Minimum Requirement for own funds and Eligible Liabilities (MREL)

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Legal and policy background

- The Bank Recovery and Resolution Directive (BRRD) includes a loss absorbing capacity requirement –the Minimum Requirement for Own Funds and Eligible Liabilities (MREL) (i.e. equity + debt)

- Applies to all EU banks, and investment firms in scope of the BRRD

- “Pillar 2” type measure – must be set case-by-case for each bank. No common requirement.

- National law must implement this by 1 Jan 2016. Some Member States have already implemented, but have not yet set requirements.

Legal and policy background

What counts towards MREL?

- Both regulatory capital and other eligible liabilities count
- Secured liabilities, derivatives, insured deposits, liabilities < 1 year **do not**
- Eligible liabilities do not have to be subordinated..
- ..and structured notes are not excluded..
- ..**but** resolution authorities must decide whether they can be credibly bailed in

EBA Technical Standards on MREL

- The BRRD includes criteria for setting MREL
- On 3 July the EBA published technical standards further specifying these criteria: https://www.eba.europa.eu/-/eba-publishes-final-technical-standards-to-ensure-effective-resolution-under-the-brrd
- These are now 'final draft' standards: once endorsed by the European Commission will become EU law
- Aims of the standards:
  - Clarity about how resolution authority discretion on MREL works
  - Similar MREL for similar banks in any Member State
  - Tailor to size and complexity, and give incentives to be resolvable
  - Avoid duplication of supervisors' effort
  - Avoid obstacles to TLAC implementation

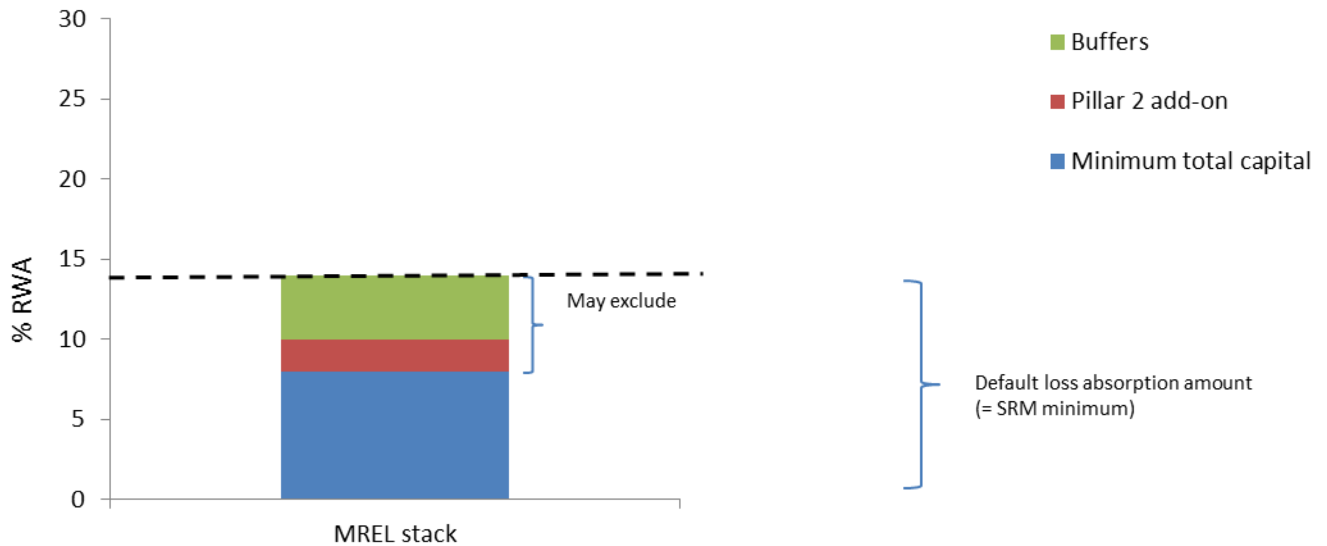
MREL Regulatory Technical Standards

- The RTS describes steps to build up the MREL requirement; they do not set binding minimum requirements or affect eligibility requirements

- The resolution authority (SRB for Banking Union, national authorities for less significant banks and in other Member States; resolution college decision for cross-border banks) needs to determine the amount of MREL needed to i) absorb losses and ii) recapitalise after resolution

