRD's involvement in MREL and bail-in instruments been additional vis-à-vis other stakeholders (local banks, private investors, other IFIs) [Additionality]
- EQ3. To what extent have EBRD's MREL and bail-in-able debt products contributed to delivery of transition impact [Effectiveness]
- EQ4. To what extent has the EBRD's involvement in MREL and bail-in instruments been carried out in a timely, efficient and economic manner [Efficiency]

Data collection and research tools

12. **The primary methodological approach towards addressing the evaluation questions was three-fold (Figure 1).** Careful triangulation between lines of evidence helped to strengthen the robustness and validity of evaluation findings.

Figure 1: Summary of IEvD methodological approach



Source: IEvD (2024).

13. **Across the three methodological pillars of this evaluation, IEvD employed a wide range of different data sources:**

- **Portfolio data review:** this comprised both standard EBRD project data, as well as bespoke data on MREL and bail-in transactions collected by the FI and Treasury teams and shared with IEvD.
- **Secondary data review:** IEvD used secondary data, including on markets, from Bloomberg and the European Banking Authority (EBA), as well as on client-level specifics (e.g., client financial reporting).
- **Document review:** the evaluation team reviewed over 150 documents, including internal documents related to MREL and bail-in-able transactions, MREL-related strategic documents, and relevant documents released by other stakeholders in the space of MREL (e.g., by the EBA, SRB or IFC). The desk review was an important data source across all three pillars of the evaluation, supporting the portfolio analysis, the case studies, and the contextual stock-taking.
- **Survey targeting EBRD bankers:** IEvD carried out a survey of 23 banking colleagues (mainly operation leaders, OLs) who worked with the Bank's clients on MREL and bail-in investments. This provided an important input into the internal contextual stock-taking, helping to understand the perspective of bankers involved in MREL and bail-in-able transactions and providing a starting point for more detailed investigation via semi-structured interviews.

- **Semi-structured interviews:** the evaluation team conducted 93 interviews of a broad range of respondents. This data source was fundamental to both the contextual stock-taking and the case studies.
- Interview participants included EBRD colleagues and clients, representatives from other MDBs, national regulators, and other market stakeholders (e.g., rating agencies and supranational regulators). Interviews provided a rich qualitative data source to triangulate and reinforce other quantitative data, including portfolio data and wider market development.

Challenges and Limitations

14. **This evaluation faced several limitations.** Even with taking a mixed-methods, theoretical approach, understanding how the EBRD's financing can contribute to wider capital markets development is a challenging process, given the complex nature of capital markets.

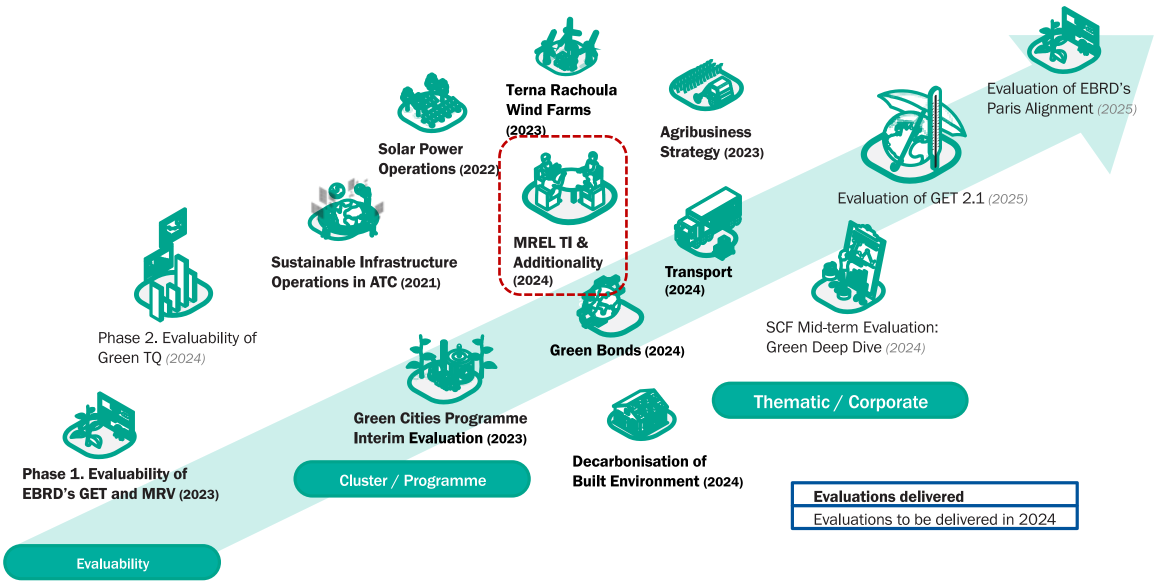
15. **Furthermore, during the period covered by the evaluation, there was significant market uncertainty.** Both the COVID-19 pandemic and the Russian invasion of Ukraine caused disruptions to capital markets, which makes understanding cause-and-effect more challenging. The evaluation took these disruptions into consideration in the analysis.

1.3. Connection with other evaluation products

16. **This evaluation has been conducted in the framework of IEvD's Work Programme.** Findings, recommendations, and suggestions from this evaluation are interconnected with other ongoing and planned IEvD evaluations of green products and beyond, with an overarching approach to ensure that findings and recommendations are coherent and complementary.

17. Other upcoming evaluations that are relevant include: the evaluation of the EBRD's Local Currency Financing, and the Bank's support to advanced transition countries (ATCs).

Figure 2: Evaluation approach to holistic coverage of the GET and green transition



18. Furthermore, this evaluation has been conducted in close coordination with the evaluation of the Bank's investments in green bonds (Box 3). The ERBD has a significant portfolio of MREL-compliant green bond investments.

Box 3: Key highlights from evaluation of the EBRD's Green Bonds

- Between 2017 and 2022, the EBRD made 42 Green Bond investments, with an overall value of €1.25bn. Out of these, 10 green bonds were issued under MREL programmes, with overall EBRD investment of €353mn.
- EBRD investments accounted for a sizable share of green bond issuances in its COOs over the period. Through supporting first-time issuers, acting as an anchor investor and catalysing demand, the EBRD delivered a significant contribution to the development of green bond markets.
- EBRD investments in green bonds may not automatically translate into green impact, where not accompanied with formalised assessment of issuers' sustainability strategies, and systematic follow-up on the standards of post-issuance allocation and impact reporting.
- The management of data on green impacts of green bond investments can be improved. GET ex-ante estimates are often unreliable due to uncertainty about the use of proceeds and lack of transparency on the methodology.
- **For the majority of its green bond investments in the sample, the Bank demanded "asset ring-fencing" as part of bilateral frameworks. There may be some valid considerations to use bilateral frameworks.**
- **However, "asset ring-fencing" raises a number of concerns and continuing it is in breach of capital markets' best practice and entails risk for the Bank and issuers.**

Source: IEvD Green Bonds Evaluation (2024).

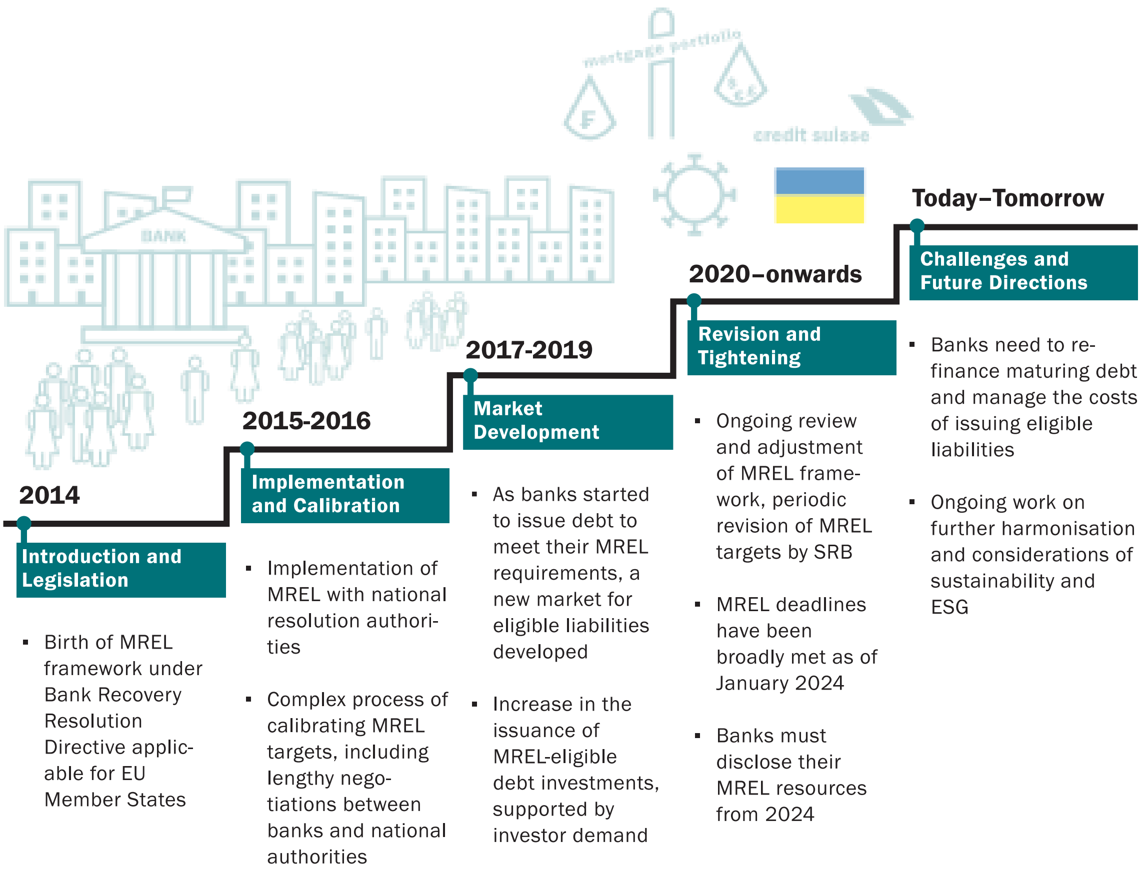
2. Understanding MREL and bail-in instruments

2.1. The wider context behind MREL and bail-in instruments

19. **The concept of MREL is rooted in the international efforts to strengthen the resilience of the banking sector following the global financial crisis (GFC) of 2007-08.** MREL targets are intended to ensure that banks have enough equity and debt capacity to absorb losses and recapitalize themselves without needing taxpayer-funded bailouts, thus mitigating systemic risks and enhancing financial stability.

20. **MREL is part of a broader regulatory framework that emerged post-GFC, which includes measures such as the Basel III regulations on bank capital and liquidity.** MREL is closely related to the concept of the Total Loss-Absorbing Capacity (TLAC), which applies to globally systemic banks and aims at ensuring these banks can be resolved without public funds, by having sufficient bail-in-able liabilities in a crisis. It is a rapidly changing market that has swiftly evolved over the last decade in the EU (Figure 3).

Figure 3: The evolution of the MREL market and its delivery within the EU banking sector.



Source: IEvD summary based on publicly available information (2024).

21. **The current stage of regulatory frameworks that underpin MREL is still uncertain.** Resolution of MREL instruments has not yet been tested in many regulatory regimes, and the recent case of

failure of Credit Suisse continued to expose taxpayers to significant fiscal risk (although was not revolved under EU jurisdiction). This uncertainty affects investor demand for MREL instruments, providing less clarity on outcomes during a resolution situation.

22. **MREL-like regulation is also applied outside of EU, in countries that aim to align their banking sector practices with that of the EU banking sector such as Albania and Montenegro.** Often, joint World Bank-IMF's Financial Sector Assessment Programs and associated Financial System Stability Assessment recommend to non-EU countries to adopt banking sector regulations in line with Basel III principles and guidance.

23. **The "bail-in" mechanism is a cornerstone of the post-crisis resolution framework.** This allows regulatory authorities to write down the value of a bank's liabilities or convert them into equity to stabilize the bank. This process is designed to preserve the critical functions of the bank while minimizing impacts on financial stability and avoiding the use of public funds.

24. **The market for bail-in-able instruments consists of various forms of debt that can be readily converted into equity or written down in value during a crisis to ensure the bank meets its MREL requirements.** This market has seen significant growth as banks issue debt instruments designed to meet these regulatory requirements, including senior non-preferred debt, subordinated debt, and other forms of unsecured debt that are explicitly designed to be bail-in-able.

25. **However, the development of capital markets for MREL and bail-instruments poses challenges.** This includes pricing the risk of bail-in, investor demand for such instruments, and the implications for financial stability. The balance between ensuring banks is adequately capitalized to withstand losses while maintaining healthy, liquid markets for bail-in-able instruments is a complex regulatory and market challenge.

2.2. Bail-in able instruments and the role of MDBs: the EBRD and other IFIs

26. **The role of MDBs in MREL markets was not defined by the Bank Recovery and Resolution Directive (BRDD), nor subsequently by any legally binding document.** This has been a cause for concern for various stakeholders and policy makers, and it was an additional motivation for this first evaluation to assess investments by an MDB in MREL transactions.

27. **The sole document that tries to define the nature of MDBs' involvement in the market for MREL instruments is the Joint Vienna Institute report, published in March 2019[1].** As articulated in the report, "*the possibility of IFIs investing in MREL-eligible securities could be considered as part of the solution, but only under specific circumstances and on a temporary basis*"[2].

28. **This report summarises the conclusions of the Working Group on IFI financial products supporting investment, established in June 2017 in the context of the Vienna Initiative (VI).** The

[1] Joint Vienna Institute (2019). Working group on IFI financial products supporting investment in CESEE – Final Report, Joint Vienna Institute, March 2019.
[2] Working group on IFI financial products supporting investment in CESEE – Final Report, Joint Vienna Institute, March 2019.

conclusions included in the report are, as any VI product, voluntary, public, and nonbinding on the participating institutions, including EBRD.

29. They were intended to inform market participants, policy makers and the general public about suggested approaches and best practices at that point in time. The document also reflects the state of the market for MREL instruments in 2018, which has changed significantly in the interim period.

30. Furthermore, this evaluation investigated also the channels of potential alignment of the EBRD's participation in the market for MREL instruments with the relevant EU policies on MREL such as the BRRD and Single Resolution Mechanism (SRM), as well as global frameworks like the Financial Stability Board's Key Attributes.

31. **The key main channels of alignment with EU policies include financial stability, banking sector resilience, and market development.** Those align well with EBRD's core mandate of fostering transition through contribution toward a more resilient and stable financial system, and fostering private sector growth, particularly through capital market development (Box 4).

Box 4: EBRD's participation in MREL market from the global and EU policy objectives underlying MREL legislation

The key "channels" of alignment of the EBRD's participation in the MREL market with the relevant EU policies on MREL include the followings:

1. Financial Stability:

- European Commission: Stressed the need for MREL instruments to reduce banks' dependence on public funds, to enhance banks' loss-absorbing capacity as to make them more stable. This aligns with the EBRD's aim of fostering resilience through bolstering banks' resilience although it has also been noted the EBRD's fund is a public fund.
- IMF: Highlighted the EBRD's role in meeting MREL regulatory requirements, balancing investments with strategic goals to ensure financial sector stability.

2. Banking Sector Resilience:

- BIS: Emphasized the role of MREL in resolution strategies, recognizing the EBRD's support for small and medium-sized banks, and through that enhancing the resilience of the wider sector:
- IMF: Acknowledged the EBRD's role in strengthening banking sector resilience in transition economies through MREL-eligible investments.

3. Market Development:

- European Commission: Acknowledged the EBRD's assistance to small and medium-sized banks in accessing capital markets, supporting market development.
- IMF: Noted the EBRD's role in bridging policy and implementation gaps, particularly in transition economies, aiding capacity building and market development.

Source: IEvD interview stocktake and desk research (2024).

▪ First, what is the EBRD's current position?

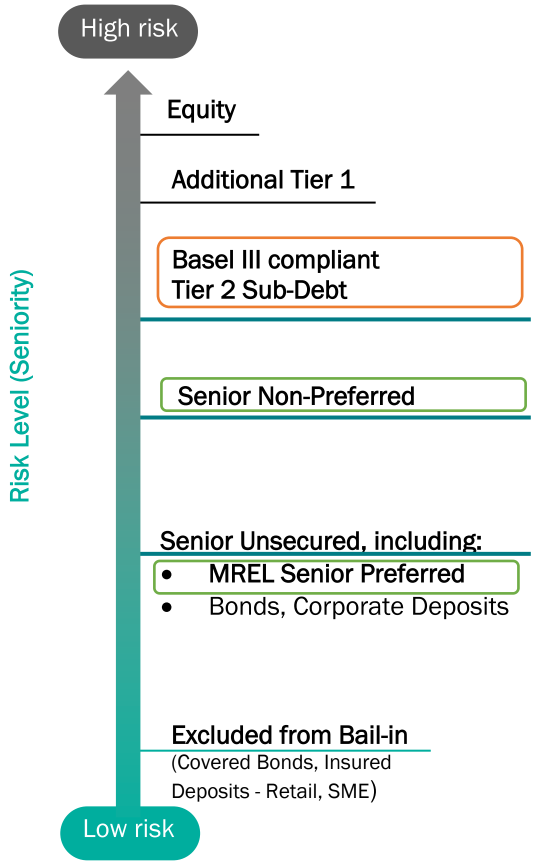
A> EBRD's approach to MREL and bail-in-able products

32. **There is no standalone strategic document specifically outlining the EBRD's involvement in the MREL market.** References to MREL and bail-in-able (Box.5) instruments are included within the EBRD Financial Sector Strategy for 2021-2025 as well as some of the latest EBRD Country Strategies (e.g., Poland). Risk governance of the EBRD's approach to MREL and bail-in-able instruments is set by an internal EBRD document.

Box 5: Key Features of Bail-in-able Debt Instruments at EBRD

There are three core MREL bail-in-able debt products at use in EBRD starting from the most senior in the capital structure.

Seniority refers to the position in the capital structure and the associated risk level corresponds to the order of repayment to security holders in the case of a default by the issuing corporation, which implies that EBRD takes a higher risk with investing into Tier 2 sub-debt instruments with clients than it does with senior preferred investments.



- Tier 2 Sub-Debt: Basel III compliant unsecured subordinated debt. Eligibility criteria: a contractual maturity of at least five years, early call option at the discretion of issuer and not earlier than 5 years, no incentive to redeem or repay, not subject to set-off or netting arrangements that would undermine their capacity to absorb losses.
- Senior Non-Preferred (SNP): unsecured debt which is senior to subordinated notes but junior to SP. Eligibility criteria: an original contractual maturity of one year or more, no embedded derivative features; and a contractual subordination clause vis-à-vis senior unsecured.
- Senior Preferred (SP): a senior unsecured instrument with no subordination status in the insolvency hierarchy. MREL eligibility criteria in the context of CRR II: limited acceleration rights, an original contractual maturity of one year or more, no embedded derivative features, no incentive to call, redeem, repurchase.

Source: Modified from EBRD BIS on MREL (January 2023)

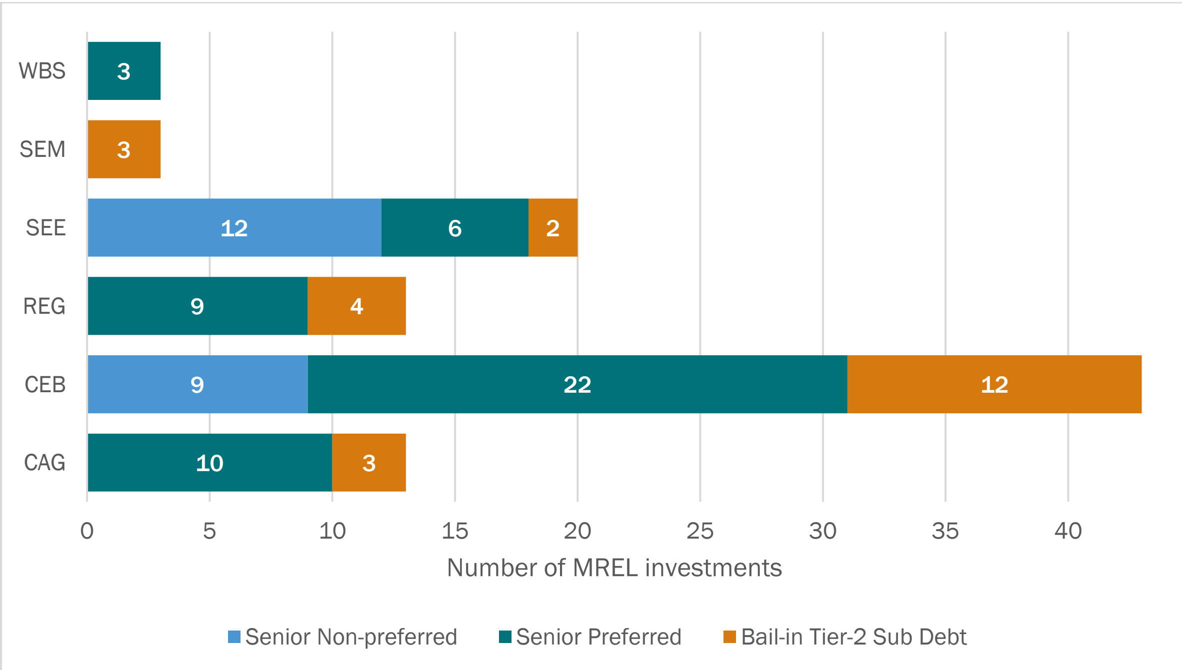
B> EBRD's Portfolio Overview (2016-2023)

33. **EBRD signed its first MREL-eligible investment in December 2016.** Since then, the EBRD's MREL and bail-in investments have been increasing rapidly, and by end-September 2023 had reached EUR 2.7bn volume of investments across 13 countries.

34. **Senior Non-preferred investments are predominantly in Southeast Europe (SEE) and Central Europe and the Baltic states (CEB)**, with SEE having 12 and CEB having 9 such investments. Senior Preferred investments are most common in CEB, with 22 investments, followed by Regional (REG) with 9 and Cyprus and Greece (CAG) with 10. Bail-in Tier-2 Sub Debt is notably present in CEB with 12 investments, while other regions such as REG, SEE, and CAG have fewer such investments (Fig.4).

35. **The Western Balkans (WBS) and Southern and Eastern Mediterranean (SEM) show limited diversity, focusing primarily on single types of products.**

Figure 4: Distribution of the bail-in-able products by country groups



Notes:
Western Balkans (WBS): Montenegro
Southern and Eastern Mediterranean (SEM): Jordan
Southeast Europe (SEE): Bulgaria, Romania
Regional (REG): Regional
Central Europe and the Baltic states (CEB): Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, Slovenia
Cyprus and Greece (CAG): Greece

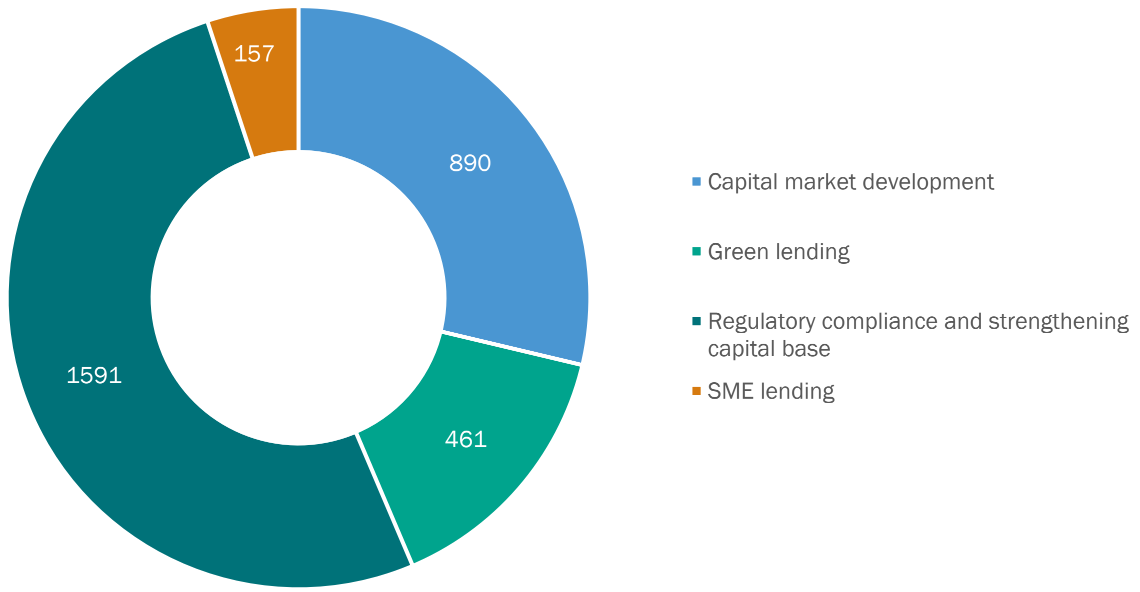
Instrument/unit	Senior Non-Preferred	Senior Preferred	Bail-in Tier 2 sub-debt
Total transactions:	21	50	24

C> Understanding the "transition narrative" of the EBRD's MREL / bail-in-able products

36. **As an initial exercise, IEvD used the Board Memorandum for projects to understand how MREL and bail-in-able projects were being presented.** This sought to identify the primary rationale and narrative underpinning each project. The methodology for this assessment was based on a review of each project's Board Memorandum, using the President's Recommendation, the Board Decision Sheet, and the Strategic Fit section.

37. **Overall projects can and do have multiple explanations provided for the reasons underpinning the EBRD's investment.** This exercise identified that for c.a. 50% of ABI the primary narrative was helping clients achieve regulatory compliance. For 29% of projects, the primary rationale was capital markets development, whilst green and SME lending accounted for 15% and 5% respectively.

Figure 5: MREL ABI by rationale (EUR mn)



Source: IEvD analysis.

38. **In order to understand the overall Transition Impact contribution fostered by EBRD's investment in MREL/Bail-in-able product, this evaluation developed a stylized Theory of Change that aims to provide useful inputs to the ongoing work on the review of the TQs pathways.**

39. **As a starting point, this revised Theory of Change differentiates between the project-level and market-level outcomes that each project is expected to contribute towards.** This follows the best practice principles set out in IFC's Anticipated Impact Measurement and Monitoring (AIMM) model[3].

40. At the project-level, outputs are focused either on allocation of financing by financial intermediaries, or the capital market component – which in the context of MREL and bail-in transactions normally implies a successful capital market issuance (or an issuance which builds upon previous issuances, with respect to tenor, levels of private sector participation, volume, instrument type etc.). At the outcome level, this translates into increased lending in the direction of the EBRD's strategic priorities (green and SME financing) and improved client capacity to access capital markets.

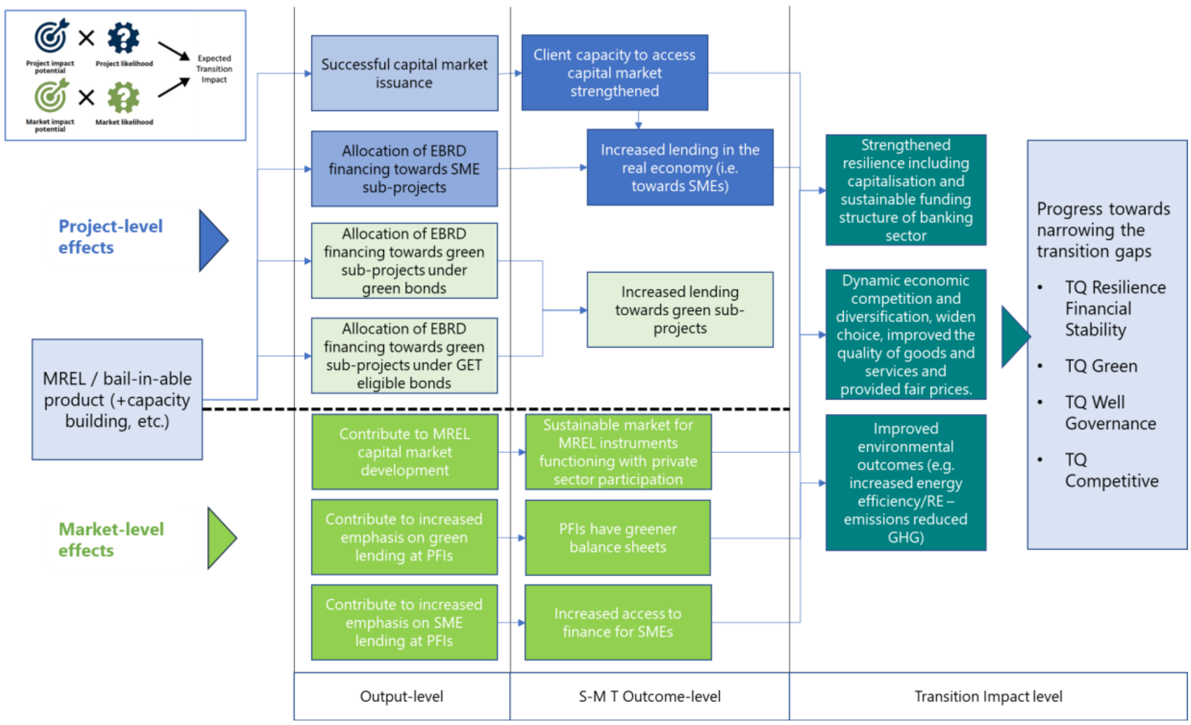
[3] IFC's AIMM Sector Framework Brief on Capital Markets is available here: https://www.ifc.org/content/dam/ifc/doc/2022/aimm-sfb-capital-markets.pdf

41. Even at the project level, this stylized Theory of Change places the emphasis on how the EBRD's interventions have supported clients to access capital markets, instead of how EBRD's financing has supported regulatory compliance.

42. This change reflects IEvD's observations that at the project and client-level, there are clear success stories with how the Bank's support has changed the capacity of clients to tap capital markets for MREL and bail-in financing, and that long-term, sustainable financial resilience will be dependent upon whether clients have access to capital markets and not on whether they can rely on MDB financing.

At the market-level, outputs and outcomes are focused on three mechanisms: capital market development, greening the balance sheet of PFIs, and increasing access to finance for SMEs. These are wider shifts which require behavioural changes not just on the part of the client but also by other market stakeholders and might result from a series of projects rather than just a single transaction.

Figure 6: IEvD's revised Theory of Change for MREL and bail-in investments



Source: IEvD analysis

▪ Second, what is the position of other MDBs?

43. **There is a fragmented view on the position of MDBs in the market for MREL instruments among MDBs.** The EBRD is prominent, as the first and largest MDB present in the MREL market since late 2016. The International Finance Corporation (IFC) entered the MREL market in 2017 and has a smaller MREL portfolio as compared to EBRD.

44. **In particular, the European Investment Bank Group (EIBG) does not currently engage in MREL market.** Stakeholders argued that given that part of the stated rationale for MREL is to reduce taxpayer liability in cases of bank resolution, it is not appropriate for taxpayer funded institutions such as MDBs to invest in these instruments. Stakeholders also highlighted the riskiness of the MREL products, as well as potential risks of distorting competition.

45. **The EBRD and the IFC are the only two MDBs active in the MREL-eligible investment market, with varied approaches to tracking and assessing these investments.** EBRD, which started its MREL investments in 2016, maintains regular portfolio-level reporting to its Board,

46. Both banks focus on different objectives and regional concentrations in their MREL investments. While EBRD reports on all three MREL products (i.e., senior preferred, senior non-preferred, Tier 2 sub-debt), IFC reports Tier 2 sub-debt product separate from MREL. IFC's country concentration overlaps with EBRD within the EU with Romania and Poland taking a large share of the portfolio.

Table 1: Mapping of the MDBs views on the use of bail-in-able (MREL) products in their respective institutions

MREL – bail-in-able products	ADB	AfDB	AIIB	EBRD	EIBG	IDB	IsDB	WBG-IFC
Yes/No	No	No	No Under review (drafting investment guidelines, simultaneous to two potential projects for Board approval)	Yes Active since end-2016, three MREL products, incl. Basel 3 compliant T2	No Under consideration	No	No	Yes Active since 2018, Basel 3-compliant T2 + two MREL products
Rationale	n/a	n/a	Considering a potential approach to MREL since early 2024 with a strong focus on the demand-driven rationale. Policy towards MREL still in drafting stage	Partner banks replacing traditional unsecured wholesale funding with MREL bail-in-able instruments. Development of efficient capital markets.	Considering a potential approach to MREL since 2018. Policy issue with MREL in case of bail-in (taxpayer money), higher risks considerations and different business model to EBRD. Not needed from the business volume targets perspective as broadly met.	n/a	n/a	Following market with the development of market for bail-in-able instruments. Needed to achieve development goals (green, social or both)

Source: IEvD interview stocktake and desk review (2024). / Notes: ADB – Asian Development Bank, AfDB – African Development Bank, AIIB – Asian Infrastructure Investment Bank, EBRD – European Bank for Reconstruction and Development, EIBG – European Investment Bank Group, IDB – Inter-American Development Bank, IsDB – Islamic Development Bank, WBG – IFC – World Bank Group – International Finance Corporation.

▪ Third, what do other key players, including industry experts, argue?