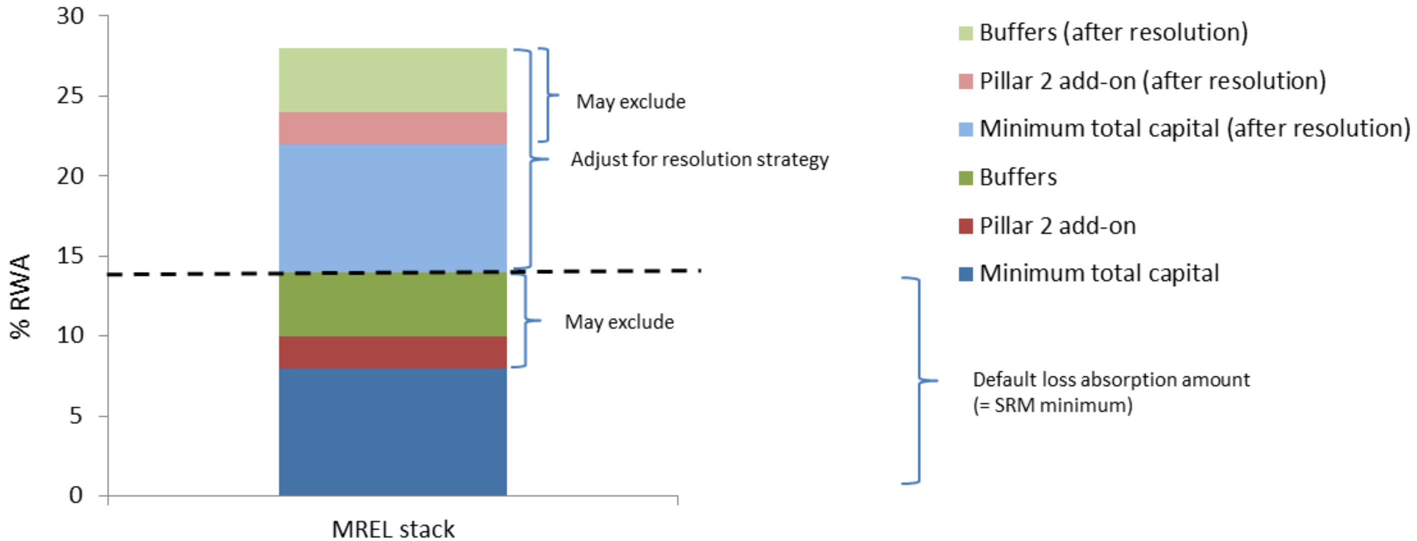
- Each part of this assessment linked to the prudential capital framework

Calibration/flexibility



- Default loss absorption requirement = CRR/CRD own funds & buffers = SRM minimum MREL
- Resolution authorities can, optionally, adjust from this level
- Upward adjustment if needed for resolvability (e.g. if capital is trapped in particular legal entities)
- Downward adjustment where not needed for resolvability (e.g. stress test requirements, macro prudential requirements)

Calibration/flexibility



- Recapitalisation requirement in addition – adjust capital requirement for impact of resolution strategy
- May conclude part of Pillar 2 or buffers not relevant after resolution (e.g. P2 management add-on if management has been changed)
- Needs to be sufficient to restore market confidence

Further features:

- **Peer group comparison:** Should compare level of recapitalisation with peer group capital levels. For G-SIBs, peer group must be other EU G-SIBS.

- **Offsetting impact of exclusions:** Resolution authority may identify liabilities that cannot be credibly bailed in. If these are a significant amount, should consider setting higher MREL. Decisions on subordination will be especially important.

- **Coordination with supervisors**: BRRD requires MREL to take into account business model, funding model & risk profile. Resolution authority should in general rely on supervisors' assessments of these.

Further features:

- **Deposit guarantee scheme:** DGS funds can – with limits – be used in resolution. Resolution authorities **may** set a lower MREL to take account of this. Assessment of risk to DGS also required.

- **Systemic institutions**: BRRD establishes **resolution funds** which can be used in resolution, but only after ‘burden-sharing’ requirements are met – bank’s shareholders and creditors must take losses of 8% of total assets. For systemic institutions should assess whether this is possible.

- **Subsidiaries:** Provided resolution strategy does not break up the group, may take account of group support as a source of market confidence

- **Transition:** Allow for a transitional path to be set

What should banks expect?

Loss absorption

Recapitalisation

Case 1. Resolution strategy: liquidation. MREL needed only for loss absorption.

Loss absorption

Case 2. Resolution strategy: resolution but only partial recapitalisation.