47. **This evaluation summarised interviews with over 60 industry experts, regulatory representatives, staff from various bodies including the European Commission, EBRD and IFC, as well as EBRD clients, to highlight several different perspectives on MDB involvement.**

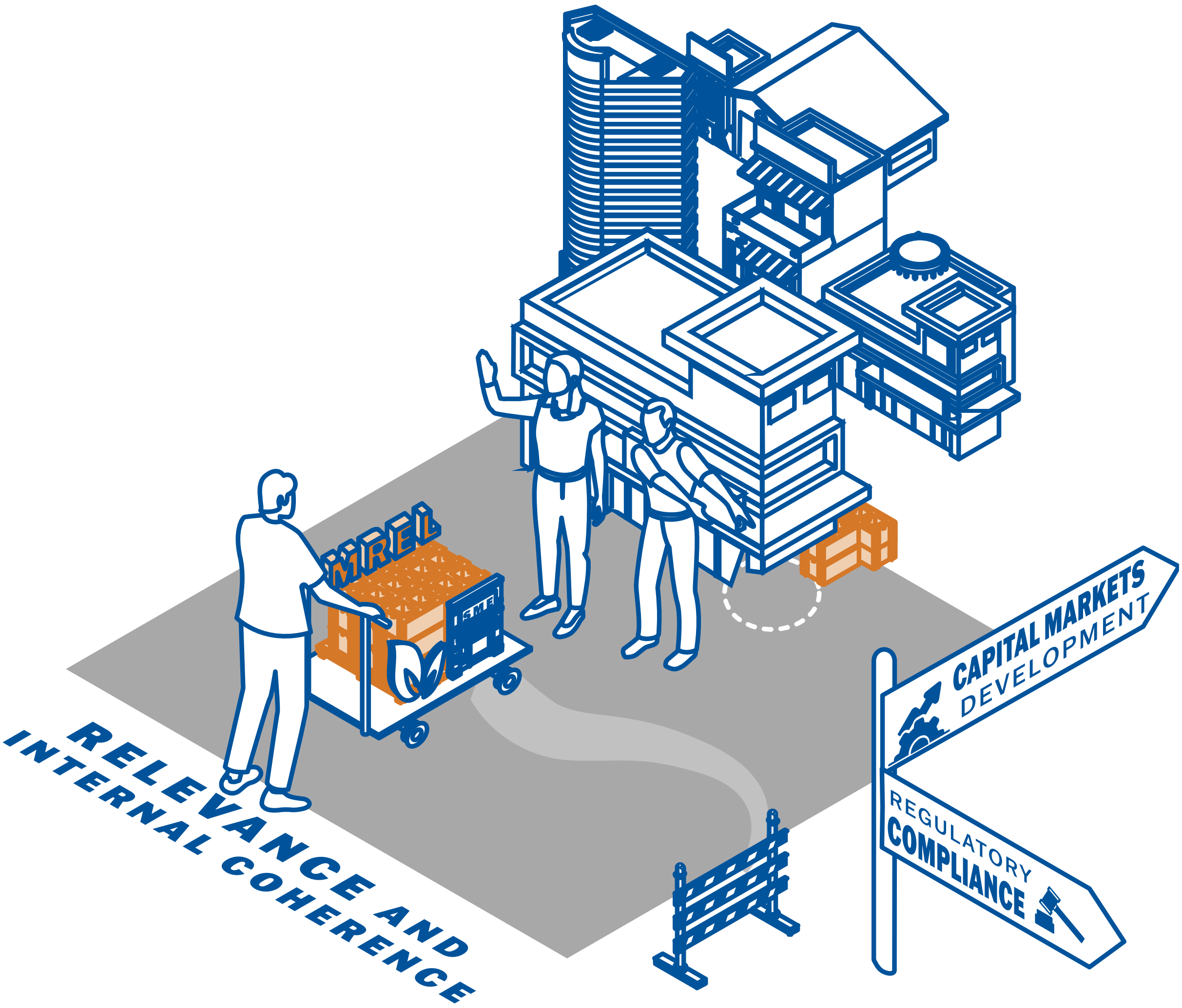
48. **These views are diverse, reflecting the complexity of MDBs' roles in enhancing financial stability and supporting sustainable financing among other strategic objectives.** The analysis below synthesizes these perspectives without attributing them to specific individuals nor their respective institutions.

Table 2: Analysis of MDB's role in bail-in-instrument markets

Opportunities	Threats
• **Development of local capital markets:** EBRD and other MDBs can play significant roles in developing capital markets, especially in countries with underdeveloped financial systems	• **Risk of market distortion:** Concerns about potential competition distortions and crowding out the private sector.
• **Positive signalling effect:** EBRD's market presence is consistently regarded positively for stabilizing the market for MREL instruments. MDB may act as an anchor investor, particularly in shallow markets, thus bringing comfort to other investors and encouraging private investment.	• **Dependence on institutional support:** Dependency highlighted by market analysts and academic perspectives noting that continuous support might inhibit market independence.
• **Support for green and social agendas:** The example of EBRD integrating ESG criteria into its MREL investments is perceived as an excellent practice.	• **Regulatory and Policy Uncertainties:** The role of MDBs in MREL can sometimes lead to policy issues, such as the use of taxpayers' money and bail-in risks, which might affect public perception and regulatory acceptance
• **Support for Financial Stability:** a role in addressing MREL shortfalls by MDBs, particularly for banks with multi-point entry MREL requirements and those operating in smaller or emerging market	• **Variability in MDB Risk Appetites and Mandates:** Differences in risk tolerance and strategic focus among MDBs (e.g., EIB vs. EBRD) can lead to inconsistent approaches in the MREL market
	• **Reputational risks:** Risks related to MDBs being too interventionist or investments failing to yield expected benefits, noted by academic critiques and internal reviews

Source: IEvD interview stocktake (2024). IEvD interviewed 62 external individuals between December 2023 and March 2024 to collect the full spectrum of views on MREL among the key external stakeholders. This included: 16 representatives from external bodies such as IMF, BIS, European Commission; 21 representatives from other IFIs (EIB, WBG/IFC); 11 officials from banking authorities and central banks from the EBRD region; 4 representatives of credit rating agencies and 9 EBRD clients.

CHAPTER 3


MREL
SME
RELEVANCE AND
INTERNAL COHERENCE
CAPITAL MARKETS
DEVELOPMENT
REGULATORY
COMPLIANCE

3. The EBRD's involvement in the MREL market is profitable, demand driven but lacks focus on systemic change

How has the EBRD's involvement in MREL and bail-in instruments been relevant to the client’s needs and the Bank’s strategic priorities?
• The EBRD’s involvement in the MREL market is opportunistic and demand driven and has evolved to keep on meeting the demand of long-term Bank clients. • Contributing to capital markets development enables a strong transition narrative for MREL/bail-in-able products, while an emphasis on supporting individual clients to achieve regulatory compliance raises potential issues of market distortion. • There is a clear strategic basis for using MREL and bail-in investments as a vehicle to deliver green or SME financing.

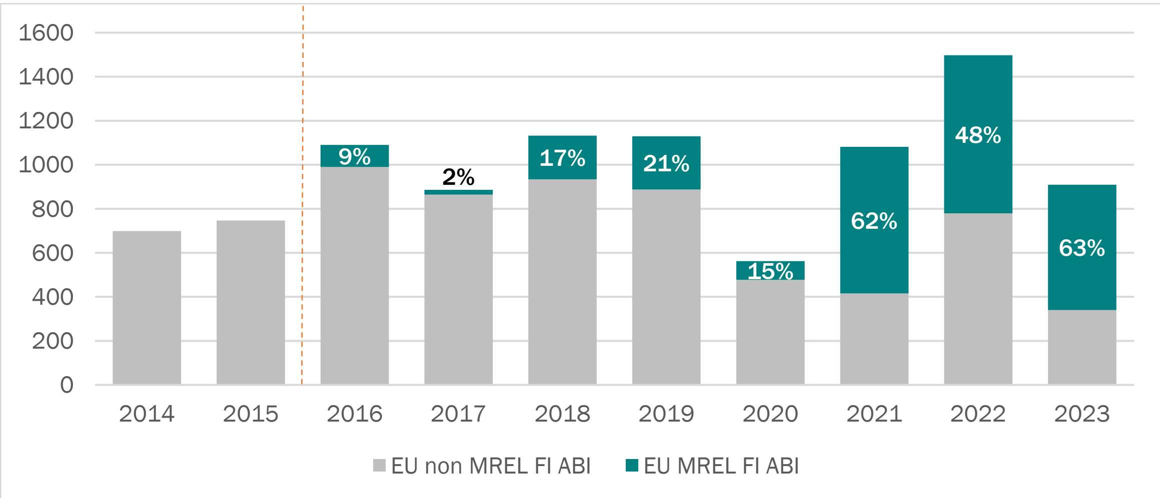
3.1. The EBRD's approach to MREL/bail-in-able products is in line with the overall Bank's business model; although it evolves to remain relevant to (long-term) clients' demand, it remains opportunistic and demand driven

49. **MREL has become the predominant instrument for EBRD financing in the FI sector in EU countries.** This process has been driven by changes in the market and client demand rather than changes in EBRD strategies.

50. **In response to scaling regulatory MREL requirements, EU banks have increasingly shifted market funding towards MREL eligible sources, and away from more traditional market funding such as non-bail-in bonds.**

51. Qualitative evidence (i.e., interviews with banking teams, clients, and other market participants) highlights that providing long-term financing to EU financial institutions will likely require participation in MREL issuances.

Figure 7: MREL financing as a share of total EBRD financing for EU FI clients (EUR mn)[4]



Source: IEvD analysis.

3.2. Contributing to capital markets development has stronger internal coherence than supporting regulatory compliance

52. **MREL and bail-in investments as an end-objective demonstrate internal coherence, but the strategic rationale for capital markets development is stronger than supporting regulatory compliance.** Supporting clients with regulatory compliance is not part of the Bank's Financial Sector Strategy 2021-2025 (BDS21-178), which instead puts the focus on developing capital markets, and similarly where MREL is mentioned within country strategies the emphasis is on capital market development rather than supporting clients' compliance with MREL regulations.

[4] Excluding all regional projects. EU non-MREL FI ABI includes both TFP and Equity.

53. **This is best demonstrated by the Bank's Financial Sector Strategy 2021-2025 (BDS21-178).** It emphasises that "EBRD investments in MREL instruments are targeted, aiming to establish functioning markets and attract investors. the EBRD can help address [the MREL gap] if it focuses on a catalytic role, building local and international investor trust to establish a market". The MREL linkage is also present under the Priority 3 of the Financial Sector Strategy ("Future-proof" the financial sector) through "improve the level of PFI resilience by strengthening their capita bases and loss absorption capacity".

54. **The Financial Sector Strategy therefore places the emphasis within MREL investments firmly on capital market development, rather than supporting regulatory compliance of clients.** This recognises that long-term financial market resilience is not dependent upon whether the EBRD's clients meet MREL requirements, but rather on whether there is a functioning and liquid capital market with private sector participation.

Box 6: MREL within country strategies – limited analytical value

- **EBRD Country Strategies do not consistently articulate the Bank's approach to MREL investments on a country-by-country basis, particularly for those drafted and approved prior to 2020 when MREL has not been so prominent.**
- There is no recognisable pattern or correlation as to whether MREL investments are specifically identified within country strategies.
- Where MREL investments are an explicit priority, there is no data provided on the size of the funding gap or market maturity, nor the challenges that the MREL market faces in terms of reaching maturity and sustainability.

Source: IEvD analysis (2024).

55. **Furthermore, supporting individual clients achieve regulatory compliance with MREL instruments raises potential issues of market distortion.** This raises issues of coherence with the Bank's wider mandate of supporting open and competitive markets. It was also raised by external stakeholders as a potential issue of external coherence with their objective of promoting level playing fields.

3.3. There is a solid strategic basis for using MREL and bail-in investments as a vehicle to deliver green or SME financing. However, this does not imply that this is an effective approach

56. Channelling finance towards SMEs via partner banks has a strong foundation within the Bank's strategic documents, including in both the Financial Sector Strategy as well as applicable country strategies.

57. **Similarly, mobilising green finance through financial intermediaries is a critical component of both the Bank's Financial Sector Strategy as well as the GET 2.1 Approach.**

58. **However, whilst this demonstrates that using MREL as a vehicle to deliver other objectives provides for internal coherence, it does not imply that this is an effective approach.** The applicable strategies do not provide any reason for why it might be advantageous from the Bank's perspective to use MREL for green or SME financing, particularly given the higher risk that MREL and bail-in

investments entail as well as their limitations as a transmission mechanism compared to traditional bilateral loans.

59. This evaluation also recognises that the EBRD is a demand-led institution, and MREL instruments are what EU clients are demanding.

- **Zoom-IN_1: Assessing the relevance and coherence of MREL and bail-in investments in non-EU countries.**

Non-EU countries with active investments within evaluation period (Dec'16-Sep'23)


Non-EU countries with active investment and/or upcoming, policy diagnostic outside evaluation period (Dec'16-Mar'24)[5]




Background:

- During the period covered under the evaluation (2016-end September 2023) the EBRD invested in bail-in debt in 2 countries outside of the EU, Jordan and Montenegro. Since then, the Bank has made additional investments in 4 other non-EU countries (Albania, Georgia, Serbia, North Macedonia).

- Example of relevance and internal coherence comes for a case study. In a nutshell, the respective country strategy does not refer to the issue with banking resilience through the regulatory compliance channel. Still, the opportunity was seized with the client through the inclusion and competitiveness transition channels.

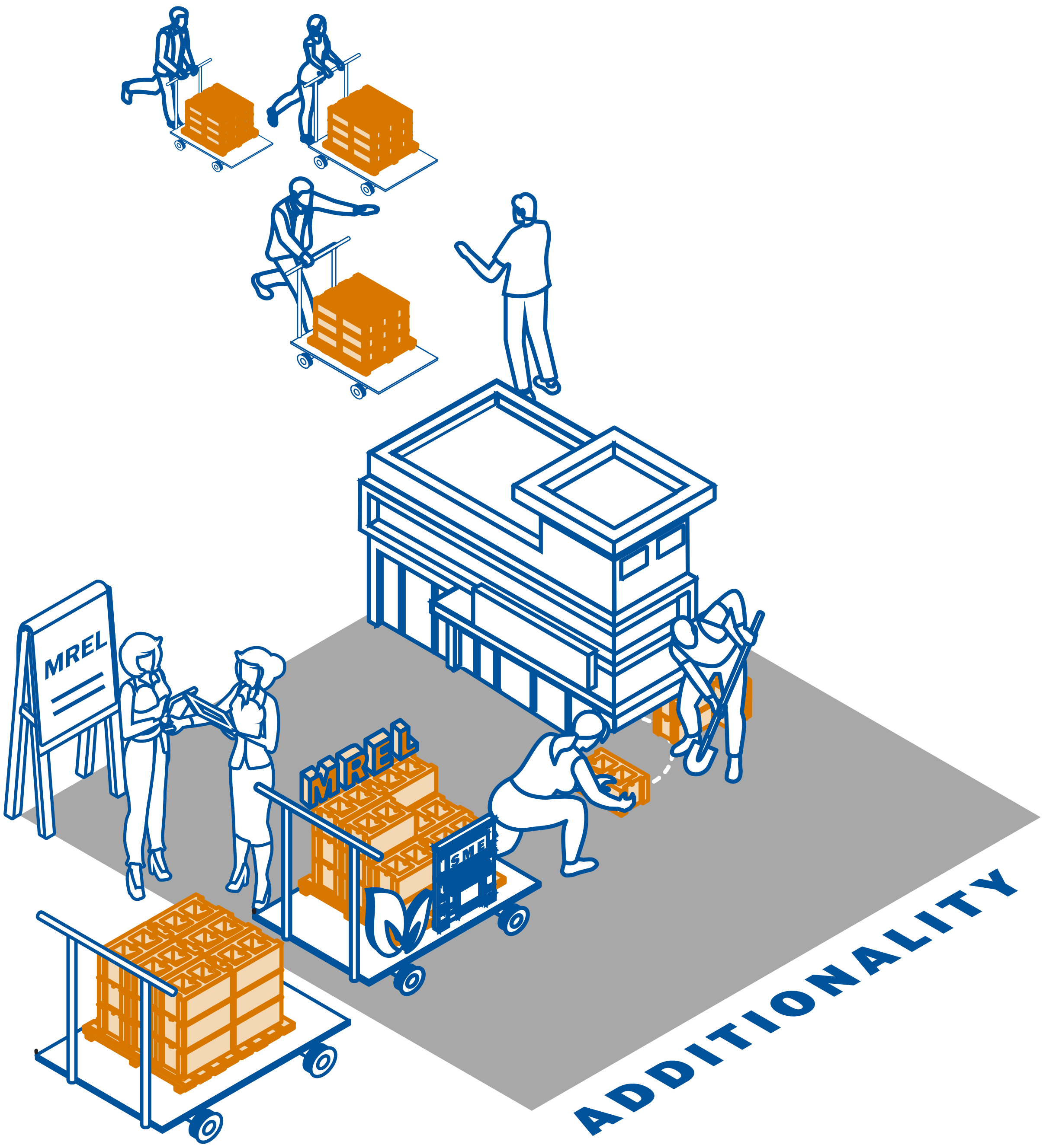
Internal Coherence:

- **The EBRD Country Strategies for the country[6] do not reference banking regulatory compliance in its priorities nor does it mention it under the key challenges in the banking sector.**
- **However, the reference is to the key transition challenges in the country that those projects relate to via use of proceeds,** namely "access to finance for inclusion target groups", and "competitiveness". For instance, a recently signed project under the Financial Intermediary Framework (FIF) aligns well with the key country strategic objective, namely, access to finance to MSMEs in general, and to female borrowers specifically, that remains limited based on the latest ATQs.

Source: IEvD analysis (2024).

[5] Example of a recent MREL diagnostic study carried out by CFMD (March 2024): Final Workshop - MREL Study in the Western Balkans - March 25, 2024.
[6] BDS/JO/14-1(F) and BDS/JO/19-01(F)

CHAPTER 4



4. The EBRD was additional but as markets evolve, additionality may decline

To what extent has the EBRD's involvement in MREL and bail-in instruments been additional vis-à-vis other stakeholders (local banks, private investors, other IFIs)?

- In most cases the Bank has been aware and pro-active in addressing the additionality risk of crowding out private sector finance.
- EBRD provided non-financial additionality through contributing expertise on MREL transactions, predominantly via informal guidance rather than formal TC.
- Evidence shows an evolution of the approach to MREL and bail-in instruments from initial EBRD involvement via private placements and bilateral loans to participation in public issuances.
- Within public placements, the EBRD has broadly followed its practice of scaled back participation in cases of oversubscription.
- Repeat transactions, which have risen over time, provide an (imperfect) indicator of declining additionality; however, there are substantial caveats which imply that each transaction should be carefully assessed on a case-by-case basis.
- As markets develop, an increase in private sector demand for MREL issuances will make it more challenging to demonstrate additionality; however, any shocks or the current crisis context may trigger a market set-back.

4.1. In most cases the Bank has been aware and pro-active in addressing the additionality risk of crowding out private sector finance

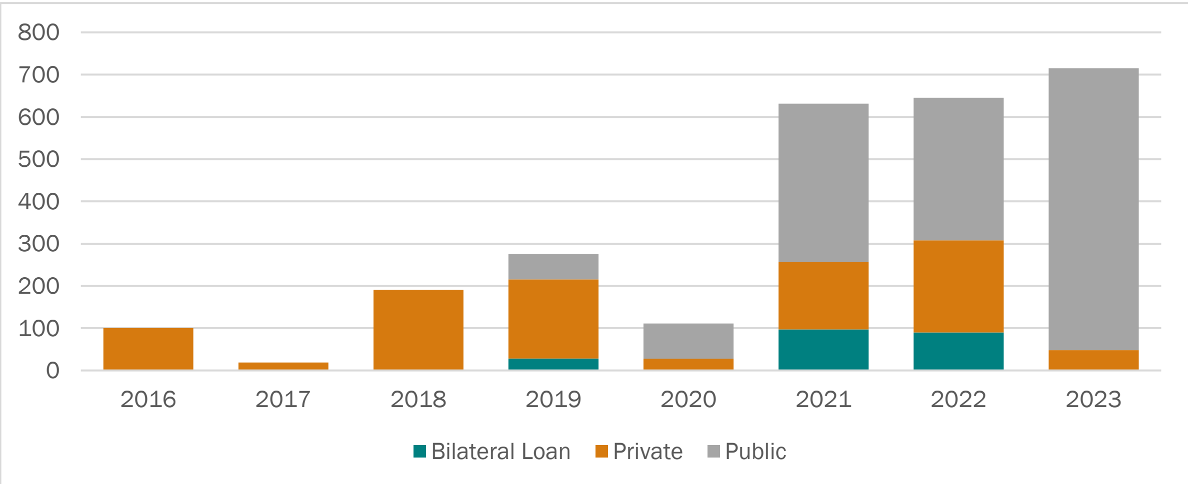
60. **To provide financial additionality in rapidly evolving markets for MREL instruments, the onus is on the Bank to provide finance where it is not available, but over time support the shift to greater private sector participation, and scale-back to avoid crowding out private sector investors.** There is good evidence overall that the Bank has fulfilled these conditions, albeit with some caveats.

61. **One indicator of this transition is the shift in the EBRD's portfolio from bilateral loans and private issuances to public issuances.** Initially, a strong emphasis on bilateral loans and private placements can indicate low investor interest in MREL instrument. However, over the longer run they are problematic. Bilateral loans provide limited input for private sector participation, and without a bond prospectus and bidding information are a further step removed from public issuances.

62. Although private issuances are an improvement on bilateral loans, these structures still restrict market access and private sector participation and provide less impetus to wider capital market development through giving fewer signals on pricing and market demand. In comparison, public issuances provide scope for private sector participation, and a clear mechanism for the EBRD to scale back participation in case of increased interest.

63. **As illustrated in Figure 8, there is clear evidence that the Bank has made that transition from private issuances to public issuances, a positive sign of supporting increased private sector participation.** Before 2020, 10% of the Banks' MREL and bail-in investments were in public issuances; from 2020 to end-September 2023, that figure was 70%.

Figure 8: MREL projects have shifted from private placements to public issuances (EUR Mn)



Source: IEvD analysis; FI MREL Investments Monitoring Tool[7].

[7] The MREL Investments Monitoring Tool is a dashboard developed by the FI team and shared with IEvD. It does not include 4 issuances within the wider MREL portfolio (a total of 94). It contains data manually collected by the FI team, and

64. **Furthermore, encouragingly there is some evidence that the EBRD has helped clients graduate from bilateral issuances and private issuances to public issuances.** Interviews with clients demonstrate that this shift is intentional, with clients reiterating that the Bank pushed for commitments for public placements and wider private sector participation.

65. **Where the Bank has engaged in bilateral loans and private placements, at least in some cases there has been significant emphasis on either mobilising private sector participation or taking clear steps towards public issuances.**

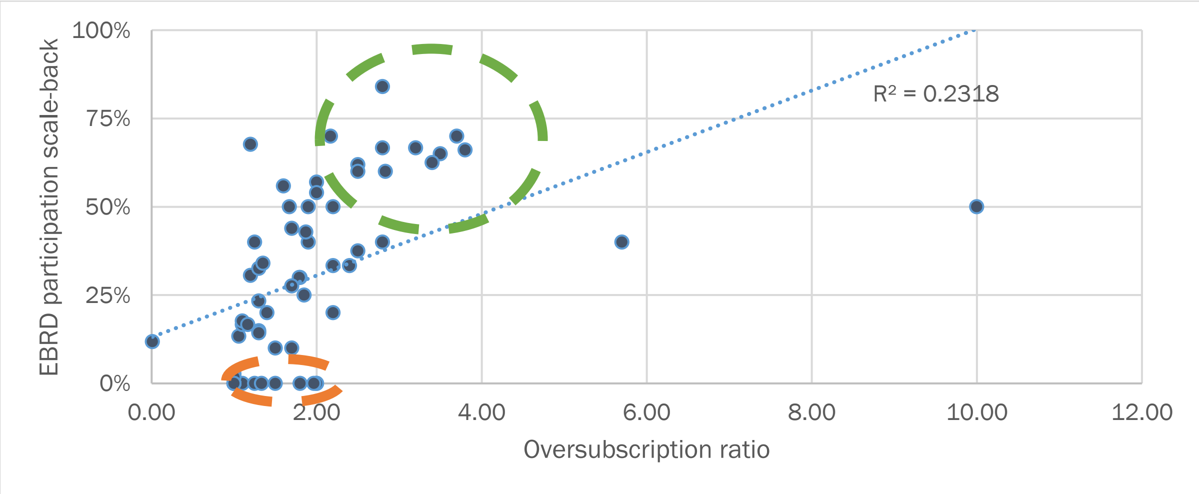
66. In the Romanian project signed in 2018, for instance, the Bank participated in a private placement which following placement was listed on the Bucharest Stock Exchange. This was in many respects a public-listing in name only – as the original buyers all planned to hold to maturity, there is no record of any secondary sales. However, it did help the client prepare for the listing process of Tier 2 capital instruments, which subsequently has been achieved.

67. **Internal documentation also highlighted to Banking teams that the Bank's approach was to transition towards public issuances.** For example, on one bilateral loan provided during the COVID-19 pandemic, the team agreed that "*the bilateral nature of this loan to be a one-off. Future MREL-eligible investments [client]by EBRD to be limited to bond issues*". This followed concerns by Risk Management that "*in offering MREL-eligible funding through bilateral loans, EBRD will not be supporting capital markets development…however, Risk Management can consider this proposal on the basis of this being a short bridge to the [bond issuance] programme planned for later this year*".

68. **This combination of portfolio data, interviews with clients, and internal documentation provides strong evidence of the Bank's awareness of the importance of moving towards public issuances and supporting private sector participation.**

69. **Within public placements, the EBRD has broadly followed its practice of being scaled back in cases of oversubscription, enabling private sector participation.** Although there is not a strict correlation, this suggests that in most cases the Bank has been aware and pro-active in addressing the additionality risk of crowding out private sector finance.

Figure 9: The EBRD has been scaled back more for more oversubscribed issuances – a positive finding



Source: IEvD analysis; FI MREL Investments Monitoring Tool (covering 84 issuances)

70. **This analysis does also highlight significant variance, e.g., a small cluster of projects which were oversubscribed but where there was no or limited scale-back (circled in orange), potentially suggesting a risk of crowding out of private sector involvement.**

71. However, the EBRD does not have unilateral power with respect to scaling-back; ultimately, that is a decision made by the issuance arranger, who may decide to prioritise the EBRD over other investors.

72. **There is also a potential question mark over EBRD involvement in projects with high levels of scaling back (outlined in Figure 9 in green).** Although it is welcome in these cases that the EBRD has scaled back, in projects where the Bank is scaling back participation by over 60% it could be worth asking the question of whether the Bank's participation is necessary from a financial perspective at all. However, this doesn't account for non-financial additionality the Bank may have provided in these cases.

73. **More broadly, across most projects oversubscription has been limited, reflecting the limited private sector demand for these projects.**

74. The majority of issuances had an oversubscription ratio of between 1-2, with only two instances of issuances with substantial oversubscription of over 4.0 suggesting significant private sector demand. This again provides good evidence of the Bank's financial additionality.

4.2. The Bank provided non-financial additionality through contributing expertise on MREL transactions

75. **There is broadly good evidence of non-financial additionality.** There were clear examples of technical support on MREL issuances (including as part of a wider green bonds programme, or help with bank resolution planning), as well as the EBRD's status as an IFI providing reassurance to wider market stakeholders, including regulators.

76. **Evidence from interviews with clients and stakeholders demonstrates the Bank's non-financial additionality on MREL transactions.** As a new, complex instrument, several clients highlighted how prior to their first transaction their understanding, as well as the understanding of wider market participants, was limited.

77. The Bank played an important role by providing support on how to structure MREL transactions, and in some cases supporting dialogue between clients and regulators on MREL requirements. The Bank's position as an anchor investor also provided reassurance to a wider range of investors, particularly during initial MREL issuances.

78. **There are some examples of non-financial additionality stemming from the use of formal TC in non-EU countries within the EBRD portfolio.** For instance, EBRD supported one of the largest banks in Jordan in strengthening their regulatory plan, a key compliance requirement. The Bank's support was highly appreciated by the client.

79. **The argument for additionality over the use of conditionalities linked to green use of proceeds is less clear.** Whilst these conditions impose limits on clients that commercial funding sources would not require, it is not clear that these conditionalities lead to a change in green lending. This is discussed in more detail in section 5.

4.3. Repeat transactions are a red flag for additionality – but there are substantial caveats

80. **Repeat transactions can be an imperfect indicator of declining additionality.** In the Bank's approach to establishing additionality, some types of repeat transactions are 'additionality' triggers, suggesting the project warrants an increased scrutiny of additionality.

81. **The logic behind increased scrutiny of repeat transactions is clear; a debut capital market transaction can help establish market credibility, implying less need for IFI involvement.** The MREL portfolio shows an increase in repeat transaction projects (defined as any repeat MREL project with the same client) over time.

82. This is not surprising; by definition, at the outset of the Bank's investments in MREL, and as the Bank expanded the MREL portfolio, nearly all transactions were 'debuts' rather than repeat transactions. Over time, however, the significance of repeat transactions has risen, potentially implying a red flag for the Bank's additionality.

83. **"Repeat transactions" are transactions with the same clients using the same bail-in-able instrument.** It is important to note that this is a generalisation as even the transactions with the same bail-in-able product might have different project design features such as listening on local/internal stock market, tenor/structure, transition objectives on the use of proceeds.

- **Portfolio distribution**: out of total 95 MREL/bail-in-able transactions, 46 were repeat transactions, accounting for 48.4% of the portfolio.
    - **The percentage of repeat transactions varies significantly by year of signing, with the gradual increase over the years and the highest in 2022 at 61.3%.**

- **Country distribution**: the concentration of repeat transactions follows the distribution of the top countries with MREL/bail-in-able investments.
    - **Countries with the highest number of MREL/bail-in-able investments are also among those with the highest share of repeat transactions, i.e., Romania (55.6%); Greece (53.8%).**
    - **An outlier is Poland, which has a relatively low share of repeat transactions, 31.3%, yet among the countries with the largest number of MREL/bail-in-able investments in the portfolio.** Slovak Republic is another outlier with 66.7% of repeat transactions, out of a small portfolio of just 6 transactions.
- **Evolution over time**: in theory, successful capital market development requires continuous support in repeat issuances until banks have established regular access to capital markets and have become regular issuers.
    - A closer look at the signing years for MREL bail-in-able portfolio illustrates the dependency of the repeat transaction on market conditions. For instance, in Poland a peak in repeat transactions came in 2018 during which the MREL requirements were increased and the there were unfavourable market conditions.
    - In Romania a peak in repeat transaction came in 2022 when the market suffered the consequences from the war in Ukraine. In contrast, countries like Greece and Croatia maintain a similar share of repeat transactions over a longer time of up to 3 years.

84. **However, with several clients the EBRD showed a track record of supporting increasingly complex issuances over subsequent transactions (e.g., green or sustainability bond issuances, public issuances, international issuances).** Therefore, despite being repeat MREL transactions with the same client, later projects could be described as having novel and ground-breaking components.

85. **Furthermore, with the immaturity of MREL markets and the disruption caused by the COVID-19 pandemic and the Russian War on Ukraine, there have been periods when market interest in MREL instruments has declined dramatically, undermining the logic that successful historical issuances should not necessitate IFI involvement.**

4.4. Going forward, as markets develop increase in private sector demand for MREL will make EBRD's additionality more challenging

86. **The market for MREL instruments is evolving swiftly.** Data on deals that the Bank participated in reflects the extent to which there is now more private sector demand for MREL issuances, as well as a shift towards shorter-term security.

87. **Going forward, as a result of this increased private sector demand, it will become more challenging for the EBRD to demonstrate additionality.** However, as mentioned, this is not a linear process; the MREL market has been affected by global events such as the COVID-19 pandemic and the War on Ukraine, as well as sector-specific events such as the Credit Suisse collapse.

88. **This change is reflected in the average scale-back rate on the EBRD's participation, as well as the shift to public issuances and repeat transactions.** The average scale-back rose in 2018-2020,

fell in 2021 and 2022 during a period where capital markets were harder to access – as also demonstrated by the rise in bilateral loans provided by the EBRD during that period – before starting to increase again in September 2023.

89. **As with financial additionality, as the market for MREL instruments in EU countries has matured, the provision of guidance on MREL requirements has become less critical.** Clients, investors, and regulators have all become more familiar with the MREL instrument, as it has become the 'standard' debt market product for EU banks, and so as a result have relied less upon the EBRD's guidance and expertise.

90. **This evolution suggests that in more recent projects and going forward, the case for the Bank's additionality is less clear-cut.** This is market dependent and will vary by country as well as over time with specific market circumstances. However, as by several parameters MREL, markets have demonstrated increasing maturity, going forward it is likely to be more challenging for the EBRD to provide additionality.