Loss absorption

Recapitalisation

Case 3. Resolution strategy: resolution with full recapitalisation

Loss absorption

Recapitalisation

Trade – off between other dimensions of resolvability and MREL

MREL and TLAC

- Same objective – ensure adequate loss absorbing and recapitalisation capacity. Want to allow a single requirement for G-SIBs

- Authorities (both home and host), institutions, and the public need to internalise the goals and costs of resolvability. Reduces moral hazard and incentivises cooperation

- TLAC proposals to be finalised soon. MREL already EU law and must be implemented in national law by 1 Jan 2016.

- TLAC only applies to G-SIBs (though other jurisdictions may also go beyond this). MREL applies to thousands of EU institutions and set within EU system of resolution authorities. So more adaptability.

MREL and TLAC

- **Scope:** TLAC for G-SIBs; MREL for all EU banks and investment firms covered by the BRRD

- **Eligibility of instruments:** Main requirements similar (unsecured term debt and equity). TLAC proposal has 'hard' requirement for instruments to be subordinated and to exclude structured notes. BRRD requires resolution authorities to assess whether these instruments (and others) can be feasibly and credibly bailed in.

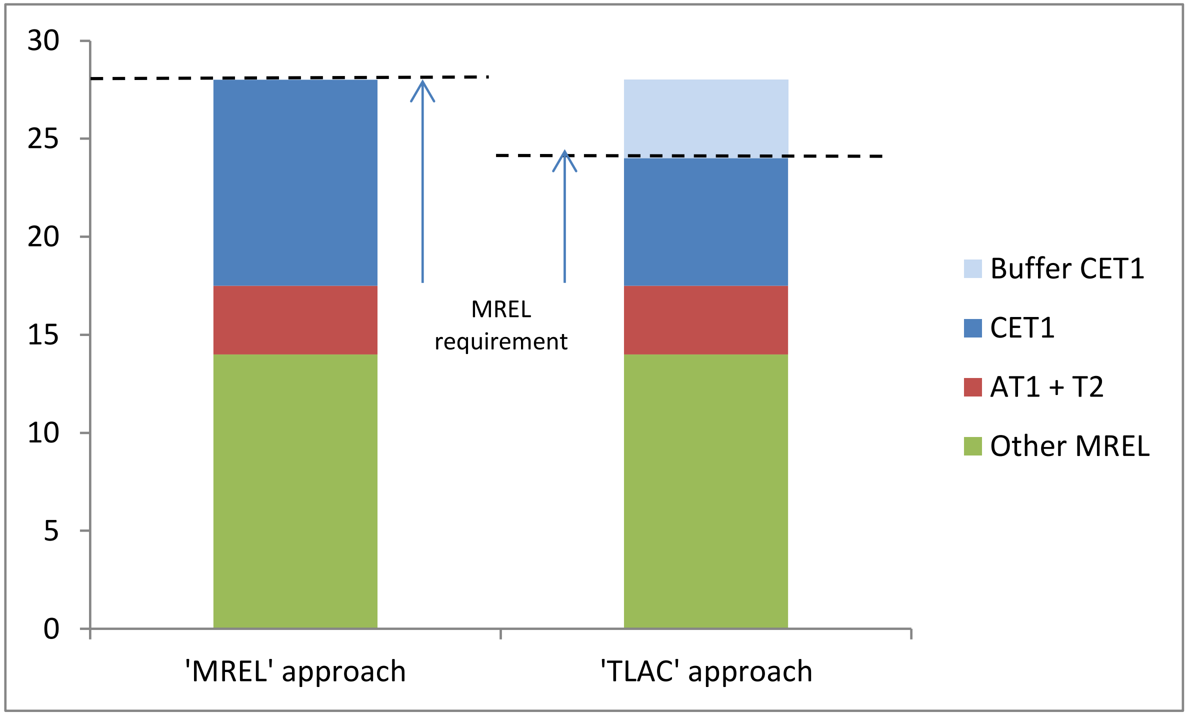
- **Denominator:** TLAC set as a percentage of RWAs, MREL as a percentage of own funds and total liabilities. Draft RTS bridges this.

- **Calibration:** TLAC proposal includes 'pillar 1' element (16-20% of RWAs) plus a pillar 2 element and minimum downstreaming of internal TLAC. MREL set case-by-case

MREL and TLAC

- **Disclosure/holdings of TLAC**: not covered by BRRD. Areas for future work.

- **Buffers:** TLAC proposal would exclude CET1 that counts towards buffers from TLAC. MREL is parallel to capital requirements



What’s next?

- Review and endorsement by the European Commission
- FSB TLAC proposals finalised imminently
- Further quantitative analysis
- Implementation by resolution authorities
- Report and review of MREL legislation late 2016

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