- **Zoom-IN_2: Additionality in non-EU countries.**

Non-EU countries with active investments within evaluation period (Dec'16-Sep'23)

Non-EU countries with active investment and/or upcoming, policy work outside evaluation period (Dec'16-Mar'24)[8]

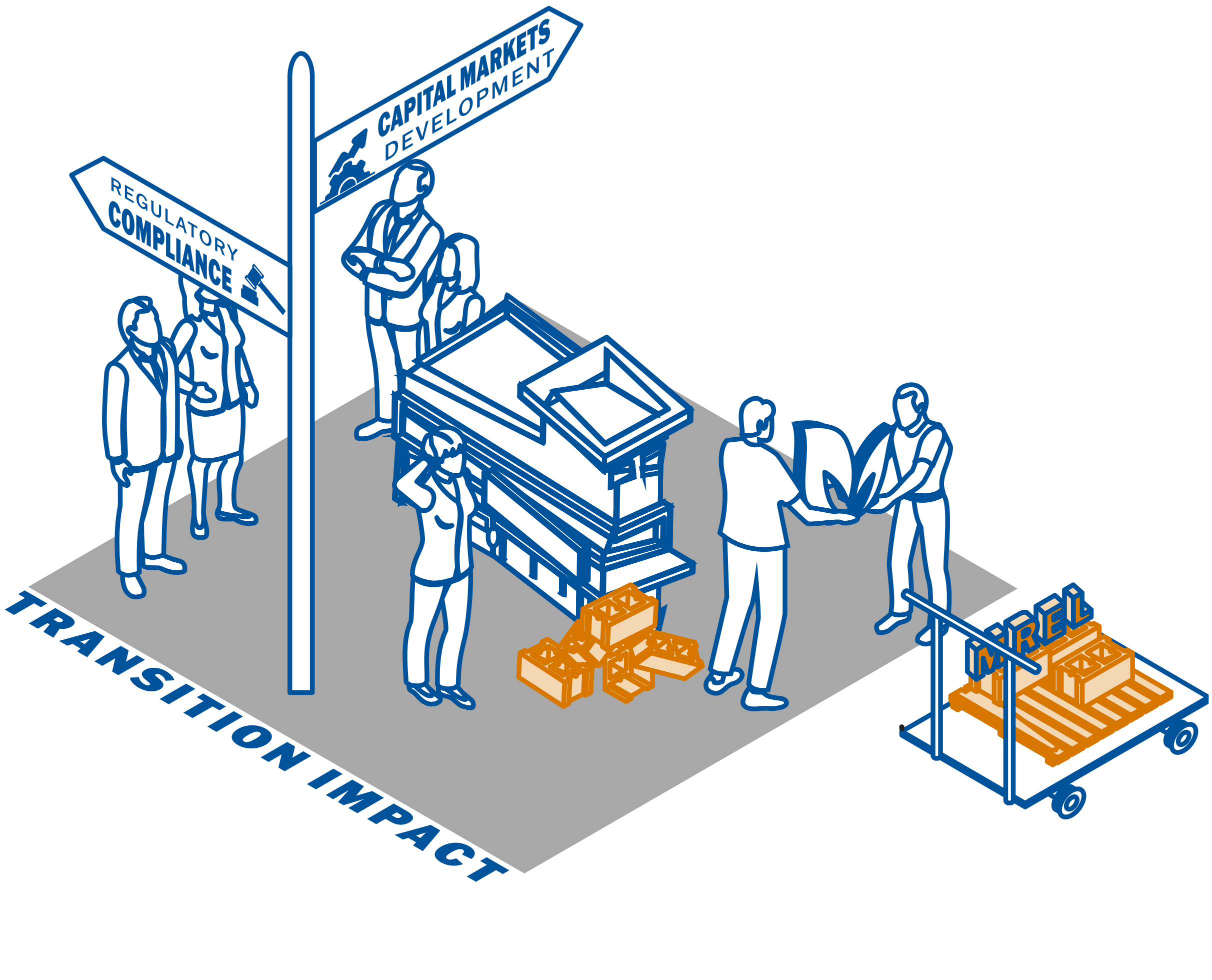
- **The Bank's projects in Jordan illustrated a solid additionality with the recent bail-in investments with one of the largest commerical banks in the country.** The EBRD's involvement with the bank represents a successful blend of financial innovation, strategic capacity building, policy influence, and commitment to inclusivity, which fed into a robust additionality steaming from those projects
  - EBRD's Tier-2 sub-debt with one of the lagest banks in Jordan was pioneering in the post-Basel III Jordanian market, with continued innovation in later projects.
  - Long tenors improved client funding structures and mitigated asset-liability mismatches, showcasing financial foresight.

    EBRD's focus on gender inclusivity delivered progress in social equity, with the client actively engaging in initiatives to empower women entrepreneurs.

Source: IEvD analysis (2024).

[8] Example of a recent MREL diagnostic study carried out by CFMD (March 2024): Final Workshop - MREL Study in the Western Balkans - March 25, 2024.

CHAPTER 5


CAPITAL MARKETS
DEVELOPMENT
REGULATORY
COMPLIANCE
TRANSITION IMPACT
MREL

5. The current Bank's transition approach is mainly project-based and not consistently geared towards market-level outcomes

To what extent have EBRD's MREL and bail-in-able debt products contributed to delivery of transition impact
• While over the years the Bank's achieved some project-level results (i.e., strengthening client's capital adequacy, solvability, etc,), there is no indication of meaningful contribution towards "systemic change" yet (i.e., capital market development). • MREL/bail-in able products serve as a crucial, yet high-risk mechanism for attaining GET objectives within the Financial Institutions sector. • However, evidence shows that GET-eligible MREL investments have limited impact on Green Transition. • Despite being designed to support environmental objectives, the current structure of GET-eligible MREL bonds does not necessarily lead to increased green financing.

5.1. The systemic change at market-level stemming from the EBRD's involvement in the MREL market remains unclear

91. **Supporting regulatory compliance and strengthening clients' capital bases as a key mechanism for MREL projects to deliver impact, based on how these projects were presented.** This pathway is based on regulatory compliance helping to strengthen client financial resilience and subsequently systemic resilience.

92. **IEvD does not find clear evidence of this pathway.** MREL clients tended to be well-run and resilient in the first place, and so therefore it is not clear that MREL and bail-in investments were addressing a resilience gap. Whether MREL and bail-in investments increase resilience is also dependent upon client behaviour. Finally, there is a question mark over the overall contribution to systemic resilience through support to individual clients.

93. **The EBRD's implicit strategy was to provide support to the most robust financial institutions, in line with sound banking principles when exploring a new, risky product.** Although there are exceptions (particularly in non-EU countries), generally MREL and bail-in investments were in financial institutions needing to meet MREL requirements but not otherwise facing capital constraints. This raises the question as to why projects with well-capitalised institutions were supported on the basis of strengthening their capital base further.

94. **This is most evident in the EU countries.** As EBRD Risk stated in comments on one project, "*EBRD risk appetite for Basel III bail-in-able sub-debt so far has been in EU-regulated banks with investment grade ratings, high minimum capital requirements and sound capital buffers at the point of entry, where EBRD provided an extra layer of capital support on top of the already existing considerable buffers above the regulatory minima*".

95. **Furthermore, capital is fungible, implying that financing provided on MREL projects intended to boost regulatory compliance can end up having a limited effect depending on how the financing is used.** Providing capital to meet raised MREL thresholds involves making an assumption about the denominator within MREL ratios – a bank's Risk-Weighted Assets (RWAs).

96. **There are examples within the portfolio where MREL ratios have not increased as the Bank expected, primarily due to a client's M&A activity raising RWAs beyond what the EBRD had anticipated – and critically, a bank's approach to RWAs is not independent of its success in raising regulatory capital.**

Box 7: "Experience from the field": meeting regulatory requirements and distorting competition

- **Regulatory compliance is a dynamic process. The MREL funds required by any given bank is dependent upon its asset base, strategy, and market movements.** Assumptions about whether the Bank's financing will help clients meet regulatory thresholds are therefore also dependent upon the client's behaviour – and by providing funding, there is the risk of changing that behaviour and distorting the market. Some stakeholders did raise concerns over whether the provision of MREL financing by MDBs and connections to M&A activity could constitute market distortion.

Source: IEvD analysis (2024).

97. **Finally, it is neither the Bank's role nor within the Bank's capacity to address MREL shortfalls, thus necessitating a systemic approach rather than one focused on individual clients.** The EBRD's stated position is that "the shortfall in MREL-eligible instruments goes beyond its capacity" within its countries of operation. This is an acknowledgement that the EBRD's financing needs to take a systemic approach towards building the MREL market; it is not enough to support individual clients achieve regulatory compliance.

98. **IEvD would suggest that this conclusion is also reflected in how support to regulatory compliance is described within the Bank's strategic priorities.** As noted in *Section 3*, the strategic relevance of MREL and bail-in instruments, there is limited focus within the Bank's applicable strategies on supporting clients achieve regulatory compliance. In contrast, there is much greater emphasis on other types of rationale provided for MREL and bail-in investments, such as supporting capital markets, delivering green finance, or widening access to finance for SMEs.

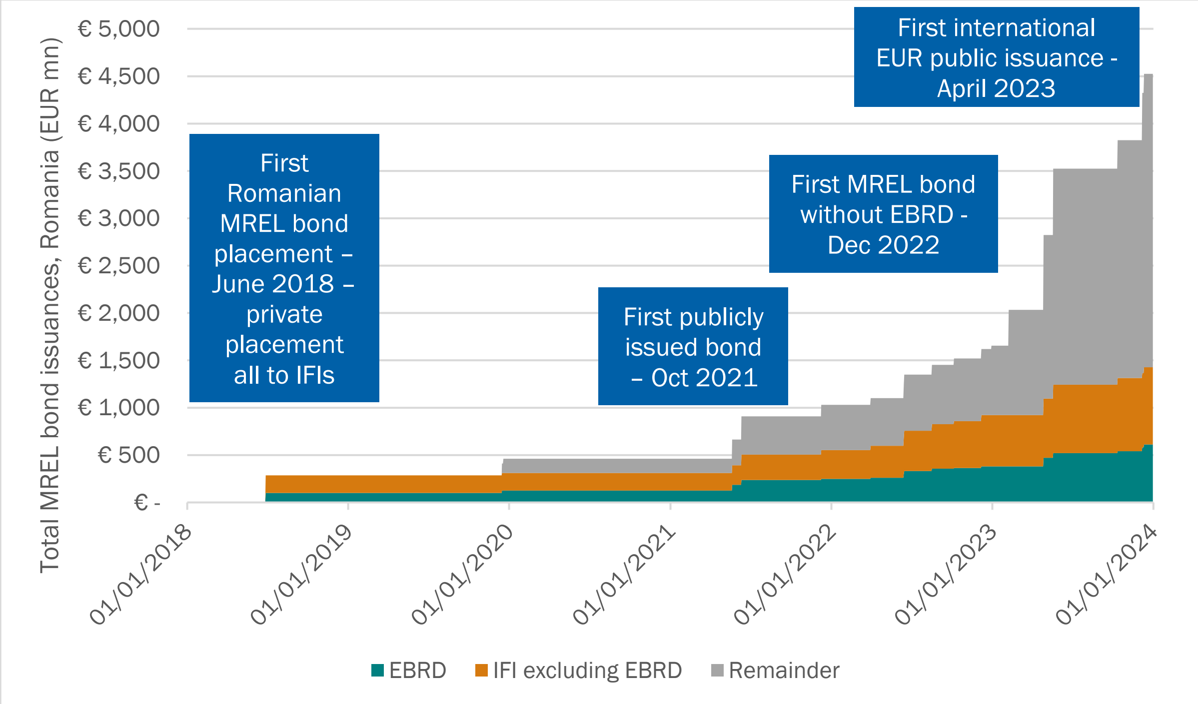
99. **This does not imply that Bank's MREL and bail-in investments with objectives around supporting regulatory compliance did not deliver transition impact.** Projects may have had stronger contributions to transition impact through capital markets development, or delivering green finance, for example. However, it does suggest that from a transition impact perspective, the primary logic underpinning the Bank's investment was weak, and that associated monitoring indicators provide a limited perspective on the extent to which the EBRD has contributed towards strengthening financial system resilience.

5.2. Despite the lack of a consistent approach to systemic change, the EBRD's involvement in the MREL market generated some market-level effects, though there are no tools to monitor and capture them

100. **Capital markets development provides a very robust pathway for delivery of transition impact.** The case studies provide some examples of how the Bank has contributed towards capital market development, but more fundamentally the logic underpinning this pathway is stronger; it is more plausible that long-term financial resilience will depend upon whether there is a functioning and effective MREL market with private sector participation, not on whether the EBRD's clients meet MREL requirements.

101. **There are clear examples from the case studies of where the Bank has supported capital markets development.** In Romania, for example, the role of the EBRD along with other IFIs was critical in supporting the MREL bond market initially, which highlights the pivotal role of IFI financing at the outset of the market, market development, and the rapidly increasing interest from non-IFI participants.

Figure 10: Cumulative MREL bond issuances from Romanian FIs



Source: IEvD analysis; Bloomberg

102. **Qualitative evidence (i.e., interviews with stakeholders) attest to the EBRD's role in this evolution.** For example, for the first issuance, the clients told IEvD that at that point, the legal framework for MRELs in Romania and Poland were still in development, and there was scepticism as to whether banks would be able to meet MREL requirements through capital market issuances. The EBRD's participation, including with the largest and most systemically important banks, contributed to sending a strong positive signal to investors, other banks, and market regulators.

Box 8: Demonstration effects of the EBRD MREL's approach

- **Local investors were initially wary about the new product. The client in Romania, for instance, described the first issuance as a "very complex exercise to bring to market" in which the EBRD's support was crucial.** Similar voices came from clients in Poland.
- Following their first issuances with EBRD support, clients noted that having seen the EBRD's participation, local investors – and particularly pension funds – were attracted to the product.
- This point was also made by a credit ratings agency interviewed, who provided their perspective that the EBRD's role helped to provide wider market reassurance.

Source: IEvD analysis (2024).

103. **Outside of the case studies, it is challenging to understand the wider contribution of the EBRD's MREL and bail-in investments towards capital market development.** The degree to which capital markets development is tracked by monitoring indicators within TIMS is limited.

104. Most indicators are focused on regulatory compliance rather than capital market development (reflecting the greater emphasis within projects on that pathway), whilst where

projects do use indicators tracking capital market development, they sometimes relate only to the first issuance under the project, rather than indicators tracking subsequent developments.

Box 9: The EBRD results architecture is not suited for tracking capital markets development
• A bail-in-able investment into a client in Romania signed in 2019 had TIMS indicators which track capital markets development. Under this project, the EBRD has participated in seven separate issuances. • **However, some indicators only relate to the first issuance, which provide limited value for tracking what changed over multiple issuances.** • In the case of this project, there are 'success stories' – whilst the first issuance was privately placed, later issuances were public, and the client also moved onto MREL-eligible green bonds, all of which reflects local capital market development. However, these positive developments were not tracked or captured by the project's monitoring framework.
Source: IEvD analysis (2024).

105. **One tool that can support the development of capital markets in some contexts is secondary market sales.** Limited liquidity is frequently cited by the Bank as a key risk of MREL facilities, and one of the barriers that restricts private sector interest.

106. As noted by in the internal project approval documentation from one project, "we are supportive of selling the bonds on the secondary market (…) as this would improve liquidity and potentially attract new investors into bail-in-able space"[9]. However, currently the Bank's standard approach is to hold bonds to maturity, with the primary exception of managing concentration risks.

107. **As a result, the Bank does not use secondary market sales as a tool for capital markets development.** Instead, secondary market sales are used for risk exposure management purposes. This is an important function (discussed in more detail in Section 6), enabling the Bank to manage its risk on an ongoing basis, and free up capital for additional projects with the same client or parent group.

108. **But from a transition impact perspective, this may present a potential missed opportunity; market liquidity in a security is, in nearly all contexts, an attractive characteristic for investors, and secondary market sales provide a route by which DFIs can contribute towards liquidity and by doing so support capital market development.** Promoting secondary sales would also be more aligned with the Agreement Establishing the Bank (AEB), Article 13 Clause X – "the Bank shall seek to revolve its funds by selling its investments to private investors whenever it can appropriately do so on satisfactory terms". However, this would entail a change in approach.

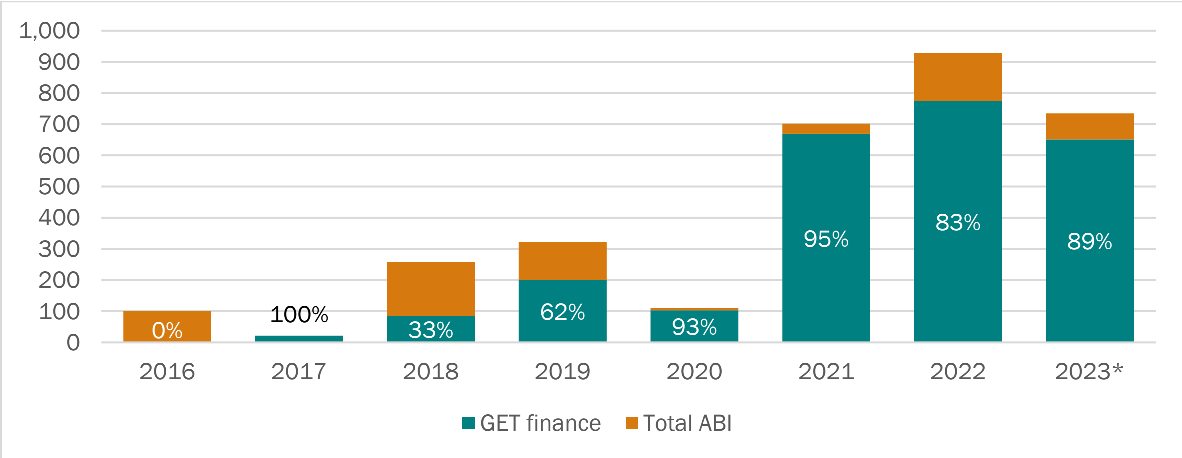
5.3. MREL instruments serve as a crucial yet high-risk mechanism for reaching GET targets; however, GET-eligible MREL investments show limited impact on Green Transition

109. **MREL and bail-in investments are predominantly GET and help to raise the GET ratio for FI investments from 31% (without MREL and bail-in) to 40% (with MREL and bail-in included).** At a corporate level, in 2022, removing MREL and bail-in investments would lower the GET ratio from

[9] Economics, Policy, and Governance (EPG – function now fulfilled by Impact) OpsCom comments from the project approval stage.

50% to 47%. Given the size of the MREL portfolio, this means it has become a significant driver for GET financing in the FI sector. As indicated on the Theory of Change, MREL and bail-in investments supporting the green transition can be separated into GET-eligible MREL bonds, and green MREL bonds.

Figure 11: GET financing within the MREL portfolio (EUR mn)



Source: IEvD analysis (2024).

110. **The delivery mechanism for MREL green bonds is the same as the rest of the EBRD's green bonds portfolio.** Concurrent to this evaluation, IEvD has conducted a cluster evaluation of the EBRD's investments in green bonds, which explores how green bonds can contribute towards the delivery of transition impact (Box 2).

111. **However, there is a substantial difference within the risk profile of MREL green bonds compared to traditional green bonds, given that MREL instruments are riskier.** As discussed in Section 6, it is not evident how the additional risk of MREL instruments is compensated for with respect to transition impact.

112. **The GET Handbook provides limited clarity on whether MREL-eligible bonds employing GET multipliers meet the threshold for GET projects.** The guidance states the "GET share of the bond will be based on the proportion of the expected GET-eligible use of proceeds. In cases where the EBRD's investment participation results in additional GET-eligible components or projects for the entire issuance, the GET share of those components could be allocated to the EBRD's participation. Otherwise, the GET share will be based on the share of GET-eligible components or projects in the bond as a whole[10].

113. **This formulation can be interpreted in different ways.** IEvD's interpretation is that unless the Bank's participations result in additional GET projects, the GET share of the Bond should be based on the proportion of the expected GET-eligible use of proceeds from the bonds as a whole.

114. **MREL bond issuances are used for the issuer's general funding purposes.** The proceeds from the bond should therefore be interpreted as equivalent to the issuer's ongoing allocation of financing as part of loans. As a result, the GET share of the bond is the GET share within the issuers'

[10] Annexes to the Green Economy Transition Handbook, Section 5.9.3

ongoing loans unless the EBRD anticipates that the Bank's participation results in the issuer increasing their volume green financing (and thereby financing additional GET sub-projects).

115. **The approach currently taken by the Bank is that this definition covers new GET-eligible financing (regardless of whether or not it constitutes an increase in financing levels), as long as it is not refinancing.** This is a material difference. IEvD understands that the Bank will provide additional clarification in an upcoming revision of the GET handbook.

Regardless of the definition within the GET handbook, the GET multiplier alone does not necessarily lead to an increase in the quantity of green financing.

116. **For GET-eligible bonds to be contributing to Green TQ, the expectation should be that the Bank's participation is increasing either the quantity or quality of green financing.** Based on how the GET multiplier is employed, there is not necessarily a causal connection between using the GET multiplier and increasing the quantity or quality of green financing, and the Bank does not have systems in place to assess how green financing levels have changed.

Currently, on GET-eligible MREL bonds, the EBRD asks that issuers allocate GET eligible sub-projects equivalent to the Bank's financing. Though this can be a multiplier of the Bank's financing (e.g., 200%), in and of itself this does not provide evidence that there has been any increase in overall issuers' green financing as a result of the Bank's participation. This can be demonstrated by the hypothetical example provided below.

Box 10: Hypothetical example

This hypothetical example is designed to show how the multiplier approach does not necessarily lead to an increase in green financing. It is not meant to imply that this reflects the standard picture on EBRD projects. In this example, an issuing bank has a very consistent business model; each year, its total loan portfolio is 10bn, it makes new loans of 1bn per year, and 5% of new loans are GET-eligible.

	2017	2018	2019	2020	2021	2022	2023	2024
Total loan book	10bn	10bn	10bn	10bn	10bn	10bn	10bn	10bn
New loans (equivalent to ABI)	1bn	1bn	1bn	1bn	1bn	1bn	1bn	1bn
Green new loans	50mn	50mn	50mn	50mn	50mn	50mn	50mn	50mn

At the beginning of 2020, the EBRD participates in a 500mn MREL bond issuance, with the use of proceeds for general financing purposes with a subscription rate of 25%, a GET multiplier of 200%, so qualifying for a 100% GET ratio, and a 5-year timeframe to achieve that objective (5 years is the standard approach the EBRD employs on GET-eligible MREL bonds).

Bond issuance	500mn

EBRD participation	100mn (25%)
GET multiplier	200% (implying 200mn of GET-eligible investments)
Timeframe to achieve GET multiplier	5 years

Without any changes in its business model, and without any changes in green financing, the issuing bank can comfortably meet these requirements with 250mn of green loans between 2020 and 2024 – even though the Bank's financing has not resulted in any increase in green funding levels nor any additional GET-eligible projects.

117. **Furthermore, with the current set-up, there is no data on whether the Bank's participation has resulted in an increase of the share of GET sub-projects or green financing at issuer level.** The EBRD does not ask for a baseline of issuers' green financing, with which the Bank could assess and monitor whether green financing levels have increased as a result of the Bank's participation, nor does it ask for an ongoing record to see how an issuer's green financing changes[11].

118. **There is also a distinction between how the Bank can direct use of proceeds on other FI credit lines, and allocation via multipliers as implemented on GET-eligible MREL bonds.** In discussions as part of this evaluation, these two mechanisms have been conflated– although there are legal differences, as well as different rules within the GET handbook, and the robustness of the transmission mechanism between the EBRD's financing and the intended outcomes.

119. **The Bank can specify the use of proceeds of its financing, with a policy statement made as part of a loan agreement.** This is the approach taken by the Bank with other FI credit lines, such as GEFF or FIF, where the EBRD has acceleration rights and can specify how funding is to be used.

120. **MREL issuances cannot have direct use of proceeds.** As public issuances for general purpose financing, the EBRD cannot place restrictions on how subscriptions are used. Instead, the Bank uses a multiplier approach, in which as part of a side agreement the client agrees to allocate financing equivalent to (or greater than) the EBRD's participation to GET-eligible sub-projects.

121. **This difference is clear from comparing the policy statement on loan agreements on FIF credit lines and policy statements on side agreements on MREL issuances e.g.**

- For FIF credit lines: "the Borrower **shall use the proceeds of the Disbursements** of the Loan and amounts received from Sub-borrowers in repayment of the Sub-loans exclusively for the purpose of making Sub-loans in accordance with this Policy Statement".
- MREL: "the Issuer **shall cause an amount equal to at least 100% of the proceeds** from the EBRD Notes in each issuance of the Notes to be used for its general funding purposes, which in case of the EBRD Notes means to apply them exclusively to the implementation of the Project through the provision of loans (the "Loans") in accordance with this Policy Statement".

[11] No GET-eligible MREL bond has a baseline and tracks an increase in green financing as part of the results measurement.

122. **Internally, the GET handbook distinguishes between these approaches.** Annex 5.8.1. – Financial Intermediary Operations specifies that "In order to be GET-eligible, financial intermediary operations use technical eligibility criteria to restrict the use of proceeds by the financial intermediary" and that this section "does not cover GET eligibility of bonds issued by financial institutions". Annex 5.9.3, which addresses GET-eligible bonds, is quoted above.

123. **To summarize, this evaluation emphasises the following three points:**

- First, that GET-eligible bonds follow a different set of guidance within the GET handbook then green lending lines.
- Second, that there is a distinction between the "use of proceeds" with respect to bilateral loans and allocation of financing under GET-eligible MREL bonds.
- Third, that it is not necessarily the case that multipliers promote additional green financing, and there is no monitoring data collected by the Bank to support this argument.

124. **This difference between use of proceeds (on intermediated financing lines) and allocation of equivalent financing (on GET-eligible bonds) is not merely one of terminology and labelling.** A fundamental part of this distinction is enforceability. With no acceleration rights on capital market issuances (other than those provided for in the bond issuance papers), the Bank has limited enforcement mechanisms. However, the Bank can rely upon informal incentives that clients face with respect to maintaining a relationship with the EBRD and the selloff of its investments (markets permitting).

125. **Beyond enforcement, there is also a distinction between how intermediated financing and allocation of equivalent financing can directly target priority lending capacity (e.g., green lending).** With intermediated financing lines, the EBRD can increase liquidity, introduce subsidies, or lower the cost of capital for limited products (e.g., green lending) targeted at a certain customer segment, often via the use of blended financing. Examples include:

- First-loss risk cover for on-lending, commonly provided for financial intermediary loans provided under the EBRD's Women in Business Programme;
- Incentives for end-borrowers, which are used as part of the EBRD's Green Economy Financing Facilities (GEFF);
- Currency risk protection (e.g., under the SME LCY Programme).

126. **These form a substantial portion of intermediated financing**; in 2022, for example, 65% of FI projects had a grant component, and 80% of grants were used for co-investment rather than TC[12].

127. **Even where blended financing is not explicitly involved, the Bank's intermediated financing can support targeted lending capacity through providing financing that is otherwise not commercially available, either on a cost or tenor basis.**

128. **The EBRD cannot do the same targeted support when providing general purpose financing (as under MREL bonds).** The Bank cannot introduce incentives for end-borrowers, minimise the cost of capital or the risk of on-lending for partner banks, or target liquidity to a distinct financial

[12] EBRD Financial Intermediaries Report 2022, CS/FO/23-20

product via participation in an MREL issuance. On bond issuances, the EBRD is also a 'market-taker', and therefore has less scope to influence lending through providing pricing or tenor that is not otherwise available. In addition to the limitation on enforceability, there is a difference in the robustness of the transmission channel between the EBRD's financing and on-lending.

129. **Of course, even without a baseline and any monitoring data, it is possible that the GET multiplier commitments that clients sign up to as part of the EBRD's participation into GET-eligible MREL bonds do catalyse increases in issuers' green lending.**

130. **What is not in doubt is that partner banks are following through on their commitments made as part of the GET multiplier.** the long relationships that the EBRD has with partner financial institutions have ensured that PFIs have allocated financing towards green sub-loans under their GET multiplier commitment as expected. These green sub-loans are in most cases supported by verification that assets are in line with GET objectives (e.g., third-party certification of green buildings).

131. **However, as outlined in Box 1 above, this does not necessarily imply an increase in the total volume of green financing.** Where IEvD has identified data, there is mixed evidence that GET multipliers could induce a change in lending behaviour to result in additional GET financing. In assessing evidence, IEvD collated three separate data points:

- A comparison of green financing levels prior to EBRD's commitment and what the GET multiplier committed the partner bank to on an ongoing basis. A commitment which is a very low percentage of historical lending provides limited confidence that the multiplier will induce increases in lending behaviour going forward.
- A comparison of green financing levels over time, to see whether the Bank's participation had any material effect on green financing levels.
- Interviews with selected clients, to hear their perspective on whether the EBRD commitments led to a ramp up in green financing.

132. **Outside of whether the GET multiplier incentivises clients to increase their green lending, it is also plausible that the EBRD's advice and support has helped increase either the quantity or the quality of green lending.** This could be through supporting the clients to raise their green lending standards, providing guidance on green lending products, or supporting the development of portfolio management systems which better track and record green financing flows.

133. **There is some evidence of this in practice, although it is mixed.** As a starting point, of the 26 issuers that the Bank worked with on GET-eligible MREL bonds (under the timeframes established within this study), only 2 had associated TC support linked to the GET-eligible MREL bond transactions. In both cases, this TC was to help identify gaps in their internal capacity to issue green bonds. This provides a stark contrast to other green finance products the Bank offers, such as GEFF financing lines, where TC to support clients scale up their green lending capacity is included as standard; in 2022, for example, all 40 GEFF projects included a TC component[13].

134. **Of course, even without formal TC, the Bank can still have a role in providing informal guidance and advice to issuers on scaling up green lending, or informally pushing institutions to raise quality standards.** This is harder to evidence – as informal engagement, there is typically

[13] EBRD Financial Intermediaries Report 2022, CS/FO/23-20

limited documentation, and activities and results are not normally captured within project monitoring frameworks. One tangible example is the use the policy statement within the framework agreement as a "knowledge product", contributing to partner banks' understanding of green finance taxonomy as well as key certification schemes.

135. **Interviews with clients conducted as part of the case studies for this evaluation did highlight the significance of the Bank's informal engagement on MREL projects**. Information collected as part of the interviews with clients was that this was mainly focused on understanding the MREL product rather than building capacity in green financing. However, IEvD has seen examples of where the Bank pushed PFIs for third-party certification of green sub-projects (e.g., green buildings), and explained the importance of validation in the green financing space. Whilst it is difficult to draw a tangible link between this input and increased green financing volume, it could be strengthening the quality and robustness of PFIs' green financing.

136. **More widely, IEvD recognises that the Bank's support for GET-eligible MREL bonds is normally part of a wider engagement with the PFI, which might span across multiple (MREL and non-MREL) transactions.** In previous evaluations, IEvD has identified that the Bank's work with PFIs is often greater than the sum of its parts, with behavioural and institutional changes stemming from engagement with the Bank across a number of individual projects and building deep relationships. In that sense, participation on MREL and bail-in bonds can help raise either the quantity or quality of green financing through contributing towards a stronger relationship and providing more opportunities and leverage to influence changes in behaviour in the long-term.

137. **One example of this approach is a project in CEE.** In addition to allocating financing as part of their commitment under GET-eligible MREL transactions, the client, which won an EBRD Sustainability Award in 2021, has with the EBRD's support strengthened its capacity to identify, monitor and report on green financing, whilst also establishing new institutional mechanisms such as an ESG Working Group to align with changes to regulatory standards as well as international best practice.

138. **Another avenue that GET-eligible bonds can deliver progress towards the green transition is by become a 'pathway' towards green bonds.** By helping clients introduce processes for screening and identifying green projects, GET-eligible bonds can support a client to subsequently issue green bonds. There are examples within the portfolio of clients who have transitioned from GET-eligible bonds towards green bonds, and interviews with clients highlighted that they viewed it as a helpful step towards understanding the requirements for green bonds.

139. However, this mechanism has limits; going forward, particularly for MREL funding requirements, general purpose bonds will need to co-exist alongside green MREL bonds, and whilst it is positive to see some clients 'transitioning' from general purpose MREL bonds to green MREL bonds, it is not reasonable to expect that same process across all issuances.

5.4. Financing SMEs through bail-in products is a tried and tested mechanism, but bilateral SME bail-in loans do not support the development of capital markets

140. **The small proportion (5%) of projects that support inclusion followed the standard Financial Intermediaries Framework (FIF) approach of specifying use of proceeds and tracking increases in**

financing towards SMEs. This follows a well-defined EBRD approach, which both IEvD and the EBRD Office of the Chief Economist (OCE) has found to be successful in contributing towards increases in SME lending.

141. **A small handful of MREL projects were financed on the basis of supporting SMEs.** These tended to be bilateral loans (SME credit lines), financed under the FIF, with the standard FIF approach specifying use of proceeds in line with a policy statement on lending to SMEs and women-owned businesses.

142. **As these were bilateral loans, the EBRD had direct control over use of proceeds.** The FIF monitoring requirements also emphasize a change in SME lending, rather than just tracking deployment of funds. These two components provide confidence that these bilateral loans are contributing towards the EBRD's objectives. More widely, previous IEvD studies have highlighted that SME credit lines, combined with targeted TC, have contributed towards systemic changes in how the financial sector approaches SME lending.

143. **However, using bilateral loans also reduces the likelihood of contribution towards capital markets development, compared to bonds.** This reduces the likelihood that these projects will be 'dual-purposed', both supporting SME financing and the development of MREL market.

144. Finally, MREL projects delivering other strategic priorities are higher risk projects than comparable tools, but there is no expectation of a higher transition impact return profile.

145. **Where MREL projects are used as a vehicle to deliver other strategic objectives, such as green or SME financing, they echo the Bank's pre-existing projects with financial intermediaries.** However, one important difference is that MREL is an inherently riskier instrument than traditional debt products, due to its place in the capital structure.

146. **As part of the ongoing development of the Transition Objectives Measurement System (TOMS) 2.0, the Impact team is exploring how to reintroduce a risk component into TI assessment.** One question raised by this evaluation is in what circumstances credit risk should be a part of that assessment, and whether there should be an expectation of a higher 'transition impact delivery' return profile, to reflect the higher risk associated with bail-in-instruments as a whole.

147. **For projects where the long-term delivery of transition impact rests on demonstrating to private investors the viability of a particular financing instrument, there is an argument that credit risk should be included within the TI assessment.** Default on these instruments is not just a financial loss to the Bank; it also constitutes an ultimately unsuccessful bond issuance, thereby not contribution towards capital market development.

▪ Zoom-IN_3: Transition Impact in non-EU countries

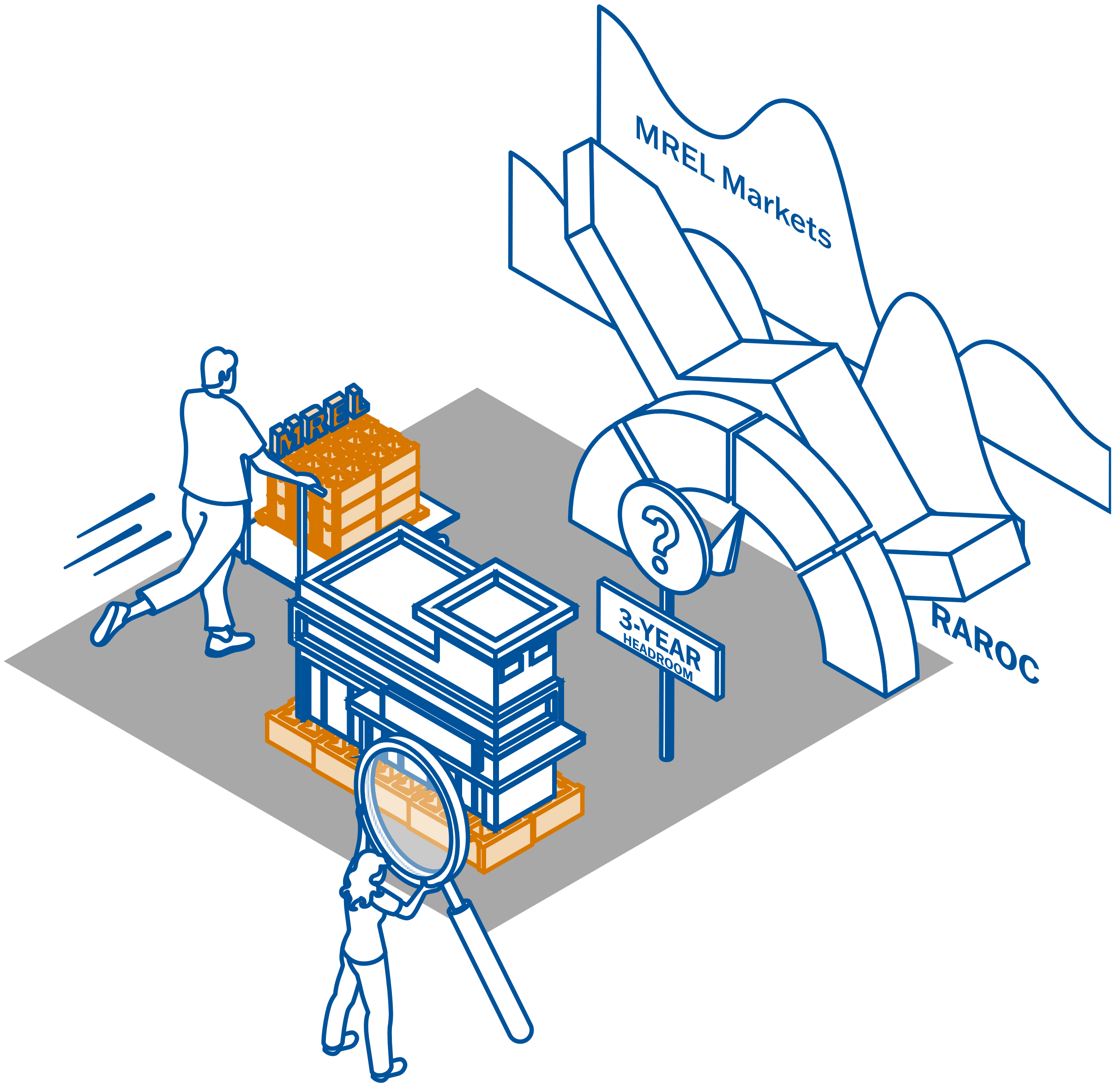
Non-EU countries with active investments within evaluation period (Dec'16-Sep'23)

Non-EU countries with active investment and/or upcoming, policy work outside evaluation period (Dec'16-Mar'24)[14]

- **The non-EU bail-in projects are the most recent addition to the MREL and bail-in portfolio. This means many are recently signed with no transition monitoring carried out yet.**
- **Some reflections on the transition impact of non-EU investments :**
  - The average ex-ante transition potential of the projects is 68, higher than that for EU countries (63.3).
  - The latest transition reports show on-track PTI -related delivery for all three projects. Those transition monitoring assessment have not been yet evaluated by IEvD. The first project with a shorter maturity than the subsequent two projects overdelivered on its transition potential with the latest PTI of 72 (compared to ETI of 60). The 2022 projects are meeting their transition expectations with latest PTI scores matching their respective ETI estimates. Many indicators, particularly under Inclusion TQ are still to be assessed.
- The first project in Georgia aims to strengthen Tier 2 capital and support long-term growth plans of a systemic bank. The project supported Well-governed TI quality through the client's commitment to develop and implement a Transition Plan.

Source: IEvD analysis (2024).

CHAPTER 6



6. Overall, EBRD's involvement in the MREL market was carried out in a timely and profitable manner; however, some challenges that may hamper efficiency and reliability remain

To what extent has the EBRD's involvement in MREL and bail-in instruments been carried out in a timely, efficient and economic manner?

- MREL/bail-in able product have been generally delivered efficiently, with quick time-to-market post-signing; Unfunded Risk Participation (URPs) and secondary sales also offer effective mechanisms for managing exposure after the initial issuance.
- Evidence shows a significant divergence in RAROC between ex-ante forecasts and actual. On the whole, estimated RAROC is more conservative than actual RAROC, although there is a wide degree of variation.
- The divergence between estimated RAROC and actual RAROC is linked to a larger question of whether the approach of giving three-year headroom on each project is appropriate, given how rapidly MREL markets are developing.
- There is evidence that some issues may hamper the efficiency of the EBRD's MREL approach, including those related to approved headroom.

6.1. MREL projects are generally delivered efficiently, with quick time-to-market post-signing

148. **The speed of MREL project delivery were found to be executed promptly and efficiently often thanks to a trust and mutual understanding that the Bank established with its clients prior to the MREL issuances.** Evidence from cases studies confirms that this has been the case in Poland and Jordan. This efficiency is also a result of the 'approved headroom' practice the Bank employs.

149. **For instance, a Polish bank has developed its relationship with EBRD over a long period.** EBRD started its cooperation with the bank back in the early 2000s through EU/EBRD SME facility. This helped with increasing the speed of the MREL project delivery with the client and thus enabled quick issuances on the stock market.

150. **The MREL portfolio is within the country limits and sub-limits.** The limits are derived by the EBRD management based on credit rating of the counterparty and the country, among other factors. Exceptions are approved by the MD, Risk management. An annual review of the limits takes place to determine if they remain appropriate given the risk environment and the business need. The revision of the limits can occur at the discretion of the Banking Management and conditional on the approval of the EBRD Board Risk Committee.

151. **Furthermore, the MREL portfolio has two primary mechanisms for exposure management purposes, in secondary market sales and URP agreements.** This flexibility is important as the Bank faces three significant exposure limits in MREL transactions: the limit at the portfolio level, the limit at the country level, and total exposure at the client parent group level. Secondary market sales and URPs provide opportunities for the EBRD to manage exposure after signing, whilst also (potentially) increasing profitability.

152. **The Bank made more extensive use of URP agreements during the evaluated period.** Whilst this has the same effect with respect to exposure management, unlike with secondary market sales, there is no direct link to capital market development; through using URPs, the Bank is neither supporting secondary market liquidity nor bringing in private sector investors directly into the market. However, it is raising awareness of URP providers about EBRD clients.

153. **With both instruments the Bank has demonstrated that MREL products have some flexibility, enabling exposure management after signing.** This is particularly critical for MREL products as the EBRD has approached close to client exposure limits for some large multi-national banks with operations in multiple EBRD countries. Selling on MREL exposure provides the EBRD with an opportunity to reallocate capital and meet new client priorities.

6.2. Expected RAROC provides limited informational value for MREL transactions

154. **As capital market instruments, actual Risk-Adjusted-Return-on-Capital (RAROC) varies from what the Bank expects at the point of project approval.** Due to changing and evolving market conditions, it is difficult to determine in advance exactly how issuances will be priced. Later issuances might also be denominated in a different currency or occupy a different place in the capital stack (e.g., senior preferred versus senior non-preferred).

155. **As a result, there is a limited relationship between expected RAROC and actual RAROC on MREL and bail-in-able transactions.** This is partly driven by the challenge in developing a RAROC estimate for capital market transactions at the outset, without full knowledge of instrument type, prevailing market conditions, currency etc. The spread between expected and actual RAROC is also a result of three-year headroom approval process, which provides a significant time period for market conditions to change after board approval, and the disruption in markets in 2022 and 2023.

156. Comparing estimated RAROC versus actual RAROC provides a number of observations.

- **Actual RAROC tends to be more extreme compared to the original estimate.**
- **Actual RAROC exceeds estimates.**
- **The divergence between actual RAROC and estimates is driven by transactions in 2022 and 2023.**

157. More broadly, the MREL portfolio is characterised by a significant range in RAROC. This reflects the immaturity and volatility of the market; with more variation in pricing as markets 'find their feet' and develop.

6.3. Some issues may hamper the efficiency of the EBRD's MREL approach, such as those related to headroom

158. **Linked to questions on RAROC is the delegated authority process that MREL bonds go through, as a capital market instrument.** Given the fast-moving nature of capital markets, Banking teams seek pre-approval for bond issuances. The approval period is normally for three years, can cover multiple issuances up to a pre-set financial headroom, and usually contains a set of restrictions for the Bank's financing – e.g., for the maximum subscription percentage of participation in any given issuance. The Board Memorandum provides an in-depth analysis of the first issuance the Bank expects to participate in, as an indicative example. The Board receives a formal Addendum to the project once the Bank has invested within the first issuance after approval, but not for any subsequent issuances the Bank has participated in under the same project.

159. **In IEvD's view, there is a question whether this process is satisfactory in terms of enabling appropriate Board-level approval and scrutiny.** MREL markets have developed rapidly over the past 5 years. As a result, the MREL issuances that the Bank invests in towards the end of a three-year approval period, and the wider market context, can look very different to the situation at the point of Board approval. This is compounded by the policy of providing a formal notification for the EBRD's first participation but not for subsequent issuances, which means, from the Board's perspective, the later issuances receive both less *ex-ante* scrutiny and less *ex-post* information disclosure. There is some evidence which demonstrates the extent to which markets can change during a three-year headroom period.

Box 11: Examples of how issuances and markets have evolved during a project's headroom

A project in the Slovak Republic provides an example of how markets can evolve during a three-year headroom period. The first issuance that the Bank participated in was in 2021, with a second issuance in 2022 and a third issuance in 2023. Key differences between the first and third issuance are presented below:

Variable	First issuance	Third issuance
Oversubscription ratio	1.9	5.7
Bond type	Green bond Bail-in SP	Green bond Bail-in SP

This comparison demonstrates the extent to which markets can change; the first issuance was modestly over-subscribed, and with a relatively low Banking RAROC. The third issuance was highly over-subscribed, with a high RAROC.

At the portfolio level, there appear to be a number of differences between a project's first issuance after board approval, and subsequent issuances. In particular, IEvD observed that subsequent issuances were more oversubscribed, and had a larger divergence to the Bank's estimated RAROC.

Variable	Average across first issuance after Board approval	Average across subsequent issuances
Oversubcription ratio	1.54	1.95

Source: IEvD analysis (2024).

160. **From a capital market development perspective, in theory later issuances should require more scrutiny, including at Board level.** Whilst capital markets development is not always linear, the expectation is that the EBRD's initial involvement in MREL bond issuances will act as a demonstration effect to other market participants for subsequent issuances.

161. **This logic suggests that later issuances should attract more scrutiny on the basis that later issuances should attract more private sector participation** – which overall is what the data suggests has occurred, with the caveat that the capital markets disruption in 2022 has made this a non-linear process.

▪ Zoom-IN_4: Efficiency in non-EU countries

Non-EU countries with active investments within evaluation period (Dec'16-Sep'23)

Non-EU countries with active investment and/or upcoming, policy work outside evaluation period (Dec'16-Mar'24)[15]

- **The preliminary observations based on a younger non-EU baill-in portfolio reveal similar efficiency to that of the older EU MREL portfolio.** One major difference is that the non-EU projects tend to be private placements due to less developed capital market. Based on the interviews with EBRD staff, the pattern of shifting towards public placements as observed with the EU clients is likely to follow conditional on private sector needs in non-EU countries. According to one client from the region: "(...) in *the region, private participation is still falling short of the needs, so EBRD's participation is highly additional and needed".*

Source: IEvD analysis (2024).

[15] Example of a recent MREL diagnostic study carried out by CFMD (March 2024): Final Workshop - MREL Study in the Western Balkans - March 25, 2024.

7. Lessons learned and recommendations

Lesson #1. Supporting capital markets development provides a stronger basis for delivering transition impact than supporting regulatory compliance. However, to effectively measure and track how the EBRD is contributing to change in capital markets, more robust transition delivery metrics are needed.

162. **Evidence collected during this evaluation shows clear examples of how MREL and bail-in investments have supported capital markets development.** Although rarely concretely tracked by monitoring indicators, the case studies conducted by IEvD provide tangible demonstrations of how the Bank has contributed to fast-developing markets, particularly in Poland and Romania.

163. **In transitioning to an approach focused on capital markets development, the Bank will have to redesign its approach to impact scoring and measurement for MREL projects.** Whilst it is plausible to design monitoring indicators to track capital market development, the current focus within the monitoring benchmarks of most MREL projects is on capital levels and MREL requirements, rather than changes in how the capital markets operate.

164. **Where indicators do focus on capital markets development, they are sometimes only focused on the first issuance rather than the whole series of transactions.** Beyond measurement, a stronger focus on capital markets development could also entail exploring other mechanisms such as secondary market sales, which are currently used by the Bank for exposure management but not for market development.

Lesson #2. GET-eligible MREL bond investments, and the use of a GET multiplier, do not demonstrate a strong link to the green transition. They lack a clear mechanism on how the EBRD is contributing to changes in how PFIs approach green financing.

165. **Reflecting global sustainability trends, there has been a strategic pivot within the Bank towards leveraging MREL instruments to promote green financing.** This shift is particularly relevant in the context of the EBRD's GET approach, which aims to integrate environmental sustainability into various financing instruments.

166. **GET-eligible MREL bonds, in their current iteration, have a weak link to supporting Green Transition Impact, and in some cases, it is not clear whether they should constitute GET finance.** This is despite the fact that on paper they are closely related with GET and Green TQ; between 2020 and September 2023, over 90% of MREL and bail-in financing was GET, whilst 71% of MREL and bail-in investments have Green as either a Primary or Secondary Transition Quality.

167. **As bonds issued for general funding purposes, the EBRD does not have direct control over use of proceeds and cannot introduce conditionalities on financing for GET-eligible bonds.** Furthermore, the current approach to GET-eligible MREL bonds, regardless of the GET multiplier employed, does not necessarily encourage clients to increase their green lending, meaning no changes in the real economy and no changes in environmental outcomes.

168. **Strengthening this approach would involve introducing targets and indicators for changes in green financing.** This would provide more confidence that the EBRD's involvement is affecting levels of green financing, and echoes the approach used in the FIF framework. An alternative could be to see GET-eligible bonds as a steppingstone to green bonds, an approach that the Bank has only currently formally employed through TC and TI benchmarks on three projects.

Lesson #3. As the markets for MREL and bail-in instruments mature, the EBRD faces challenges in demonstrating its financial additionality, particularly in more advanced markets. The Bank's non-financial contributions continue to be vital and well-regarded, especially in non-EU markets.

169. **As the capital markets for MREL and bail-in instruments develop, there has been increasing private sector engagement.** Whilst this reflects a success story – the establishment of functioning capital markets – it also makes it more challenging for the EBRD to provide financial additionality going forward. The Bank's role as an anchor investor has diminished as markets developed, which calls for a reassessment of how the EBRD can add value in more developed market settings.

170. **The Bank's non-financial additionality remains a strong asset in both EU and non-EU contexts.** The EBRD provides substantial value through technical assistance, market stabilization efforts, and regulatory guidance, which continue to be highly valued by clients and help navigate the complexities of capital markets for MREL and bail-in instruments.

171. **The MREL market is evolving rapidly. This raises the question of whether the Bank's current approach, using a three-year approval timespan and only providing notifications for the first bond issuance, is appropriate.** This approach provides limited visibility to the Board on EBRD transactions in the latter part of a three-year approval period, when the market context may have changed significantly, and notifications are no longer sent after each transaction. EBRD should consider shortening the standard approval period and provide notifications for each issuance the Bank participates in, rather than only the first.

7.1. Recommendations: how bail-in able products can play a key role in fostering transition

172. **This evaluation proposes four recommendations aim to optimize the EBRD's engagement with MREL and bail-in instruments, ensuring alignment with its overarching goals and responsiveness to market dynamics, while maintaining a strong focus on fostering transition on the system-wide scale in the Bank's countries of operations.**

A - Strategic-level recommendations

Issues related to the recommendation	*Recommendation 1 – Strengthening capital market focus*
There is a lack of clarity and focus on "resilience systemic change" related to MREL/bail-in-able products. Although regulatory compliance is not an EBRD strategic transition priority, the current approach towards financial resilience does not clearly differentiate between project-level effects and market-level outcomes. At the project-level, financial resilience may include strengthening the capitalisation of banks (by meeting regulatory requirements and making them more resolvable) At market-level, the emphasis is on reinforcing the sustainable funding structure of banking sector and capital market development. In the long-term, a sustainable and resilient financial system will be dependent on whether there is a functioning and effective market for MREL/bail-in-able instruments with private sector participation, which should be viewed as the ultimate objective.	**In order to foster resilience transition at the systemic level, the EBRD should develop a set of clear principles and guidelines, focusing more on targeting sustainable market-level strategic outcomes with bail-in-able instruments.** It is recommended that to enhance the effectiveness of its bail-in-able instruments the Bank develops unified MREL/bail-in-able products strategic guidelines clarifying the principles guiding EBRD's investments in MRELs, the objective of MREL/bail-in transactions and emphasising the focus on systemic change and capital market development. These guidelines should be initially captured in a position paper that could then become a 'living document' to retain flexibility to respond to changing market circumstances. *Linked to this recommendation is recommendation 3, on strengthening the monitoring and measurement system for capital market development.*

Issues related to the recommendation	Recommendation 2 – *increasing emphasis on changes in green lending behaviour*
MREL and bail-in bonds are currently linked to the delivery of green objectives via both green bonds and GET-eligible bonds. **This issue and recommendation relate to GET-eligible bonds; green-bond specific recommendations were covered under a recent IEvD evaluation.** **The approach of applying GET multipliers does not provide robust evidence of changes in partner financial institution lending behaviour, and might not meet the threshold set for GET-eligibility following the guidelines set out in the GET Handbook.** What is missing is a system for assessing how the Bank's contribution changed how financial intermediary clients approach green finance, without which there is limited data to draw conclusions on how the EBRD's engagement has changed either the quantity or quality of PFI green financing. When GET-eligible bonds were first introduced, many clients did not have MIS systems to track green financing, so it was difficult to determine a baseline. This is no longer the case.	**To ensure that GET-eligible MREL / bail-in-bonds deliver a tangible impact on green financing levels, the Bank should encourage and monitor partner financial institutions to increase the quantity and quality of their green financing.** This should involve setting green finance objectives that gradually increase the requirements for environmental outcomes or tracking how levels of green financing change in PFIs through the EBRD's engagement. This could integrate but also build on the current GET multiplier approach, providing confidence not just that partner financial institutions (PFIs) are meeting their green finance commitments but also that how clients approach green finance is changing. The Bank should also consider ways to capture the capacity building/best-practice work carried out with the client, which often is not officially reported on nor captured. This would provide a more holistic picture of how the Bank's engagement has supported the greening of financial institutions at the corporate as well as at the project-level. The Bank may also explore ways to use MREL / bail-in-able projects as "learning journey" towards the issuance of fully-fledged green bonds. Whilst it would not be realistic to expect all issuances to make this transition towards green bonds, and that green bonds and general-funding bonds will co-exist going forward, explicitly targeting that objective on a case-by-case basis would provide an additional avenue towards contribution to Green TQ.

B - Operational-level recommendations

Issues related to the recommendation	Recommendation 3 – *capturing the Bank's contribution towards capital market development*
The Bank has limited instruments to understand how the capital market in a country develops, its contribution towards it, and its additionality. The current result architecture provides an incomplete perspective on capturing and monitoring ex-post results on capital market development. There is no clear theory of change underlying bail-in-able projects, which would unlock the pathways and measurement of system-level outcomes. The current methodology for incorporating risk into TI assessments, including the risk of bail-in, is limited and leaves little room for nuance in assessing the relationship between risk factors and the ETI computation.	**In order to enhance its additionality and to incentivize the most impactful MREL / bail-in-able projects, the Bank should develop an adequate results-based approach that 1) clearly differentiate between project-level results (focus on client capital adequacy and ability to lend in the real economy) and market-level effects (focus on capital market development); and 2) is able to monitor and measure progress towards both.** This would require an evolution of the transition impact approach for MREL/bail-in-able projects, in both the *ex-ante* ETI questionnaire and monitoring benchmarks. More alignment and combined reporting with relevant technical cooperation (TC) work on capital market development should also be considered to strengthen the focus on market-level outcomes. Finally, building on the guidelines within the position paper incorporated as part of Recommendation 1, the updated "TOMS training manual / guidance" that is currently in preparation should provide MREL/bail-in specific guidance on drafting a transition impact (TI) narrative and on selection of specific transition quality(ies). This latter point may become even more critical if the flexible approach to the number of TQs is implemented. It is also understood that as part of the redevelopment of the TOMS 2.0 system, the Bank is considering how risk is integrated into TI assessments. As part of that process, it should be considered how bail-in risk is treated in the expected transition impact (ETI) scoring calibration including external (market-related) risks.

Issues related to the recommendation	Recommendation 4 – *enhancing governance for greater transparency and additionality*
The overall governance of MREL / bail-in-able products is challenging, as is the understanding and assessing of project-level additionality. **The level of information provided on each issuance varies significantly**; for the first issuance, there is a formal Board notification, but not for subsequent issuances under the same project. The format and depth of the board notification for the first issuance of each project also varies. This limits the transparency of the Bank's engagement on subsequent issuances. **The rapid evolution of markets for MREL and bail-in instruments and the increasing private sector participation also raises questions about the appropriateness of providing approval for headroom usage over a three-year period.** This three-year time window provides significant scope for markets to change and for the EBRD's additionality to decline over that time period.	**In order to ensure MREL / bail-in-able products are additional and conducive to systemic change, the Bank should enhance transparency and strengthen the ability to assess MREL / bail-in-able products at any point in time, not just at signing, without adding burden to Board members or Management.** **Concrete actions should include:** **1) Developing a standardised template for issuance notifications**, with key metrics including oversubscription ratio, extent of EBRD scale-back, RAROC versus estimate, and investor composition and using them for all projects in a systematic manner. **2) Notifying the Board about each issuance the Bank participates in**, rather than only the first, to ensure ongoing oversight. This could be done as part of quarterly performance review (QPR) reporting or provided on quarterly basis as part of Board Online Information. **3) Consider the cost-benefit of reducing the headroom period from 3 years to 1 year**, particularly for advanced transition countries in the EU where the MREL/bail-in-able markets are starting to mature and the EBRD's financial additionality shrinks.

Annex - External viewpoint note

Brandeis | INTERNATIONAL BUSINESS SCHOOL

Professor Stephen G. Cecchetti
Rosen Family Chair in International Finance

London, 19 June 2024

External Viewpoint on the "Forging Resilience: An evaluation of the Transition Impact and Additionality of the EBRD's MREL bail-in-able products"

Stephen G. Cecchetti

I write in response to the IEvD's request that I review the report entitled "Forging Resilience: An evaluation of the Transition Impact and Additionality of the EBRD's MREL bail-in-able products." Overall, I agree with the logic and conclusions in the report, as well as the recommendations. The EBRD's purchase and holding of debt issued to meet Minimum Requirement for Own Funds and Eligible Liabilities (MREL) requirements is generally sensible. Furthermore, I agree that the structure for participation MREL can be further improved.

I have a number of comments about the report. Taking a somewhat broader perspective, I think of the decision to purchase and hold MREL instruments as occurring in two steps. First the EBRD must decide whether to initiate purchase and second, it must decide how to implement this purchase. As an international financial institution run by governments, the EBRD has a number of important responsibilities that are distinct from those of a private sector financial intermediary. In the current context, the most important are that transactions need to be impartial and arms-length. Furthermore, as stated in the Basic Agreement signed in 1990 at the founding of the EBRD, its purpose is to

> *"foster the transition towards open market-oriented economies and to promote private and entrepreneurial initiative in … countries committed to and applying the principles of multiparty democracy, pluralism and market economics."*

In its statement of values, the EBRD elaborates on this a bit, stating that:

> *"We seek to develop a sound investment climate based on an effective legal and regulatory framework which promotes corporate governance, including sound management practices, a firm stance against corrupt practices, disclosure of information, and clear and consistent accounting and auditing practices.*
>
> *All our operations are guided by the need to promote environmentally sound and sustainable development as well as appropriate procurement practices."*

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Cecchetti Review of Forging Resilience

The reason that I start with these quotes is to emphasize that the primary objective of the EBRD is the development of a sound financial system that promotes economic development and long-run prosperity. While there is a desire for investment to be profitable, profit is not the primary objective of EBRD investments. Put slightly different, in the current context, the goal is to improve systemic resilience by improving the resolvability of private sector banks in a way that promotes economic development.

Initiation

This brings me to the first major point about MREL. In my view, the EBRD can further improve its guidelines for investment in MREL by developing and promulgating a set of principles (a structure) that clearly articulates the following:

- When the EBRD should invest in a particular country or jurisdiction.
- Which private sector banks qualify for EBRD investment.

Once a country or jurisdiction meets the (presumably) detailed requirements that qualify it for EBRD investment, then they can consider which private banks ("banks") should be eligible for MREL investment. The basic principle of equal treatment and nondiscrimination that guides all international financial institution suggests that the initial list should include all of the banks in the country. I could surely imagine (and expect) that there are going to be cases where particular banks would be disqualified from inclusion, but the presumption should be that all banks are eligible for EBRD MREL investment. Furthermore, to the extent possible, the guidelines for qualification should involve as little discretion as possible.

My reading of the report is that a number of the IEvD's recommendations are consistent with the development and promulgation of an explicit guidelines of the sort that I describe. My suggestion is that this be more explicit.

Implementation

This brings me to my second major point. Once there is a decision that a particular bank in a given country or jurisdiction meets the requirement for EBRD purchase of MREL, there is a need to implement that recommendation. Here, I see the following questions:

- How much should the EBRD purchase?
- At what price should the EBRD purchase?
- How long should the EBRD hold the debt?

Answers to these questions are difficult and depend on the purpose of purchasing the debt. As the IEvD report emphasizes, there are two possible reasons for the EBRD to participate in MREL issues. The first is to catalyze the creation of capital markets and the second is to further the goals of the EBRD more generally. I will discuss each of these in turn.

Cecchetti Review of Forging Resilience

Helping Banks Meet Regulatory Requirements

Before starting, I should note that I find it odd that the EBRD would purchase MREL liabilities solely in an effort to aid a bank meet its regulatory capital requirements. In my view, doing this requires clear justification for why it is that the banks in a given country or jurisdiction are unable to raise equity or subordinated debt financing in other ways. Either that, or there should be an explicit decision that the EBRD is intervening in a country to improve banking sector resilience in order to promote financial system development more broadly and that the most efficient and effective way to do this is to support individual banks through the purchase of MREL. But, to return to my earlier comment, this should provide for universal access to all banks that qualify.

Catalyze Capital Market Development

When the goal is to catalyze capital market development, I very much doubt that the EBRD needs to purchase much as it is the imprimatur that matters. Here I draw a comparison with the recent behavior of central banks that engaged in sovereign and corporate bond purchases in order to ensure the operation of certain systemically important markets. In many cases, the central bank made only very modest purchases, and the disgorged the bonds quickly. This leads to the conclusion that, when the purpose is to promote the development of capital markets, it should not have to purchase much and it should not have to hold the bonds for long. Put slightly differently, when the rationale for purchasing MREL-qualifying debt from a particular bank is to catalyze the development of capital markets, the EBRD should have a clear guidelines that establishes the minimum quantity required to meet that objective and the minimum time that it is necessary to hold the instruments. Surely, the former will be small and the later short. Most importantly, the conditions under which the EBRD enters or exit should be clearly stated and monitored before the process starts.

General Comments on Financial Sector Resilience

To be clear, my view a well-functioning and resilient financial system – one that promotes growth and development – has two essential attributes: high levels of capital funding and first-rate supervision.[1]

Banks have a clear incentive to take on risk to the benefit of their owners, but to the determinant of society as a whole. The reason for this is that the bank's owners reap the rewards of high profits, but are able to force the costs of insolvency onto the public at large. Furthermore, the central bank provides liquidity insurance when the bank faces unanticipated deposit outflow. Together, these give bankers an incentive to take on credit

[1] See Cecchetti, Stephen G. and Kermit L. Schoenholtz, "Making Banking Safe," CEPR Discussion Paper No. 18302, July 2023.

and liquidity risk, holding assets that are both too risky and less liquid. Capital and liquidity regulation exist to reduce this incentive.

On capital requirements, I favor that banks have capital funding that is substantially higher than the current minimum embodied in the Basel III agreement. While bail-in-able debt can act as a substitute, it is an imperfect one. The reason is that authorities are clearly reticent to activate bail-in provisions for fear of the spillover effects this will have on other parts of the system. Instead, they are prone to bailout banks and other intermediaries using various means, including forbearance and subsidies through the central bank.

Finally, high-quality supervision is essential to ensure banks meet the requirements. But supervision is an arms race where banks are trying to hide credit and liquidity risk – within the rules – and authorities are trying to find that risk and force appropriate management.

Facilitating the EBRD Social Goals

This brings me to the second possible rationale for purchasing MREL: furthering the social goals of the EBRD. The report mentions two categories: the Green Economy Transition (GET), the financing of small- and medium-sized enterprises, and the financing of women in business. Given that the EBRD has agreed to pursue these objectives, the question is how to do it. What is the most efficient and effective use of funds?

Here, I agree with the report. It is difficult to establish that MREL financing is the most efficient way of achieving these objectives. In my view, it is incumbent on those advocating the purchase of MREL to provide compelling evidence that this is an efficient and effective way of financing either the green transition, the financing of SMEs or women in business. Doing so requires careful ex post evaluation of the returns (as measured in the units of the objective) from various types of investment in each of these categories.

Conclusions

I find the report balanced and its conclusions well-reasoned. Resilient banks, banks that are resolvable in the case of insolvency, provide the basis for financial development that promotes real economic growth. In this context, the purchase of MREL can play a role as the EBRD strive to *"foster the transition towards open market-oriented economies and to promote private and entrepreneurial initiative."*

I recommend a few small further refinements that I believe would help clarify of some of the recommendations. First, I recommend that the EBRD articulate a detailed structure to determine which banks should be included, emphasizing universal access with as little discretion as possible. Second, I suggest that the structure include clear requirements for that include justification for the quantity of MREL to purchase, the price to pay, and the timing of the exit from the position. Third, I recommend that when the justification is to further the general goals of the EBRD, the proposal to purchase MREL should be accompanied by an evaluation of the efficiency and effectiveness of this investment as compared with others available to the EBRD.

I hope that you find these comments useful. Should you need anything further, please do not hesitate to contact me.

Sincerely yours,

Stephen G. Cecchetti
Professor and Rosen Family Chair in International Finance

About the author:

Professor Cecchetti - Stephen G Cecchetti - King's College London (kcl.ac.uk) - is an American economist who is the Barbara and Richard M Rosenberg Professor of Global Finance at Brandeis International Business School, Chair of the Advisory Scientific Committee of the European Systemic Risk Board, Research Associate at the National Bureau of Economic Research, and Research Fellow at the Centre for Economic Policy Research.

From 2008 to 2013, he was the economic adviser and head of the monetary and economic department at the Bank for International Settlements, contributing to global regulatory reform. Previously, he served as Executive Vice President and Director of Research at the Federal Reserve Bank of New York and was editor of the Journal of Money, Credit, and Banking. He has also taught at NYU Stern School of Business and Ohio State University.

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